Ratings: S&P: "AA-"
Fitch: "AA-"
(See "Ratings" herein)

NEW ISSUES

BOOK-ENTRY ONLY

*In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, and D. Seaton and Associates, Co-Bond Counsel to the Corporation, under existing statutes and court decisions, and assuming continuing compliance with certain tax covenants as described herein, (i) interest on the Series 2013 Bonds is excluded from gross income for federal income tax purposes under Section 103 of the Internal Revenue Code of 1986, as amended (the "**Code**") and (ii) interest on the Series 2013 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 addition, in the opinion of Bond Counsel and Co-Bond Counsel, under the Act, interest on the Series 2013 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.*

$1,225,745,000
TOBACCO SETTLEMENT FINANCING CORPORATION
(State of New York)
Asset-Backed Revenue Bonds, Series 2013
(State Contingency Contract Secured)
Consisting of

$660,090,000
Asset-Backed Revenue Bonds,
Series 2013A
(State Contingency Contract Secured)

$565,655,000
Asset-Backed Revenue Bonds,
Series 2013B
(State Contingency Contract Secured)

Dated: Date of Delivery

Due: June 1, as shown on the inside front cover

Payment and Security: The Asset-Backed Revenue Bonds, Series 2013 (State Contingency Contract Secured) (the "**Series 2013 Bonds**") are special obligations of the Tobacco Settlement Financing Corporation (the "**Corporation**"), consisting of the Asset-Backed Revenue Bonds, Series 2013A (State Contingency Contract Secured) (the "**Series 2013A Bonds**") and the Asset-Backed Revenue Bonds, Series 2013B (State Contingency Contract Secured) (the "**Series 2013B Bonds**").

The Series 2013A Bonds are issued under the Indenture, dated as of June 1, 2003, as supplemented, including as supplemented by the Series 2013A Supplement (collectively, the "**Series A Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series A Trustee**"). The Series 2013A Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series A Indenture (collectively, the "**Series A Bonds**"), are payable from and secured by a pledge of the "**Series A Pledged Revenues**," which consist primarily of (i) the Series A Pledged Settlement Payments (defined below) sold by the State of New York (the "**State**") to the Corporation pursuant to the Purchase and Sale Agreement, dated as of June 1, 2003 (the "**Series A Sale Agreement**"), between the State and the Corporation and (ii) the payments (the "**Series A Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of June 1, 2003 (the "**Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent that amounts on deposit in the Series A Pledged Revenues Account, the Series A Debt Service Account, the Series A Supplemental Account and the Series A Debt Service Reserve Account (collectively, the "**Series A Pledged Accounts**") are insufficient therefor. The Series A Debt Service Reserve Requirement is $227,545,572. The Series A Debt Service Reserve Account is fully funded. Upon the issuance of the Series 2013A Bonds and the application of the proceeds thereof, $1,025,690,000 of Series A Bonds will be outstanding under the Series A Indenture.

Pursuant to the Act and the Series A Sale Agreement, the State sold to the Corporation the "**Series A Pledged Settlement Payments**," consisting of fifty percent (50%) of the State's Share (as defined herein) of (i) the Annual Payments and Strategic Contribution Fund 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) all Lump Sum Payments (as defined herein) received at any time on or after June 19, 2003.

The Series 2013B Bonds are issued under the Indenture, dated as of December 1, 2003, as supplemented, including as supplemented by the Series 2013B Supplement (collectively, the "**Series B Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series B Trustee**"). The Series 2013B Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series B Indenture (collectively, the "**Series B Bonds**"), are payable from and secured by a pledge of the "**Series B Pledged Revenues**," which consist primarily of (i) the Series B Pledged Settlement Payments (defined below) sold by the State to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Series B Sale Agreement**"), between the State and the Corporation and (ii) the payments (the "**Series B Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent that amounts on deposit in the Series B Pledged Revenues Account, the Series B Debt Service Account, the Series B Supplemental Account and the Series B Debt Service Reserve Account (collectively, the "**Series B Pledged Accounts**") are insufficient therefor. The Series B Debt Service Reserve Requirement is $221,582,344. The Series B Debt Service Reserve Account is fully funded. Upon the issuance of the Series 2013B Bonds and the application of the proceeds thereof, $1,027,655,000 of Series B Bonds will be outstanding under the Series B Indenture.

Pursuant to the Act and the Series B Sale Agreement, the State sold to the Corporation the "**Series B Pledged Settlement Payments**," consisting of fifty percent (50%) of the State's Share of (i) the Annual Payments and Strategic Contribution Fund payments (as defined herein) and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all Lump Sum Payments (as defined herein) received at any time on or after December 2, 2003.

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**"). Payments by the PMs under the MSA are subject to certain adjustments, including the NPM Adjustment (defined herein), some of which have occurred and may continue to occur and may be material. See "BONDHOLDERS' RISKS" herein.

The Series A Bonds and the Series B Bonds are each separately secured by the Series A Pledged Revenues and the Series B Pledged Revenues, respectively. The Series A Trustee does not have the right to make a claim to mitigate all or any part of an asserted deficiency in the Series A Pledged Revenues from the Series B Pledged Revenues and, likewise, the Series B Trustee does not have the right to make a claim to mitigate all or part of an asserted deficiency in the Series B Pledged Revenues from the Series A Pledged Revenues. The rights of the Series A Trustee and the Series B Trustee to receive its respective Pledged Revenues are equal to and on a parity with each other and one right is not inferior or superior to the other.

The Corporation will apply the proceeds of the Series 2013 Bonds to (i) refund (A) all of its Asset–Backed Revenue Bonds, Series 2003 A-1C (State Contingency Contract Secured), in the aggregate principal amount of $700,220,000 (the "**Series 2003 A-1C Refunded Bonds**") and (B) all of its Asset-Backed Revenue Bonds, Series 2003 B-1C (State Contingency Contract Secured), in the aggregate principal amount of $603,265,000 (the "**Series 2003 B-1C Refunded Bonds**," and, items (A) and (B), collectively, the "**Refunded Bonds**"), and (ii) pay the costs of issuance incurred in connection with the issuance of the Series 2013 Bonds.

The proceeds of the Series 2013A Bonds, and other assets of the Corporation (other than the Series A Pledged Revenues) are not pledged to the payment of, and are therefore not available to the holders of, the Series 2013A Bonds. The proceeds of the Series 2013B Bonds, and other assets of the Corporation (other than the Series B Pledged Revenues) are not pledged to the payment of, and are therefore not available to the holders of, the Series 2013B Bonds. Pursuant to the Act and each of the Series A Sale Agreement and the Series B Sale Agreement, the State has covenanted for the benefit of each of the Series A Bondholders and the Series B Bondholders, respectively, that it will not in any way impair the rights and remedies of each of the Series A Bondholders and the Series B Bondholders, respectively, or the security for each of the Series A Bonds and the Series B Bonds, respectively.

PURSUANT TO THE ACT, THE SERIES 2013 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 2013A BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES A PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES A PLEDGED ACCOUNTS OR ANY SERIES 2013B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES B PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES B PLEDGED ACCOUNTS. THE CORPORATION HAS NO TAXING POWER.

Description: The Series 2013 Bonds will be dated their date of delivery, and mature on the dates and in the aggregate principal amounts set forth on the inside front cover. Interest on the Series 2013 Bonds will be payable on June 1 and December 1 of each year, commencing on June 1, 2014.

Redemption: *The Series 2013 Bonds are subject to optional redemption prior to maturity and mandatory clean-up redemption as set forth herein. See "THE SERIES 2013A BONDS" and "THE SERIES 2013B BONDS."*

See Inside Front Cover for Maturity Schedule,
Interest Rates and Yields

Citigroup **Barclays** **Ramirez & Co., Inc.**
Academy Securities, Inc. **BofA Merrill Lynch** **BNY Mellon Capital Markets, LLC**
Drexel Hamilton, LLC **Goldman, Sachs & Co.** **Jefferies**
J.P. Morgan **Lebenthal & Co., LLC** **Loop Capital Markets LLC**
Morgan Stanley **Raymond James** **RBC Capital Markets**
Rice Financial Products Company **Roosevelt & Cross, Incorporated** **Siebert Brandford Shank & Co., L.L.C.**
Wells Fargo Securities

The Series 2013 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Hawkins Delafield & Wood LLP, New York, New York, as Bond Counsel to the Corporation and D. Seaton and Associates, New York, New York, as Co-Bond Counsel to the Corporation. Certain legal matters will be passed upon for the Corporation by its Counsel and by Orrick, Herrington & Sutcliffe LLP, Disclosure Counsel to the Corporation. Certain legal matters will be passed upon for the State by the Attorney General. Certain legal matters will be passed upon for the Underwriters by Hiscock & Barclay, LLP, Albany, New York, as Underwriters' Counsel. It is expected that the Series 2013 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 12, 2013.

December 5, 2013

$1,225,745,000
Tobacco Settlement Financing Corporation
(State of New York)
Asset-Backed Revenue Bonds, Series 2013
(State Contingency Contract Secured)

$660,090,000
Series 2013A Bonds†

Maturity					First Optional
Date	Principal	Interest			Redemption
(June 1)	Amount	Rate	Yield	CUSIP††	Date (June 1)
2018	$ 5,800,000	3.000%	0.550%	88880TNA0	2014
2019	85,735,000	5.000	0.700	88880TNB8	2014
2020	12,415,000	4.000	0.950	88880TNC6	2014
2020	132,630,000	5.000	1.200	88880TNF9	2015
2020	33,260,000	5.000	1.580	88880TNG7	2016
2021	189,345,000	5.000	1.680	88880TND4	2016
2022	63,535,000	5.000	1.780	88880TNE2	2016
2022	137,370,000	5.000	2.030	88880TNH5	2017

$565,655,000
Series 2013B Bonds†

Maturity					First Optional
Date	Principal	Interest			Redemption
(June 1)	Amount	Rate	Yield	CUSIP††	Date (June 1)
2019	$ 67,900,000	5.000%	0.700%	88880TNJ1	2014
2019	60,085,000	5.000	0.950	88880TNN2	2015
2020	34,470,000	5.000	1.200	88880TNK8	2015
2020	143,145,000	5.000	1.580	88880TNP7	2016
2021	124,220,000	5.000	1.680	88880TNL6	2016
2021	65,385,000	5.000	1.880	88880TNQ5	2017
2022	70,450,000	5.000	2.030	88880TNM4	2017

† Priced at the stated yield to the applicable first optional redemption date at a redemption price of 100%. Subject to optional redemption and mandatory clean-up redemption as set forth herein.

†† CUSIP® is a registered trademark of the American Bankers Association. CUSIP data herein is provided by the CUSIP Service Bureau, operated by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. This data is not intended to create a database and does not serve in any way as a substitute for the CUSIP Services Bureau. CUSIP numbers have been assigned by an independent company not affiliated with the Corporation and are included solely for the convenience of the registered owners of the applicable Series 2013 Bonds. The Corporation and the Underwriters are not responsible for the selection or uses of these CUSIP numbers, and no representation is made as to their correctness by the Corporation or the Underwriters as included therein. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2013 Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part 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 2013 Bonds.

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

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED 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, IHS Global (defined herein) 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 IHS GLOBAL REPORT" and in "APPENDIX F – IHS GLOBAL REPORT" hereto has been included in reliance upon IHS Global 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 G - CERTAIN INFORMATION RELATING TO THE DOMESTIC 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 not independently verified the information contained in APPENDIX G hereto and cannot and does not warrant 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 IHS Global included as APPENDIX F to this Official Statement 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 Series A Pledged Settlement Payments and of Series B 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, IHS Global or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

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

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 its 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 2013 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.

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

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Official Statement and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2013 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 H – 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 $1,225,745,000 aggregate principal amount of its Asset–Backed Revenue Bonds, Series 2013 (State Contingency Contract Secured) consisting of $660,090,000 Asset–Backed Revenue Bonds, Series 2013A (State Contingency Contract Secured) (the "**Series 2013A Bonds**") and $565,655,000 Asset–Backed Revenue Bonds, Series 2013B (State Contingency Contract Secured) (the "**Series 2013B Bonds**" and, together with the Series 2013A Bonds, the "**Series 2013 Bonds**"). The Series 2013A Bonds are issued under the Indenture, dated as of June 1, 2003, as supplemented, including as supplemented by the Series 2013A Supplement (collectively, the "**Series A Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series A Trustee**"). The Series 2013B Bonds are issued under the Indenture, dated as of December 1, 2003, as supplemented, including as supplemented by the Series 2013B Supplement (collectively, the "**Series B Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series B Trustee**"). "**Trustee**" as used herein refers to the Series A Trustee or the Series B Trustee, as applicable.

The Series 2013A Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series A Indenture (collectively, the "**Series A Bonds**"), are special obligations of the Corporation, payable from and secured by a pledge of the "**Series A Pledged Revenues,**" which consist primarily of (i) the Series A Pledged Settlement Payments (defined below) received by the State of New York (the "**State**") pursuant to the MSA (defined below) and sold to the Corporation pursuant to the Purchase and Sale Agreement, dated as of June 1, 2003 (the "**Series A Sale Agreement**"), between the State and the Corporation and (ii) the payments (the "**Series A Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of June 1, 2003 (the "**Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent that amounts on deposit in the Series A Pledged Revenues Account, the Series A Debt Service Account, the Series A Supplemental Account and the Series A Debt Service Reserve Account (collectively, the "**Series A Pledged Accounts**") are insufficient therefor.

The Series 2013B Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series B Indenture (collectively, the "**Series B Bonds**"), are special obligations of the Corporation, payable from and secured by a pledge of the "**Series B Pledged Revenues,**" which consist primarily of (i) the Series B Pledged Settlement Payments (defined below) received by the State pursuant to the MSA and sold to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Series B Sale**

Agreement"), between the State and the Corporation and (ii) the payments (the "**Series B Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent that amounts on deposit in the Series B Pledged Revenues Account, the Series B Debt Service Account, the Series B Supplemental Account and the Series B Debt Service Reserve Account (collectively, the "**Series B Pledged Accounts**") are insufficient therefor.

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) on November 23, 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.

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 (the "**Act**"). The Corporation is not a party to the MSA. As of November 1, 2013, the Corporation had outstanding $1,065,820,000 Series A Bonds and **$**1,065,265,000 Series B Bonds.

Securities Offered........................... The Series 2013 Bonds are being issued pursuant to the Act, the Series A Indenture and the Series B Indenture. The Series A Indenture permits the issuance of additional parity refunding bonds. See "THE SERIES 2013A BONDS – Refunding Bonds." The Series B Indenture permits the issuance of additional parity refunding bonds. See "THE SERIES 2013B BONDS – Refunding Bonds."

It is expected that the Series 2013 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 12, 2013 (the "**Closing Date**"). Beneficial owners of the Series 2013 Bonds will not receive physical delivery of bond certificates.

Security for the Series A Bonds...... The Series A Bonds, including the Series 2013A Bonds, are special obligations of the Corporation, payable from and secured by a pledge of the Series A Pledged Revenues and amounts on deposit in the Series A Debt Service Reserve Account.

Pursuant to the Act and the Series A Sale Agreement, the State sold to the Corporation the "**Series A Pledged Settlement Payments,**" consisting of fifty percent (50%) of the State's Share (as defined below) of (i) the Annual Payments and Strategic Contribution Fund Payments (as defined below) and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all Lump Sum Payments (as defined below) payable to the State pursuant to the MSA and received at any time on or after June 19, 2003.

The Series A Bonds and the Series B Bonds are each separately secured by the Series A Pledged Revenues and the Series B Pledged Revenues, respectively. The Series A Trustee shall not have the right to make a claim to mitigate all or any part of an asserted deficiency in the Series A Pledged Revenues from the Series B Pledged Revenues and, likewise, the Series B Trustee shall not have the right to make a claim to mitigate all or part of an asserted deficiency in the Series B Pledged Revenues from the Series A Pledged Revenues. The rights of the Series A Trustee and the Series B Trustee to receive its respective Pledged Revenues are equal to and on a parity with each other and one right is not inferior or superior to the other.

The Series A Bonds, including the Series 2013A Bonds, are additionally secured by the amounts on deposit in the Series A Pledged Accounts.

Pursuant to the Series A Contract, the State has agreed to pay Series A Contract Payments to the Corporation, subject to appropriation by the State Legislature, in such amounts as are necessary to pay when due the principal of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent that amounts on deposit in the Series A Pledged Accounts are insufficient therefor. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS."

PURSUANT TO THE ACT, THE SERIES A BONDS, INCLUDING THE SERIES 2013A 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 A BONDS, INCLUDING THE SERIES 2013A BONDS, BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES A PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES A PLEDGED ACCOUNTS. THE CORPORATION HAS NO TAXING POWER.

Security for the Series B Bonds...... The Series B Bonds, including the Series 2013B Bonds, are special obligations of the Corporation, payable from and secured by a pledge of the Series B Pledged Revenues and amounts on deposit in the Series B Debt Service Reserve Account.

Pursuant to the Act and the Series B Sale Agreement, the State sold to the Corporation the "**Series B Pledged Settlement Payments,**" consisting of fifty percent (50%) of the State's Share of (i) the Annual Payments and Strategic Contribution Fund Payments (as defined below) and of all adjustments to prior payments, payable to the State pursuant to the MSA and received on and after January 1, 2004 and (ii) all Lump Sum Payments (as defined below) payable to the State pursuant to the MSA and received at any time on or after December 2, 2003.

The Series B Bonds and the Series A Bonds are each separately secured by the Series B Pledged Revenues and the Series A Pledged Revenues, respectively. The Series B Trustee shall not have the right to make a claim to mitigate all or any part of an asserted deficiency in the Series B Pledged Revenues from the Series A Pledged Revenues and, likewise, the Series A Trustee shall not have the right to make a claim to mitigate all or part of an asserted deficiency in the Series A Pledged Revenues from the Series B Pledged Revenues. The rights of the Series B Trustee and the Series A Trustee to receive its respective Pledged Revenues are equal to and on a parity with each other and one right is not inferior or superior to the other.

The Series B Bonds, including the Series 2013B Bonds, are additionally secured by the amounts on deposit in the Series B Pledged Accounts.

Pursuant to the Series B Contract, the State has agreed to pay Series B Contract Payments to the Corporation, subject to appropriation by the State Legislature, in such amounts as are necessary to pay when due the principal of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent that amounts on deposit in the Series B Pledged Accounts are insufficient therefor. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS."

PURSUANT TO THE ACT, THE SERIES B BONDS, INCLUDING THE SERIES 2013B 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 B BONDS, INCLUDING THE SERIES 2013B BONDS, BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES B PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES B PLEDGED ACCOUNTS. THE CORPORATION HAS NO TAXING POWER.

Covenants ....

Pursuant to the Act and each of the Series A Sale Agreement and the Series B Sale Agreement, the State has covenanted for the benefit of the Bondholders, among other things, that it will (i) enforce, at the expense of the State, its right to collect all monies due from the PMs under the MSA, (ii) diligently enforce, at the expense of the State, the Qualifying Statute (as defined herein) 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 and (iii) not, in any way, impair the rights and remedies of the Bondholders or the security for the Bonds. See "COVENANTS OF THE STATE." See also "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Potential Payment Decreases Under the Terms of the MSA – 2003 NPM Adjustment Claims; Arbitration Results" for a discussion of the State having been determined by the Arbitration Panel (as defined herein) to have diligently enforced the Qualifying Statute in 2003. The Corporation and the State have covenanted not to impair the exclusion of interest on the Series 2013 Bonds from gross income for federal income tax purposes. See "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT" and "APPENDIX H – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – The Indentures" for a summary of the covenants made by the Corporation. See "APPENDIX H – DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS – the Series A Sale Agreement and the Series B Sale Agreement" and "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT" for the covenants made by the State.

Amendment to Covenants.............. Each of the Series 2013A Supplement to the Series A Indenture and the Series 2013B Supplement to the Series B Indenture amend the Series A Indenture and the Series B Indenture to permit the Series A Sale Agreement and the Series B Sale Agreement, respectively, to be amended to permit the State to consent to an amendment to the MSA under certain circumstances. See "COVENANTS OF THE STATE" for a description of the circumstances that would, under the proposed amendments, permit the State to consent to an amendment to the MSA.

Use of Proceeds .... The proceeds of the Series 2013 Bonds will be applied by the Corporation to: (i) refund (A) all of its outstanding Asset–Backed Revenue Bonds, Series 2003A-1C (State Contingency Contract Secured), in the aggregate principal amount of $700,220,000 and (B) all of its outstanding Asset-Backed Revenue Bonds, Series 2003B-1C (State Contingency Contract Secured), in the aggregate principal amount of $603,265,000 (items (A) and (B), collectively, the "**Refunded Bonds**" as set forth in APPENDIX J – BONDS TO BE REFUNDED), and (ii) pay the costs of issuance incurred in connection with the issuance of the Series 2013 Bonds.

Master Settlement Agreement .... The MSA was entered into on November 23, 1998 among the attorneys general of the 46 states (including the State), the Commonwealth of 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 then four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. References herein to the Original Participating Manufacturers or OPMs means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively, Philip Morris, Reynolds American and Lorillard.

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 Fund Payments, each as defined herein), and the imposition of certain tobacco advertising and marketing restrictions, among other things.

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

As reported by the National Association of Attorneys General ("**NAAG**"), based upon OPM shipments reported to Management Science Associates, Inc., an independent third-party database management organization that collects wholesale shipment data ("**MSAI**"), the OPMs accounted for approximately 84.52%[*] of the U.S. domestic cigarette market in payment year 2013 (sales year 2012), based upon shipments and measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

Also as reported by NAAG, based upon shipments reported to MSAI, the SPMs accounted for approximately 9.11%[*] of the U.S. domestic cigarette market in payment year 2013 (sales year 2012), based upon shipments and measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate, or approximately 9.39%[*] measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate.

MSA Payments.............................. Under the MSA, the OPMs are required to pay to the Settling States:

(a) five initial payments, all of which have been paid (the "**Initial Payments**");

(b) annual payments on each April 15, commencing April 15, 2000 and continuing in perpetuity (of which the April 15, 2000 through April 15, 2013 annual payments have already been paid) (the "**Annual Payments**") in the following base amounts (subject to adjustment as described herein):

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

(c) ten annual payments of $861 million each (subject to adjustment as described herein) required to be made on each April 15, commencing April 15, 2008 and continuing through April 15, 2017 (of which the April 15, 2008 through April 15, 2013 payments have already been paid) (the "**Strategic Contribution Fund Payments**").

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and each Strategic Contribution Fund Payment based on its respective market share of the United States cigarette market during the preceding calendar year, in each case, subject to certain adjustments as described herein. Each SPM has Annual Payment and Strategic Contribution Fund Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share. However,

[*] The aggregate market share information is based on information as reported by NAAG and may differ materially from the market share information as reported by the OPMs for purposes of their filings with the Securities and Exchange Commission. See "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and "APPENDIX G—CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY." The aggregate market share information for the sales year 2012 from NAAG used in the Cash Flow Assumptions may differ materially in the future from the market share information used by the MSA Auditor in calculating the adjustments to Annual Payments and Strategic Contribution Payments in future years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT— Adjustments to Payments."

any SPM that became a party to the MSA within 90 days after it became effective pays only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share.

The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent, which is required pursuant to the instructions of the MSA Escrow Agreement to remit an allocable share of such payments to the parties entitled thereto.

Under the MSA, the Annual Payments and the Strategic Contribution Fund Payments due may be subject to numerous adjustments, some of which have occurred and may continue to occur and may be material. Such adjustments include, among others, reductions when a PM experiences a loss of market share to Non-Participating Manufacturers as a result of such PM's participation in the MSA (the **"NPM Adjustment"**), reductions for decreased domestic cigarette shipments and to account for those states that settle or have settled their claims against the PMs independently of the MSA, increases related to inflation in an amount of not less than 3% per year and offsets for disputed and/or miscalculated payments. NPM Adjustments have resulted in reduced Annual Payments due since 2003 and the Strategic Contribution Fund Payments due since 2008. On September 11, 2013, a panel arbitrating the 2003 NPM Adjustment claims determined that the State is not subject to the 2003 NPM Adjustment because the State diligently enforced its Qualifying Statute (defined herein) in 2003. No assurance can be given as to whether the State will be subject to NPM Adjustment for sales years subsequent to 2003. See "BONDHOLDERS' RISKS - Potential Payment Decreases Under the Terms of the MSA" and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT–Annual Payments" herein.

Industry Overview .... The three OPMs – Philip Morris, Reynolds American and Lorillard – are the largest manufacturers of cigarettes in the United States (based on 2012 domestic market share). The market for cigarettes is highly competitive and is characterized by brand recognition. See "APPENDIX F – IHS GLOBAL REPORT" and "APPENDIX G – CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY".

Cigarette Consumption .... As described in the IHS Global Report, attached hereto as APPENDIX F, domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980s and 1990s, falling to less than 400 billion cigarettes in 2003 and, when measured by cigarette shipments, is estimated to have fallen to approximately 290 billion cigarettes (measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate) in sales year 2012, as reported by NAAG.

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. 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 Fund Payments. 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 Fund Payments and 51.176% of the Annual Payments (which represents 6.5310970% of the Annual Payments payable under the MSA), of which the amounts received by the State on and after January 1, 2004 constitute the "**State's Share**". The remaining 48.824% of Annual Payments is allocated among The City of New York and all other counties located within the State.

Sale of Pledged Settlement Payments..

Pursuant to the Act and the Series A Sale Agreement, the State sold the Series A Pledged Settlement Payments (consisting of fifty percent (50%) of the State's Share) to the Corporation. Under the Series A Indenture, the Corporation assigned and pledged the Series A Pledged Settlement Payments to the Trustee. Such Series A Pledged Settlement Payments are paid directly by the MSA Escrow Agent to the Trustee and the Trustee causes the Series A Pledged Settlement Payments to be deposited under the Series A Indenture.

Pursuant to the Act and the Series B Sale Agreement, the State sold the Series B Pledged Settlement Payments (consisting of fifty percent (50%) of the State's Share) to the Corporation. Under the Series B Indenture, the Corporation assigned and pledged the Series B Pledged Settlement Payments to the Trustee. Such Series B Pledged Settlement Payments are paid directly by the MSA Escrow Agent to the Trustee and the Trustee causes the Series B Pledged Settlement Payments to be deposited under the Series B Indenture. Neither the Series A Pledged Settlement Payments nor the Series B Pledged Settlement Payments are subject to appropriation by the State.

Series A Debt Service Reserve Account.......

A reserve account (the "**Series A Debt Service Reserve Account**") is held by the Trustee and was funded from proceeds of the Series 2003A Bonds in an amount equal to $227,545,572.00 (the "**Debt Service Reserve Requirement**"). The Series A Debt Service Reserve Account is currently fully funded. The amount in the Series A Debt Service Reserve Account must be maintained, to the extent of available investment earnings therein and Series A Pledged Settlement Payments, at the Series A Debt Service Reserve Requirement. Series A Contract Payments will not be applied to satisfy any deficiencies in the Series A Debt Service Reserve Account.

Amounts on deposit in the Series A Debt Service Reserve Account will be available to pay the principal of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent amounts on deposit in the Series A Pledged Revenues Account, the Series A Debt Service Account and the Series A Supplemental Account are insufficient for such purpose.

Series A Contract............................

Pursuant to the Series A Contract, the State, acting through the Director of Budget of the State of New York, has entered into the Series A Contract to provide additional security for the Series A Bonds, including the Series 2013A Bonds. The Series A 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 (as defined in APPENDIX H hereto) of such amount, if any, as shall be necessary to provide for the payment of the principal of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to be paid on such date, if the amounts on deposit in the Series A Pledged Accounts are insufficient therefor. The Corporation has covenanted to request from the State annually by certification of an Authorized Officer thereof to the Director of the Budget, not later than December 15 of each year, an appropriation of an amount equal to the principal of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to come due during the next succeeding Fiscal Year. The State has covenanted 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.

The Corporation and the State have both complied with their respective covenants in each year since the issuance of the Series 2003A Bonds. The Governor of New York has included in the Executive Budget, and the State has appropriated, an amount sufficient to pay annual debt service on the Series A Bonds for each year since the first Series A Bonds were issued.

Payments made by the State pursuant to the Series A Contract are only available to pay the principal of and interest on the Series A Bonds, including the Series 2013A Bonds. The Series A Contract is attached hereto in APPENDIX A. The obligation of the State to pay or fund amounts provided for by the Series A Contract is subject to and dependent upon annual appropriations being made by the State Legislature. There can be no assurance that the State Legislature will make any such appropriations. See "SUMMARY OF THE SERIES A CONTRACT."

If, on the fifth Business Day (as defined in APPENDIX H) preceding any Distribution Date the sum of the amounts on deposit to the credit of the Series A Pledged Accounts shall be less than the principal of and interest on the Series A Bonds, including the Series 2013A 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 Series A Contract, such payment to be received in any event on or before such Distribution Date, and any amounts paid pursuant to the Series A Contract shall be deposited directly to the credit of the Series A Debt Service Account for the purpose of paying the debt service coming due on such Distribution Date.

PURSUANT TO THE ACT, THE SERIES 2013A 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 2013A BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES A PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES A PLEDGED ACCOUNTS. THE CORPORATION HAS NO TAXING POWER. SEE "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT."

Series B
Debt Service Reserve Account ....

A reserve account (the "**Series B Debt Service Reserve Account**") is held by the Trustee and was funded from proceeds of the Series 2003B Bonds in an amount equal to $221,582,343.75 (the "**Debt Service Reserve Requirement**"). The Series B Debt Service Reserve Account is currently fully funded. The amount in the Series B Debt Service Reserve Account must be maintained, to the extent of available investment earnings therein and Series B Pledged Settlement Payments, at the Series B Debt Service Reserve Requirement. Series B Contract Payments will not be applied to satisfy any deficiencies in the Series B Debt Service Reserve Account.

Amounts on deposit in the Series B Debt Service Reserve Account will be available to pay the principal of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent amounts on deposit in the Series B Pledged Revenues Account, the Series B Debt Service Account and the Series B Supplemental Account are insufficient for such purpose.

Series B Contract .... Pursuant to the Series B Contract, the State, acting through the Director of Budget of the State of New York, has entered into the Series B Contract to provide additional security for the Series B Bonds, including the Series 2013B Bonds. The Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid on such date, if the amounts on deposit in the Series B Pledged Accounts are insufficient therefor. The Corporation has covenanted to request from the State annually by certification of an Authorized Officer thereof to the Director of the Budget, not later than December 15 of each year, an appropriation of an amount equal to the principal of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to come due during the next succeeding Fiscal Year. The State has covenanted 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.

The Corporation and the State have both complied with their respective covenants in each year since the issuance of the Series 2003B Bonds. The Governor of New York has included in the Executive Budget, and the State has appropriated, an amount sufficient to pay annual debt service on the Series B Bonds for each year since the first Series B Bonds were issued.

Payments made by the State pursuant to the Series B Contract are only available to pay the principal of and interest on the Series B Bonds, including the Series 2013B Bonds. The Series B Contract is attached hereto in APPENDIX A. The obligation of the State to pay or fund amounts provided for by the Series B Contract is subject to and dependent upon annual appropriations being made by the State Legislature. There can be no assurance that the State Legislature will make any such appropriations. See "SUMMARY OF THE SERIES B CONTRACT".

If, on the fifth Business Day preceding any Distribution Date the sum of the amounts on deposit to the credit of the Series B Pledged Accounts shall be less than the principal of and interest on the Series B Bonds, including the Series 2013B 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 Series B Contract, such payment to be received in any event on or before such Distribution Date, and any amounts paid pursuant to the Series B Contract shall be deposited directly to the credit of the Series B Debt Service

Account for the purpose of paying the debt service coming due on such Distribution Date.

PURSUANT TO THE ACT, THE SERIES 2013B 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 2013B BONDS BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES B PLEDGED REVENUES AND AMOUNTS ON DEPOSIT IN THE SERIES B PLEDGED ACCOUNTS. THE CORPORATION HAS NO TAXING POWER. SEE "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT."

Series A Supplemental Account ..... An account (the "**Series A Supplemental Account**") has been established and is held by the Trustee and is funded from Series A 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 2013A BONDS – Series A Flow of Funds" (the "**Series A Surplus Pledged Revenues**"). Amounts on deposit in the Series A Supplemental Account may be used to purchase, redeem in accordance with their terms or defease the Series A Bonds as set forth under the caption "THE SERIES 2013A BONDS —Redemption and Purchase Provisions — *Application of Series A Surplus Pledged Revenues*."

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

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series A Supplemental Account shall be applied or set aside to defease Series A Bonds or to pay the optional redemption or purchase price of Series A Bonds unless there is held in the Series A Pledged Revenues Account and the Series A Debt Service Account sufficient amounts to pay all principal of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to be paid in such year.

Series B Supplemental Account ..... An account (the "**Series B Supplemental Account**") has been established and is held by the Trustee and is funded from Series B 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 2013B BONDS – Series B Flow of Funds" (the "**Series B Surplus Pledged Revenues**"). Amounts on deposit in the Series B Supplemental Account may be used to purchase, redeem in accordance with their terms or defease the Series B Bonds as set forth under the caption "THE SERIES 2013B BONDS —Redemption and Purchase Provisions — *Application of Series B Surplus Pledged Revenues.*"

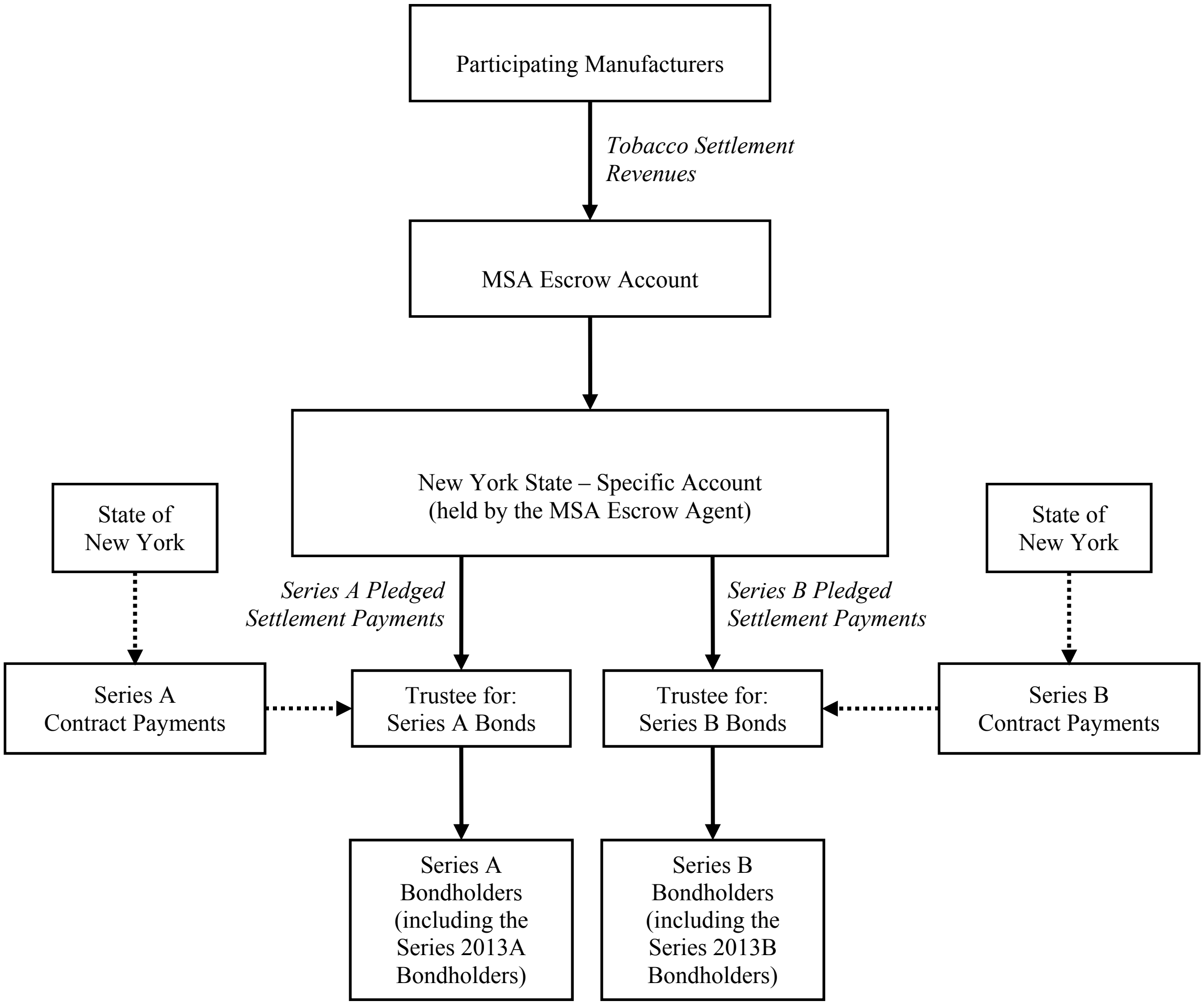
Amounts on deposit in the Series B Supplemental Account will not be released from the lien of the Series B Indenture until (i) applied to the purchase, redemption, or defeasance of Series B Bonds, (ii) applied to the payment of principal of or interest on Series B Bonds to the extent amounts on deposit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

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series B Supplemental Account shall be applied or set aside to defease Series B Bonds or to pay the optional redemption or purchase price of Series B Bonds unless there is held in the Series B Pledged Revenues Account and the Series B Debt Service Account sufficient amounts to pay all principal of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid in such year.

Flow of Funds to the Trustee..........

The MSA Escrow Agent disburses the Series A Pledged Settlement Payments and the Series B Pledged Settlement Payments from the New York State-Specific Account directly to the Trustee. Additionally, the State pays any Series A Contract Payments and Series B Contract Payments, to the extent funds have been appropriated for such purposes, directly to the Trustee in accordance with the provisions of the Series A Contract and the Series B Contract.

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


Participating Manufacturers
Tobacco Settlement Revenues
MSA Escrow Account
New York State – Specific Account (held by the MSA Escrow Agent)
State of New York
State of New York
Series A Pledged Settlement Payments
Series B Pledged Settlement Payments
Series A Contract Payments
Trustee for: Series A Bonds
Trustee for: Series B Bonds
Series B Contract Payments
Series A Bondholders (including the Series 2013A Bondholders)
Series B Bondholders (including the Series 2013B Bondholders)

Distributions and Priorities.............

The Trustee will deposit all Series A Pledged Revenues in the Series A Pledged Revenues Account and distribute them in accordance with the “Series A Flow of Funds” set forth herein under the caption “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS.” The Trustee will deposit all Series B Pledged Revenues in the Series B Pledged Revenues Account and distribute them in accordance with the “Series B Flow of Funds” set forth herein under the caption “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS.”

Series 2013A Bonds
Optional Redemption......................

The Series 2013A Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Corporation, at the direction of the State, at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	**Principal Amount**	**First Optional Redemption Date (June 1)**	**CUSIP**
2018	$ 5,800,000	2014	88880TNA0
2019	85,735,000	2014	88880TNB8
2020	12,415,000	2014	88880TNC6
2020	132,630,000	2015	88880TNF9
2020	33,260,000	2016	88880TNG7
2021	189,345,000	2016	88880TND4
2022	63,535,000	2016	88880TNE2
2022	137,370,000	2017	88880TNH5

Optional redemption of the Series 2013A Bonds may be made from Series A Surplus Pledged Revenues on deposit in the Series A Supplemental Account, from sources other than Series A Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation.

Series 2013A Bonds
Mandatory Clean-Up Call..............

The Series 2013A Bonds are subject to mandatory redemption in full on any Distribution Date, and on any date after which there are no Series 2011A Bonds outstanding, at a redemption price equal to par plus accrued interest if, in each case, the amount on deposit in the Series A Debt Service Account, the Series A Supplemental Account and the Series A Debt Service Reserve Account is greater than the outstanding par amount of all of the Series A Bonds plus accrued interest thereon.

Purchase of Series 2013A Bonds....

The Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013A Bonds to be purchased), may cause the Trustee to purchase Series 2013A Bonds in the open market from Series A Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2013A Bonds being purchased at such time, plus accrued interest thereon.

Series 2013B Bonds
Optional Redemption......................

The Series 2013B Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Corporation, at the direction of the State, at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	Principal Amount	First Optional Redemption Date (June 1)	CUSIP
2019	$67,900,000	2014	88880TNJ1
2019	60,085,000	2015	88880TNN2
2020	34,470,000	2015	88880TNK8
2020	143,145,000	2016	88880TNP7
2021	124,220,000	2016	88880TNL6
2021	65,385,000	2017	88880TNQ5
2022	70,450,000	2017	88880TNM4

Optional redemption of the Series 2013B Bonds may be made from Series B Surplus Pledged Revenues on deposit in the Series B Supplemental Account, from sources other than Series B Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation.

Series 2013B Bonds
Mandatory Clean-Up Call...............

The Series 2013B Bonds are subject to mandatory redemption in full on any Distribution Date, and on any date after which there are no Series 2011B Bonds outstanding, at a redemption price equal to par plus accrued interest if, in each case, the amount on deposit in the Series B Debt Service Account, the Series B Supplemental Account and the Series B Debt Service Reserve Account is greater than the outstanding par amount of all of the Series B Bonds plus accrued interest thereon.

Purchase of Series 2013B Bonds....

The Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013B Bonds to be purchased), may cause the Trustee to purchase Series 2013B Bonds in the open market from Series B Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2013B Bonds being purchased at such time, plus accrued interest thereon.

Application of Series A
Surplus Pledged Revenues..............

Series A Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase, redeem in accordance with their terms or defease Series A Bonds at the times, with such maturities and in such amounts as the State directs, and by lot if within a maturity, including, with respect to the Series 2013A Bonds, in accordance with the provisions set forth herein under "THE SERIES 2013A BONDS – Redemption and Purchase Provisions – Series 2013A Bonds Optional Redemption," "–Series 2013A Bonds Mandatory Clean-Up Call," and "–Purchase of Series 2013A Bonds." To the extent not used to purchase, redeem or defease Series A Bonds, all Series A Surplus Pledged Revenues will remain in the Series A Supplemental Account until applied to the payment of principal or interest on Series A Bonds, including the Series 2013A Bonds, to the extent amounts on deposit in the Series A Pledged Revenues Account and the Series A Debt Service Account are insufficient therefor or (ii) there are no Series A Bonds Outstanding under the Series A Indenture.

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series A Supplemental Account shall be applied or set aside to defease Series A Bonds or to pay the optional redemption or purchase price of Series A Bonds unless there is held in the Series A Pledged Revenues Account and the Series A Debt Service Account sufficient amounts to pay all principal of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to be paid in such year.

The State currently intends to continue to direct all or a significant portion of the Series A Surplus Pledged Revenues to purchase, redeem in accordance with their terms or defease Series A 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 "OUTSTANDING BONDS." See also "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE – Series A Bonds" for the projection of Series A Pledged Settlement Payments. This projection is based upon, among other things, the forecast of cigarette consumption shown in the IHS Global Report. The actual amounts of Series A Pledged Settlement Payments may be more or less than such projections of Series A Pledged Settlement Payments. See "APPENDIX F – IHS GLOBAL REPORT." There can be no assurance of the actual amounts of Series A Surplus Pledged Revenues or the application thereof to the purchase, redemption or defeasance of Series A Bonds. See "BONDHOLDERS' RISKS."

Since the issuance of the Series 2003A Bonds, $646,320,000 of the original principal amount of the Series 2003A Bonds have been redeemed by operation of the Series A Supplemental Account, representing 28.0% of the original principal amount of the Series 2003A Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS-Series A Pledged Accounts-*Series A Supplemental Account*."

Application of Series B Surplus Pledged Revenues.............

Series B Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase, redeem in accordance with their terms or defease Series B Bonds at the times, with such maturities and in such amounts as the State directs, and by lot if within a maturity, including, with respect to the Series 2013B Bonds, in accordance with the provisions set forth herein under "THE SERIES 2013B BONDS – Redemption and Purchase Provisions – Series 2013B Bonds Optional Redemption," "–Series 2013B Bonds Mandatory Clean-Up Call," and "–Purchase of Series 2013B Bonds." To the extent not used to purchase, redeem or defease Series B Bonds, all Series B Surplus Pledged Revenues will remain in the Series B Supplemental Account until (i) applied to the payment of principal of or interest on Series B Bonds, including the Series 2013B Bonds, to the extent amounts on deposit in the Series B Pledged Revenues Account and the Series B Debt Service Account are insufficient therefor or (ii) there are no Series B Bonds Outstanding under the Series B Indenture.

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series B Supplemental Account shall be applied or set aside to defease Series B Bonds or to pay the optional redemption or purchase price of Series B Bonds unless there is held in the Series B Pledged Revenues Account and the Series B Debt Service Account sufficient amounts to pay all principal of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid in such year.

The State currently intends to continue to direct all or a significant portion of the Series B Surplus Pledged Revenues to purchase, redeem in accordance with their terms or defease Series B 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 “OUTSTANDING BONDS.” See also “TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE – Series B Bonds” for the projection of Series B Pledged Settlement Payments. This projection is based upon, among other things, the forecast of cigarette consumption shown in the IHS Global Report. The actual amounts of Series B Pledged Settlement Payments may be more or less than such projections of Series B Pledged Settlement Payments. See “APPENDIX F IHS GLOBAL REPORT.” There can be no assurance of the actual amounts of Series B Surplus Pledged Revenues or the application thereof to the purchase, redemption or defeasance of Series B Bonds. See “BONDHOLDERS’ RISKS.”

Since the issuance of the Series 2003B Bonds, $514,610,000 of the original principal amount of the Series 2003B Bonds have been redeemed by operation of the Series B Supplemental Account, representing 23.0% of the original principal amount of the Series 2003B Bonds. See “SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS-Series B Pledged Accounts-*Series B Supplemental Account.*”

Events of Default............................ For a description of the Events of Default under the Series A Indenture and the Series B Indenture and the remedies available therefor, see “THE SERIES 2013A BONDS − Events of Default and Remedies” and “THE SERIES 2013B BONDS − Events of Default and Remedies,” respectively. In no event will principal of any Bond be declared due and payable in advance of its stated maturity.

Series A Refunding Bonds............. The Series A Indenture provides that additional Series of Bonds may be issued by the Corporation solely for refunding purposes. Additional refunding Series A Bonds would be issued on a parity with the Series 2011A Bonds and the Series 2013A Bonds. See “THE SERIES 2013A BONDS – Refunding Bonds.” No other additional Bonds may be issued under the Series A Indenture.

Series B Refunding Bonds............. The Series B Indenture provides that additional series of Bonds may be issued by the Corporation solely for refunding purposes. Additional refunding Series B Bonds would be issued on a parity with the Series 2011B Bonds and the Series 2013B Bonds. See “THE SERIES 2013B BONDS – Refunding Bonds.” No other additional Bonds may be issued under the Series B Indenture with a parity claim against the Series B Pledged Revenues.

Continuing Disclosure
Agreements.................................... The Corporation and the State have agreed to provide, or cause to be provided, to the Municipal Securities Rulemaking Board, through its Electronic Municipal Market Access system, pursuant to Rule 15c2-12(b)(5) adopted by the Securities and Exchange Commission (the “**SEC**”), certain

annual financial information and operating data and, in a timely manner, notices of certain events. See “CONTINUING DISCLOSURE AGREEMENTS” herein.

Ratings... Standard & Poor’s Ratings Services (“**S&P**”) has rated the Series 2013 Bonds “AA-” and Fitch, Inc. (“**Fitch”** and, together with S&P, the “**Rating Agencies**”) has rated the Series 2013 Bonds “AA-”. See “RATINGS” herein. It is expected that the Rating Agencies’ ratings of the Series 2013

Bonds will not reflect the security provided by the Pledged Settlement Payments, but rather, the Series A Contract and the Series B Contract and the risks inherent thereto. See "APPENDIX B-INFORMATION CONCERNING THE STATE OF NEW YORK."

Legal Considerations Relating to Series A Pledged Settlement Payments and Series B Pledged Settlement Payments....................... Reference is made to "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" for a description of certain legal issues relevant to receipt of payments under the MSA.

Bondholders' Risks......................... Reference is made to "BONDHOLDERS' RISKS" for a description of certain considerations relevant to an investment in the Series 2013 Bonds.

PLAN OF FINANCE

The Corporation has previously issued pursuant to the Series A Indenture its Asset–Backed Revenue Bonds, Series 2003A (State Contingency Contract Secured) certain of which are currently outstanding and mature on June 1 of the years 2018 through and including 2022, in the aggregate principal amount of $700,220,000 (the "**Series 2003A-1C Refunded Bonds**"). See "APPENDIX J – BONDS TO BE REFUNDED." The Corporation will apply a portion of the proceeds from the sale of the Series 2013A Bonds to establish an irrevocable escrow to refund the Series 2003A-1C Refunded Bonds. Such escrowed proceeds of the Series 2013A Bonds will be deposited with The Bank of New York Mellon, as escrow agent (the "**Refunding Escrow Agent**") pursuant to an Escrow Agreement dated as of December 1, 2013 (the "**Series 2003A-1C Refunding Escrow Agreement**"), by and between the Corporation and the Refunding Escrow Agent. The amounts deposited under the Series 2003A-1C Refunding Escrow Agreement will be held by the Refunding Escrow Agent and invested in Defeasance Collateral (as defined in the Series 2003A-1C Refunding Escrow Agreement) (the "**Series A Defeasance Collateral**"), the principal of and interest on which, when received, will be sufficient to pay the redemption price of and interest on the Series 2003A-1C Refunded Bonds upon maturity or redemption thereof. See also "VERIFICATION OF MATHEMATICAL COMPUTATIONS."

The Corporation has previously issued pursuant to the Series B Indenture its Asset-Backed Revenue Bonds, Series 2003B (State Contingency Contract Secured) certain of which are currently outstanding and mature on June 1 of the years 2019 through and including 2022, in the aggregate principal amount of **$**603,265,000 (the "**Series 2003B-1C Refunded Bonds**" and, together with the Series 2003B-1C Bonds, the "**Refunded Bonds**"). See "APPENDIX J – BONDS TO BE REFUNDED." The Corporation will apply a portion of the proceeds from the sale of the Series 2013B Bonds to establish an irrevocable escrow to refund the Series 2003B1-C Refunded Bonds. Such escrowed proceeds of the Series 2013B Bonds will be deposited with the Refunding Escrow Agent pursuant to an Escrow Agreement dated as of December 1, 2013 (the "**Series 2003B-1C Refunding Escrow Agreement**"), by and between the Corporation and the Refunding Escrow Agent. The amounts deposited under the Series 2003B-1C Refunding Escrow Agreement will be held by the Refunding Escrow Agent and invested in Defeasance Collateral (as defined in the Series B Refunding Escrow Agreement) (the "**Series B Defeasance Collateral**"), the principal of and interest on which, when received, will be sufficient to pay the redemption price of and interest on the Series 2003B-1C Refunded Bonds upon maturity or redemption thereof. See also "VERIFICATION OF MATHEMATICAL COMPUTATIONS."

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A 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 2013A Bonds issued under the Series A Indenture. These provisions have been summarized and this description does not purport to be complete. Reference should be made to the Act, the Series A Indenture, the Series A Sale Agreement and the Series A Contract for a more complete description of such provisions. Copies of the Act, the Series A Indenture, the Series A Sale Agreement and the Series A Contract are on file with the Corporation and the Trustee. See also "APPENDIX A - THE SERIES A CONTRACT AND THE SERIES B CONTRACT" and "APPENDIX H - DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS" for a more complete statement of the rights, duties and obligations of the parties thereto.

The Series 2013A Bonds

The Series 2013A Bonds are special obligations of the Corporation issued under the Indenture, dated as of June 1, 2003, as supplemented, including as supplemented by the Series 2013A Supplement (collectively, the "**Series A Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series A Trustee**"). "Trustee" as used in this Official Statement refers to the Series A Trustee or the Series B Trustee (as defined herein) as applicable. The Series 2013A Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series A Indenture (collectively, the "**Series A Bonds**"), are payable from and secured by a pledge of the "**Series A Pledged Revenues**," which consist of (i) the Series A Pledged Settlement Payments (defined below) sold by the State to the Corporation pursuant to the Purchase and Sale Agreement, dated as of June 1, 2003 (the "**Series A Sale Agreement**"), between the State and the Corporation, (ii) the payments (the "**Series A Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of June 1, 2003 (the "**Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent that amounts on deposit in the Series A Pledged Revenues Account, the Series A Debt Service Account, the Series A Supplemental Account and the Series A Debt Service Reserve Account (collectively, the "**Series A Pledged Accounts**") are insufficient therefor, (iii) payments made to the Corporation or the Series A Trustee under any Series A Ancillary Contracts and swap contracts and (iv) all fees, charges, payments, investment earnings and other income and receipts paid or payable to the Corporation or the Series A Trustee for the account of the Corporation or the Beneficiaries. The Series A Bonds are also payable from the amounts on deposit in the Series A Debt Service Reserve Account. The Series A Pledged Revenues and the right to receive them have been pledged to the Trustee for the benefit of the Holders of the Series A Bonds, including the Series 2013A Bonds.

The Series A Bonds and the Series B Bonds (collectively referred to herein as the "**Bonds**") are each separately secured by the Series A Pledged Revenues and the Series B Pledged Revenues, respectively. The Series A Trustee shall not have the right to make a claim to mitigate all or any part of an asserted deficiency in the Series A Pledged Revenues from the Series B Pledged Revenues and, likewise, the Series B Trustee shall not have the right to make a claim to mitigate all or part of an asserted deficiency in the Series B Pledged Revenues from the Series A Pledged Revenues. The rights of the Series A Trustee and the Series B Trustee to receive its respective Pledged Revenues are equal to and on a parity with each other and one right is not inferior or superior to the other.

Pursuant to the Act, the Series A Bonds, including the Series 2013A 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 A Bonds, including the Series 2013A Bonds, payable out of any funds or assets other than the Series A Pledged Revenues and amounts on deposit in the Series A Pledged Accounts. The Corporation has no taxing power.

The Series A Sale Agreement

Pursuant to the Act and the Series A Sale Agreement, the State sold to the Corporation the "**Series A Pledged Settlement Payments**", consisting of fifty percent (50%) of the State's Share of (i) the Annual Payments and Strategic Contribution Fund Payments (as defined in the MSA) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received by the Trustee on and after January 1, 2004 and (ii) all payments 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 ("**Lump Sum Payments**"), received at any time on or after June 19, 2003. The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Fund Payments.[†] See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Initial Payments," "— Annual Payments" and "—Strategic Contribution Fund 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 Series A Pledged Settlement Payments directly to the Trustee. The disbursement of Series A Pledged Settlement Payments is required to be made to the Trustee by the MSA Escrow Agent ten business days after the MSA Escrow Agent receives the related Annual Payments and Strategic Contribution Fund Payments from the PMs. The Trustee will, within two Business Days after receipt, transfer the Series A Pledged Settlement Payments to the Series A Pledged Revenues Account established by the Series A Indenture. Series A Pledged Settlement Payments will be disbursed from the Series A Pledged Revenues Account in accordance with the provisions of the Series A Indenture. See "Series A Flow of Funds" below and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Payments Made to Date."

The Series A Sale Agreement contains certain representations and covenants of the State for the benefit of the holders of the Series A Bonds. See "COVENANTS OF THE STATE" and "APPENDIX H - DEFINITIONS

[†] 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.

AND SUMMARY OF THE TRANSACTION DOCUMENTS – The Series A Sale Agreement and the Series B Sale Agreement" for a more detailed discussion of such representations and covenants.

The Series A Contract

The Series A Bonds, including the Series 2013A Bonds, are secured by a pledge of all of the Corporation's interest under the Series A Contract, including, without limitation, the Series A Contract Payments made by the State thereunder. The Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, coming due on such date, if all other funds pledged and available therefor, as described herein, are inadequate.

The Series A 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 Series A Contract further provides that neither the Corporation nor the State will terminate the Series A 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 Series A Contract.

The Director of the Budget on behalf of the State has agreed in the Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, coming due in such ensuing fiscal year. See "HISTORY OF APPROPRIATIONS." The obligations of the State pursuant to the Series A Contract shall not terminate so long as any Series A Bond is Outstanding.

The obligation of the State to fund or pay the amounts provided for by the Series A 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 2013A 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 Series A Contract has been duly authorized, executed and delivered by the State, and, assuming the due execution and delivery by the Corporation, the Series A 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 Series A Contract, see "SUMMARY OF THE SERIES A CONTRACT." A copy of the Series A Contract is attached hereto as APPENDIX A.

Series A Pledged Accounts

Each of the following accounts were established under the Series A Indenture as a segregated trust account and are held by the Trustee for the benefit of the holders of the Series A Bonds, including the Series 2013A Bonds. All moneys on deposit in the following accounts will be invested in Eligible Investments as defined in the Series A Indenture.

Series A Pledged Revenues Account. The Trustee holds the "**Series A Pledged Revenues Account**" into which the Trustee deposits all Series A Pledged Revenues. Funds on deposit in the Series A Pledged Revenues Account are transferred to various other accounts under the Series A Indenture and applied to certain other purposes as described below.

Series A Debt Service Account. The Trustee holds the "**Series A Debt Service Account**" into which the Trustee deposits amounts transferred from the Series A Pledged Revenues Account in respect of principal of and interest on the Series A Bonds, including the Series 2013A Bonds. The Trustee makes payments on the Series A Bonds, including the Series 2013A Bonds, in accordance with the priority of the deposits and transfers as described below under "Series A Flow of Funds."

Series A Debt Service Reserve Account. The Trustee holds the "**Series A Debt Service Reserve Account**", which was funded from Series 2003A Bond proceeds in the amount of $227,545,572 **(**the "**Series A Debt Service Reserve Requirement**"). The Series A Debt Service Reserve Account is currently fully funded. To the extent of available investment earnings therein and Series A Pledged Settlement Payments, the amount in the Series A Debt Service Reserve Account must be maintained at the Series A Debt Service Reserve Requirement. Series A Contract Payments will not be applied to satisfy any deficiencies in the Series A Debt Service Reserve Account. See Note 5 of the Corporation's Financial Statements.

Amounts in the Series A Debt Service Reserve Account are available to pay principal of and interest on the Series A Bonds, including the Series 2013A Bonds, to the extent that amounts on deposit in the Series A Pledged Revenues Account, the Series A Debt Service Account and the Series A Supplemental Account are insufficient for such purpose. All earnings on amounts in the Series A Debt Service Reserve Account are retained in it if the amount therein is not equal to the Series A Debt Service Reserve Requirement. On each Distribution Date, amounts on deposit in the Series A Debt Service Reserve Account in excess of the Series A Debt Service Reserve Requirement will be transferred to the Series A Pledged Revenues Account and from there, immediately to the Series A Debt Service Account.

Series A Supplemental Account. The Trustee holds the "Supplemental Account" into which the Trustee deposits Series A 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 "Series A Flow of Funds" (the "**Series A Surplus Pledged Revenues**"). Amounts on deposit in the Series A Supplemental Account may be used to purchase, redeem in accordance with their terms or defease Series A Bonds as set forth under the caption "THE SERIES 2013A BONDS — Redemption and Purchase Provisions — *Application of Series A Surplus Pledged Revenues*."

Amounts on deposit in the Series A Supplemental Account will not be released from the lien of the Series A Indenture until (i) applied to the purchase, redemption or defeasance of Series A Bonds, (ii) applied to the payment of principal of or interest on Series A Bonds, including the Series 2013A Bonds, to the extent amounts on deposit in the Series A Pledged Revenues Account and the Series A Debt Service Account are insufficient therefor or (iii) there are no Series A Bonds Outstanding under the Series A Indenture.

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series A Supplemental Account shall be applied or set aside to defease Series A Bonds or to pay the optional redemption or purchase price of Series A Bonds unless there is held in the Series A Pledged Revenues Account and the Series A Debt Service Account sufficient amounts to pay all principal of and interest on Series A Bonds, including the Series 2013A Bonds, scheduled to be paid on such Distribution Date.

Series A Additional Accounts

Each of the following accounts were established under the Series A Indenture and held by the Trustee. None of these accounts is a Series A Pledged Account and amounts on deposit therein are not available to pay principal and Sinking Fund Installments, if any, of and interest on the Series A Bonds, including the Series 2013A Bonds.

Series A Costs of Issuance Account. The Trustee holds the "**Series A Costs of Issuance Account**" into which the Trustee shall deposit amounts funded from the proceeds of Series 2013A Bonds and disburse such amounts for the Costs of Issuance for the Series 2013A Bonds. Amounts in the Series A Costs of Issuance Account certified by the Corporation as being in excess of required Series 2013A Costs of Issuance shall be transferred to the Series A Pledged Revenues Account.

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

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

Series A Flow of Funds

Except as provided in the Series A Indenture and described in paragraph (A) below, the Trustee will deposit all Series A Pledged Revenues in the Series A Pledged Revenues Account. Subject to the foregoing, amounts deposited during the period January 1 through June 30 in any Fiscal Year (each period from July 1 through the following June 30, a "**Bond Year**") will be applied to expenses and debt service requirements on the Series A Bonds for the current Bond Year and 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 Series A Bonds, including the Series 2013A Bonds, for the current Bond Year.

As used herein, the term "**Deposit Date**" means the date of actual receipt by the Trustee of any Series A 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 Series A Pledged Revenues to the Series A Pledged Revenues Account (but in no event later than the next Distribution Date), the Trustee will withdraw Series A Pledged Revenues on deposit in the Series A 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 Series A Debt Service Reserve Account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the Series A Debt Service Reserve Requirement, and on the second Business Day preceding each Distribution Date amounts on deposit in the Series A Debt Service Reserve Account in excess of the Series A Debt Service Reserve Requirement shall be deposited directly to the Series A Debt Service Account) will be deposited directly to the Series A Debt Service Account and (y) the Series A Contract Payments, whether or not a Series A Event of Default has occurred, will be deposited directly to the Series A 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 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 Series A 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 or in assistance to the Corporation) (the "**Series A Operating Expenses**") (provided that such amounts paid pursuant to clauses (a) and (b) shall not exceed $500,000, adjusted for inflation annually from Fiscal Year ending October 31, 2003, plus any arbitrage rebate and penalties, calculated as set forth in the Series A Indenture (the "**Series A Operating Cap**") and Series A Operating Expenses will not include any termination payments, term-out payments or loss amounts on Series A 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;

(ii) to the Series A 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 Series A 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 Series A Bonds, including the Series 2013A Bonds, and on overdue interest, if any) due on the next succeeding Distribution Date, together with any unpaid interest due on prior Distribution Dates, pro rata, based upon the respective amounts of interest due;

(iii) to the Series A 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 Series A 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 pursuant to clause (ii) above, to equal the principal and Sinking Fund Installments due during the current Fiscal Year;

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

(v) to the Series A Debt Service Account the amount which, together with the amounts deposited pursuant to clause (ii) above, exclusive of amounts deposited therein 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 Series A 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 Series A Bonds, including the Series 2013A 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, assuming that principal and Sinking Fund Installments, if any, of the Series A Bonds, including the Series 2013A 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 A Indenture for (a) termination payments and loss amounts on Series A Ancillary Contracts and any payments on Swap Contracts, if any, (b) Series A Bond principal payable under term-out provisions of Series A Ancillary Contracts, if any, (c) other amounts due under Series A Ancillary Contracts, if any, and not payable as debt service, (d) payments of principal of and interest on Series A Subordinate Indebtedness, if any, (e) the purchase price of the Series A Bonds, including the Series 2013A Bonds, (f) annual payments required to be paid by the Corporation pursuant to subdivisions 2 and 3 of Section 2975 of the Public Authorities Law, (g) litigation expenses incurred by the Corporation and (h) any other junior payments, but not in excess of $500,000 in the aggregate for any Fiscal Year, identified as such by the Series A Indenture (the "**Series A Junior Payments**"); and

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

On each December 31 and each April 15, the Trustee shall calculate the amount of cash and investments on deposit in the Series A Pledged Accounts. On or before each (i) 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, if any, of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to be paid on the next succeeding June 1 and December 1.

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

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

(ii) from the Series A Debt Service Account (and to the extent that amounts in the Series A Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Series A Debt Service Account from the Series A Supplemental Account and the Series A Debt Service Reserve Account, in that order), to pay interest on the Outstanding Series A Bonds, including the Series 2013A Bonds, (including interest on overdue interest, if any) due on such Distribution Date, plus any unpaid interest due on prior Distribution Dates;

(iii) from the Series A Debt Service Account (and to the extent that amounts in the Series A Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Series A Debt Service Account from the Series A Supplemental Account and the Series A Debt Service Reserve Account, in that order), to pay, in order of maturity dates and Sinking Fund Installment Dates, the principal and Sinking Fund Installments due on such Distribution Date;

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

(v) from the Series A Funds and Series A Accounts therefor, to make Series A Junior Payments; and

(vi) from the Series A Supplemental Account, to one or more separate subaccounts therein, to provide irrevocably for the payment of the Series A Bonds, including the Series 2013A Bonds, in accordance with the Series A Indenture or to pay the optional redemption or purchase price of the Series A Bonds to be redeemed or purchased on such Distribution Date.

SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B 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 2013B Bonds issued under the Series B Indenture. These provisions have been summarized and this description does not purport to be complete. Reference should be made to the Act, the Series B Indenture, the Series B Sale Agreement and the Series B Contract for a more complete description of such provisions. Copies of the Act, the Series B Indenture, the Series B Sale Agreement and the Series B Contract are on file with the Corporation and the Trustee. See also "APPENDIX A - THE SERIES A CONTRACT AND THE SERIES B CONTRACT" and "APPENDIX H - DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS" for a more complete statement of the rights, duties and obligations of the parties thereto.

The Series 2013B Bonds

The Series 2013B Bonds are special obligations of the Corporation issued under the Indenture, dated as of December 1, 2003, as supplemented, including as supplemented by the Series 2013B Supplement (collectively, the "**Series B Indenture**"), between the Corporation and The Bank of New York Mellon, as indenture trustee (the "**Series B Trustee**"). The Series 2013B Bonds, together with all outstanding bonds previously issued and any additional refunding bonds to be issued under the Series B Indenture (collectively, the "**Series B Bonds**"), are payable from and secured by a pledge of the "**Series B Pledged Revenues**," which consist of (i) the Series B Pledged Settlement Payments (defined below) sold by the State to the Corporation pursuant to the Purchase and Sale Agreement, dated as of December 1, 2003 (the "**Series B Sale Agreement**"), between the State and the Corporation, (ii) the payments (the "**Series B Contract Payments**") to be made by the State pursuant to the Contingency Contract, dated as of December 1, 2003 (the "**Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent that amounts on deposit in the Series B Pledged Revenues Account, the Series B Debt Service Account, the Series B Supplemental Account and the Series B Debt Service Reserve Account (collectively, the "**Series B Pledged Accounts**") are insufficient therefor, (iii) payments made to the Corporation or the Series B Trustee under any Series B Ancillary Contracts and swap contracts and (iv) all fees, charges, payments, investment earnings and other income and receipts paid or payable to the Corporation or the Series B Trustee for the account of the Corporation or the Beneficiaries. The Series A Pledged Revenues and the Series B Pledged Revenues are herein collectively referred to as the "**Pledged Revenues**." The Series B Bonds are also payable from the amounts on deposit in the Series B Debt Service Reserve Account. The Series B Pledged Revenues and the right to receive them have been pledged to the Trustee for the benefit of the Holders of the Series B Bonds, including the Series 2013B Bonds.

The Series B Bonds and the Series A Bonds are each separately secured by the Series B Pledged Revenues and the Series A Pledged Revenues, respectively. The Series B Trustee shall not have the right to make a claim to mitigate all or any part of an asserted deficiency in the Series B Pledged Revenues from the Series A Pledged Revenues and, likewise, the Series A Trustee shall not have the right to make a claim to mitigate all or part of an asserted deficiency in the Series A Pledged Revenues from the Series B Pledged Revenues. The rights of the Series B Trustee and the Series A Trustee to receive its respective Pledged Revenues are equal to and on a parity with each other and one right is not inferior or superior to the other.

Pursuant to the Act, the Series B Bonds, including the Series 2013B 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 B Bonds, including the Series 2013B Bonds, payable out of any funds or assets other than the Series B Pledged Revenues and amounts on deposit in the Series B Pledged Accounts. The Corporation has no taxing power.

The Series B Sale Agreement

Pursuant to the Act and the Series B Sale Agreement, the State sold to the Corporation the "**Series B Pledged Settlement Payments**", consisting of fifty percent (50%) of the State's Share of the (i) annual payments and Strategic Contribution Fund Payments (as defined in the MSA) and of all adjustments to prior payments, payable to the State pursuant to the MSA (as defined below) and received by the Trustee on and after January 1, 2004 and (ii) all Lump Sum Payments received by the Trustee at any time on or after December 2, 2003. The Series A Pledged Settlement Payments and the Series B Pledged Settlement Payments are herein collectively referred to as the "**Pledged Settlement Payments**." The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Fund Payments.[†] See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Initial Payments," "— Annual Payments" and "—Strategic Contribution Fund 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 Series B Pledged Settlement Payments directly to the Trustee. The disbursement of Series B 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 Fund Payments from the PMs. The Trustee will, within two Business Days after receipt, transfer the Series B Pledged Settlement Payments to the Series B Pledged Revenues Account established by the Series B Indenture. Series B Pledged Settlement Payments will be disbursed from the Series B Pledged Revenues Account in accordance with the provisions of the Series B Indenture. See "Series B Flow of Funds" below and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Payments Made to Date."

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

The Series B Contract

The Series B Bonds, including the Series 2013B Bonds, are secured by a pledge of all of the Corporation's interest under the Series B Contract, including, without limitation, the Series B Contract Payments made by the State thereunder. The Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, coming due on such date, if all other funds pledged and available therefor, as described herein, are inadequate.

[†] 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 Series B 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 Series B Contract further provides that neither the Corporation nor the State will terminate the Series B 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 Series B Contract.

The Director of the Budget on behalf of the State has agreed in the Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, coming due in such ensuing fiscal year. See "HISTORY OF APPROPRIATIONS." The obligations of the State pursuant to the Series B Contract shall not terminate so long as any Series B Bond is Outstanding.

The obligation of the State to fund or pay the amounts provided for by the Series B 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 2013B 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 Series B Contract has been duly authorized, executed and delivered by the State, and, assuming the due execution and delivery by the Corporation, the Series B 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 Series B Contract, see "SUMMARY OF THE SERIES B CONTRACT." A copy of the Series B Contract is attached hereto as APPENDIX A.

Series B Pledged Accounts

Each of the following accounts were established under the Series B Indenture as a segregated trust account and are held by the Trustee for the benefit of the holders of the Series B Bonds, including the Series 2013B Bonds. All moneys on deposit in the following accounts will be invested in Eligible Investments as defined in the Series B Indenture.

Series B Pledged Revenues Account. The Trustee holds the "**Series B Pledged Revenues Account**" into which the Trustee deposits all Series B Pledged Revenues. Funds on deposit in the Series B Pledged Revenues Account are transferred to various other accounts under the Series B Indenture and applied to certain other purposes as described below.

Series B Debt Service Account. The Trustee holds the "**Series B Debt Service Account**" into which the Trustee deposits amounts transferred from the Series B Pledged Revenues Account in respect of principal of and interest on the Series B Bonds, including the Series 2013B Bonds. The Trustee makes payments on the Series B Bonds, including the Series 2013B Bonds, in accordance with the priority of payments as described below under "Series B Flow of Funds."

Series B Debt Service Reserve Account. The Trustee holds the "**Series B Debt Service Reserve Account**," which was funded from Series 2003B Bond proceeds in the amount of $221,582,343.75 (the "**Series B Debt Service Reserve Requirement**"). The Series B Debt Service Reserve Account is currently fully funded. To the extent of available investment earnings therein and Series B Pledged Settlement Payments, the amount in the Series B Debt Service Reserve Account must be maintained at the Series B Debt Service Reserve Requirement. Series B Contract

Payments will not be applied to satisfy any deficiencies in the Series B Debt Service Reserve Account. See Note 5 of the Corporation's Financial Statements**.**

Amounts in the Series B Debt Service Reserve Account are available to pay principal of and interest on the Series B Bonds, including the Series 2013B Bonds, to the extent that amounts on deposit in the Series B Pledged Revenues Account, the Series B Debt Service Account and the Series B Supplemental Account are insufficient for such purpose. All earnings on amounts in the Series B Debt Service Reserve Account are retained in it if the amount therein is not equal to the Series B Debt Service Reserve Requirement. On each Distribution Date, amounts on deposit in the Series B Debt Service Reserve Account in excess of the Series B Debt Service Reserve Requirement will be transferred to the Series B Pledged Revenues Account and from there, immediately to the Series B Debt Service Account.

Series B Supplemental Account. The Trustee holds the "Supplemental Account" into which the Trustee deposits Series B 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 "Series B Flow of Funds" (the "**Series B Surplus Pledged Revenues**"). Amounts on deposit in the Series B Supplemental Account may be used to purchase, redeem in accordance with their terms or defease Series B Bonds as set forth under the caption "THE SERIES 2013B BONDS — Redemption and Purchase Provisions — *Application of Series B Surplus Pledged Revenues*."

Amounts on deposit in the Series B Supplemental Account will not be released from the lien of the Series B Indenture until (i) applied to the purchase, redemption or defeasance of Series B Bonds, (ii) applied to the payment of principal of or interest on the Series B Bonds, including the Series 2013B Bonds, to the extent amounts on deposit in the Series B Pledged Revenues Account and the Series B Debt Service Account are insufficient therefor or (iii) there are no Series B Bonds Outstanding under the Series B Indenture.

In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series B Supplemental Account shall be applied or set aside to defease Series B Bonds or to pay the optional redemption or purchase price of Series B Bonds unless there is held in the Series B Pledged Revenues Account and the Series B Debt Service Account sufficient amounts to pay all principal of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid on or before such Distribution Date.

Series B Additional Accounts

Each of the following accounts were established under the Series B Indenture and held by the Trustee. None of these accounts is a Series B Pledged Account and amounts on deposit therein are not available to pay principal and Sinking Fund Installments of and interest on the Series B Bonds, including the Series 2013B Bonds.

Series B Costs of Issuance Account. The Trustee holds the "**Series B Costs of Issuance Account**" into which the Trustee shall deposit amounts funded from the proceeds of Series 2013B Bonds, and disburse such amounts for the Costs of Issuance for the Series 2013B Bonds. Amounts in the Series B Costs of Issuance Account certified by the Corporation as being in excess of required Series 2013B Costs of Issuance shall be transferred to the Series B Pledged Revenues Account.

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

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

Series B Flow of Funds

Except as provided in the Series B Indenture and described in paragraph (A) below, the Trustee will deposit all Series B Pledged Revenues in the Series B Pledged Revenues Account. Subject to the foregoing, amounts deposited during the period January 1 through June 30 in any Fiscal Year (each period from July 1 through the following June 30, a "**Bond Year**") will be applied to expenses and debt service requirements on the Series B Bonds for the current Bond Year and 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 Series B Bonds, including the Series 2013B Bonds, for the current Bond Year.

As used herein, the term "**Deposit Date**" means the date of actual receipt by the Trustee of any Series B 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 Series B Pledged Revenues to the Series B Pledged Revenues Account (but in no event later than the next Distribution Date), the Trustee will withdraw Series B Pledged Revenues on deposit in the Series B 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 Series B Debt Service Reserve Account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the Series B Debt Service Reserve Requirement, and on the second Business Day preceding each Distribution Date amounts on deposit in the Series B Debt Service Reserve Account in excess of the Series B Debt Service Reserve Requirement shall be transferred to the Series B Pledged Revenues Account and from there immediately to the Series B Debt Service Account) will be deposited directly to the Series B Debt Service Account and (y) the Series B Contract Payments, whether or not a Series B Event of Default has occurred, will be deposited directly to the Series B 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 Series B 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 or in assistance to the Corporation) (the "**Series B Operating Expenses**") (provided that such amounts paid pursuant to clauses (a) and (b) shall not exceed $500,000, adjusted for inflation annually from Fiscal Year ending October 31, 2004, plus any arbitrage rebate and penalties calculated as set forth in the Series B Indenture, plus any state fee (the "**Series B Operating Cap**"), and Series B Operating Expenses will not include any termination payments, term-out payments or loss amounts on Series B 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;

(ii) to the Series B 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 Series B 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 Series B Bonds, including the Series 2013B Bonds, and on overdue interest, if any) due on the next succeeding Distribution Date, together with any unpaid interest due on prior Distribution Dates, pro rata, based upon the respective amounts of interest due;

(iii) to the Series B 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 Series B 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;

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

(v) to the Series B 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 Series B 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 Series B Bonds, including the Series 2013B 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, assuming that principal and Sinking Fund Installments of the Series B Bonds, including the Series 2013B 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 B Indenture for (a) termination payments and loss amounts on Series B Ancillary Contracts and any payments on Swap Contracts, if any, (b) Series B Bond principal payable under term-out provisions of Series B Ancillary Contracts, if any, (c) other amounts due under Series B Ancillary Contracts, if any, 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, if any, (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 Series B Indenture (the "**Series B Junior Payments**"); and

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

On each December 31 and each April 15, the Trustee shall calculate the amount of cash and investments on deposit in the Series B Pledged Accounts. On or before each (i) 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, if any, of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid on the next succeeding June 1 and December 1.

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

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

(ii) from the Series B Debt Service Account (a) at any time, as directed in an Officer's Certificate, to the Series B 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 Series B Bonds, including the Series 2013B 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 Series B Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Series B Debt Service Account from the Series B Supplemental Account and the Series B Debt Service Reserve Account, in that order);

(iii) from the Series B Debt Service Account (and to the extent that amounts in the Series B Debt Service Account are insufficient therefor, from amounts that shall be transferred on such Distribution Date to the Series B Debt Service Account from the Series B Supplemental Account and the Series B Debt Service Reserve Account, in that order), to pay, in order of maturity dates and Sinking Fund Installment Dates, the principal and Sinking Fund Installments due on such Distribution Date;

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

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

(vi) from the Series B Supplemental Account, to one or more separate subaccounts therein, to provide irrevocably for the payment of the Series B Bonds, including the Series 2013B Bonds, in accordance with the Series B Indenture or to pay the optional redemption or purchase price of the Series B Bonds to be redeemed or purchased on such Distribution Date.

COVENANTS OF THE STATE

General

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 Series A Pledged Settlement Payments and Series B 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 each of the Series A Sale Agreement and the Series B 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 Series A Pledged Settlement Payments and Series B 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, the Series A Indenture or the Series B 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 (defined herein) in any way that would materially adversely affect the amount of payment to or 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 "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Potential Payment Decreases Under the Terms of the MSA – 2003 NPM Adjustment Claims; Arbitration Results" for a discussion of the State having been determined by the Arbitration Panel (as defined herein) to have diligently enforced the Qualifying Statute in 2003.

Amendments Affecting State Covenants

Both the Series 2013A Supplement to the Series A Indenture and the Series 2013B Supplement to the Series B Indenture contain provisions which would permit the Series A Sale Agreement and the Series B Sale Agreement, respectively, to be amended to permit the amendment of the Series A Indenture and the Series B Indenture by adding a proviso to the covenant in (iv)(c) of the paragraph above under "COVENANTS OF THE STATE – General" to the following effect:

> "; and provided further that any amendment to the MSA entered into by the State in good faith, and in the furtherance of the best interests of the

> State, shall not be deemed to be an impairment of the rights and remedies of the Beneficiaries or the security for the Bonds so long as (i) the State's percentage allocations of total settlement payments due from the PMs under the MSA as of June 1, 2011 are not decreased, and (ii) all Pledged Settlement Payments due to the State continue to be paid to the Trustee in the manner and for the time period provided in the Sale Agreement and this Indenture".

The amendment would not take effect until none of the Bonds issued prior to June 1, 2011 remain Outstanding (which will be the case upon the issuance of the Series 2013 Bonds) and the Corporation certifies in writing to the Trustee that (i) the Act has been amended (1) to insert such a proviso in the State's pledge and agreement with the Corporation and the Bondholders in the Act, and (2) to authorize the Governor of the State, acting through the Director of the Budget, to insert said proviso in the Series A Sale Agreement and the Series B Sale Agreement, and (ii) the Trustee receives an opinion of Bond Counsel 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 (defined in APPENDIX H) from gross income for federal income tax purposes.

By their acceptance of the Series 2013 Bonds, the Bondholders will be deemed to have consented to, and to have waived prospectively and retrospectively any notice of or regarding, the execution and delivery of amendments to the Series A Sale Agreement and the Series B Sale Agreement inserting substantially the same new proviso set forth above in the Series A Sale Agreement and the Series B Sale Agreement.

HISTORY OF APPROPRIATIONS

The State has covenanted in each of the Series A Contract and the Series B 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 Series A Scheduled Debt Service and Series B Scheduled Debt Service, as applicable, coming due during such next succeeding fiscal year. The State has complied with such covenants in each year since the issuance of the Refunded Bonds. See "APPENDIX B - INFORMATION CONCERNING THE STATE OF NEW YORK."

The schedule for requesting the appropriation for payment of debt service on the Series A Bonds and the Series B Bonds is set forth below:

Date	Action
By December 15	The Corporation requests from the State an amount equal to the Series A Scheduled Debt Service and the Series B Scheduled Debt Service (collectively, the "**Scheduled Debt Service**") for the next succeeding fiscal year of the State which includes interest and principal due on the Bonds on the succeeding June 1 and December 1.
By February 1	The State's Director of the Budget includes, as a requested appropriation item in the State budget, an amount equal to the Corporation's Scheduled Debt Service request.
By March 31	The debt service budget bill, which includes appropriations to pay all debt service obligations on general obligation bonds, bonds payable from 25% of State personal income taxes, service contract bonds and contingency contract bonds (including the Series A Bonds and the Series B Bonds), is passed by both houses of the Legislature, is signed by the Governor and becomes law. (The debt service budget bill has passed on time for the past 19 years.) The full amount of debt service on the Bonds for the next June 1 and December 1 becomes available to the Director of the Budget for payment of debt service, if needed.

April 15

Pledged Settlement Payments are scheduled to be received by the Trustee and deposited into the Series A Pledged Revenues Account and Series B Pledged Revenues Account. After not more than five Business Days, the Series A Pledged Revenues and Series B Pledged Revenues are applied as described under "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES A BONDS-Series A Flow of Funds" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES B BONDS - Series B Flow of Funds" herein.

April 20

The Trustee notifies the Corporation and the State as to whether amounts and investments on deposit in the Series A Pledged Accounts and Series B Pledged Accounts are sufficient to pay debt service on the Bonds on the next succeeding June 1 and December 1.

Five Business Days prior to June 1

If all amounts on deposit in the Series A Pledged Accounts and Series B Pledged Accounts are insufficient to pay the next succeeding June 1 principal and interest payment, the Chairman of the Corporation certifies the amount of such deficiency to the Director of the Budget and the State Comptroller. The State pays the Trustee the certified amount prior to June 1.

June 1

Payment of principal and interest and potential application of the Series A Supplemental Account and Series B Supplemental Account to purchase or redeem Bonds.

Five Business Days prior to December 1

If all amounts on deposit in the Series A Pledged Accounts and Series B Pledged Accounts are insufficient to pay the next succeeding June 1 principal and interest payment, the Chairman of the Corporation certifies the amount of such deficiency to the Director of the Budget and the State Comptroller. The State pays the Trustee the certified amount prior to December 1.

December 1

Payment of interest and potential application of the Series A Supplemental Account and Series B Supplemental Account to purchase or redeem Bonds.

Since the first issuance of the Refunded Bonds in 2003, the State has made the following appropriations with respect to the Bonds:

State Fiscal Year	Scheduled Debt Service[1]	Corporation Appropriation Request	State Debt Service Appropriation	Date of State Appropriation
2004-05	$342,681,176	$342,681,176	$343,000,000	March 31, 2004
2005-06	356,537,479	356,537,479	360,000,000	March 8, 2005
2006-07	353,085,179	353,085,179	360,000,000	March 14, 2006
2007-08	351,378,991	351,378,991	352,000,000	March 27, 2007
2008-09	384,658,216	384,658,216	390,000,000	March 12, 2008
2009-10	289,915,351	289,915,351	290,000,000	March 5, 2009
2010-11	336,592,998	336,592,998	337,000,000	March 17, 2010
2011-12	304,792,148	304,792,148	305,000,000	March 16, 2011
2012-13	344,289,653	344,289,653	346,000,000	March 20, 2012
2013-14	252,140,734	252,140,734	254,000,000	March 20, 2013

[1] Includes debt service on auction rate securities (all of which have been retired) at an assumed rate of 15% for fiscal years 2004-05 through 2008-09.

THE SERIES 2013A BONDS

The following summary describes certain terms of the Series 2013A 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 Series A Indenture and the Series 2013A Bonds. Copies of the Series A Indenture and the Series A Contract may be obtained upon written request to the Trustee.

Description of the Series 2013A Bonds

The Series 2013A 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 2013A Bonds. The Series 2013A Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof, in book-entry only form. Except under the limited circumstances described herein, no Beneficial Owner of the Series 2013A Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2013A Bonds. See "BOOK-ENTRY ONLY SYSTEM" herein.

The Series 2013A Bonds will be issued pursuant to the Act and the Series A Indenture, will be dated as of the Closing Date and will mature at the times and in the aggregate principal amounts set forth on the inside front cover hereof. Interest on the Series 2013A Bonds will be payable on each Distribution Date, commencing on June 1, 2014 (for which an amount has been set aside pursuant to the Series A Indenture). For each Distribution Date, payments that are to be made on the Series 2013A Bonds will be made to holders of the Series 2013A Bonds of record (the "**Series 2013A 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 Series 2013A Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months.

Redemption and Purchase Provisions

Series 2013A Bonds Optional Redemption

The Series 2013A Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013A Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	Principal Amount	First Optional Redemption Date (June 1)	CUSIP
2018	$ 5,800,000	2014	88880TNA0
2019	85,735,000	2014	88880TNB8
2020	12,415,000	2014	88880TNC6
2020	132,630,000	2015	88880TNF9
2020	33,260,000	2016	88880TNG7
2021	189,345,000	2016	88880TND4
2022	63,535,000	2016	88880TNE2
2022	137,370,000	2017	88880TNH5

Optional redemption of the Series 2013A Bonds may be made from Series A Surplus Pledged Revenues on deposit in the Series A Supplemental Account, from sources other than Series A Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation.

Series 2013A Bonds Mandatory Clean-Up Call

The Series 2013A Bonds are subject to mandatory redemption in full on any Distribution Date, and on any date after which there are no Series 2011A Bonds outstanding, at a redemption price equal to par plus accrued interest if, in each case, the amount on deposit in the Series A Pledged Accounts is greater than the outstanding par amount of all Series A Bonds plus accrued interest thereon.

Purchase of Series 2013A Bonds

The Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013A Bonds to be purchased), may cause the Trustee to purchase Series 2013A Bonds in the open market from Series A Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2013A Bonds being purchased at such time, plus accrued interest thereon.

Application of Series A Surplus Pledged Revenues

Series A Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase, redeem in accordance with their terms or defease Series 2013A 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 SERIES 2013A BONDS – Redemption and Purchase Provisions – Series 2013A Bonds Optional Redemption," "–Series 2013A Bonds Mandatory Clean-Up Call," and "–Purchase of Series 2013A Bonds." To the extent not used to purchase, redeem or defease Series A Bonds, all Series A Surplus Pledged Revenues will remain in the Series A Supplemental Account until (i) applied to the payment of principal of or interest on Series A Bonds to the extent amounts on deposit in the Series A Pledged Revenues Account and the Series A Debt Service Account are insufficient therefor, or (ii) there are no Series A Bonds Outstanding under the Series A Indenture. In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series A Supplemental Account shall be applied or set aside to defease Series A Bonds or to pay optional redemption or the purchase price of Series A Bonds unless there is held in the Series A Pledged Revenues Account and the Series A Debt Service Account sufficient amounts to pay all principal of and interest on Series A Bonds, including the Series 2013A Bonds, scheduled to be paid in such year.

The State currently intends to continue to direct all or a significant portion of the Series A Surplus Pledged Revenues to purchase, redeem in accordance with their terms or defease Series A 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 "OUTSTANDING BONDS." See also "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE" for the projection of Series A Pledged Settlement Payments. This projection is based upon, among other things, the forecast of cigarette consumption shown in the IHS Global Report. The actual amounts of Series A Pledged Settlement Payments may be more or less than such projection of Series A Pledged Settlement Payments. See "APPENDIX F – IHS GLOBAL REPORT" for a discussion of the other consumption forecasts prepared by IHS Global. There can be no assurance of the actual amounts of Series A Surplus Pledged Revenues or the application thereof to the redemption, purchase or defeasance of Series A Bonds. See "BONDHOLDERS' RISKS".

Refunding Bonds

The Corporation may authorize, issue, sell and deliver Series A Bonds from time to time in such principal amounts as the Corporation may determine but solely to refund Series A Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine.

Events of Default and Remedies

Events of Default

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

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

(ii) the Corporation fails to observe or perform any other provision of the Series A 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 Series A 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 a Series A 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 "COVENANTS OF THE STATE," "APPENDIX H - DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — The Indentures" or "— The Series A Sale Agreement and the Series B Sale Agreement," 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 at least 25% of the principal amount of the Outstanding Series A 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 Series A Bonds in accordance with the Series A 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, if any, of and interest on the Series A 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 Series A 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 Series A Sale Agreement;

(ii) sue upon such Series A Bonds;

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

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

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

THE SERIES 2013B BONDS

The following summary describes certain terms of the Series 2013B 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 Series B Indenture and the Series 2013B Bonds. Copies of the Series B Indenture and the Series B Contract may be obtained upon written request to the Trustee.

Description of the Series 2013B Bonds

The Series 2013B 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 2013B Bonds. The Series 2013B Bonds will be available for purchase in denominations of $5,000 or any integral multiple thereof, in book-entry only form. Except under the limited circumstances described herein, no Beneficial Owner of the Series 2013B Bonds will be entitled to receive a physical certificate representing its ownership interest in such Series 2013B Bonds. See "BOOK-ENTRY ONLY SYSTEM" herein.

The Series 2013B Bonds will be issued pursuant to the Act and the Series B Indenture, will be dated as of the Closing Date and will mature at the times and in the aggregate principal amounts set forth on the inside front cover hereof. Interest on the Series 2013B Bonds will be payable on each Distribution Date, commencing on June 1, 2014 (for which an amount has been set aside pursuant to the Series B Indenture). For each Distribution Date, payments that are to be made on the Series 2013B Bonds will be made to holders of the Series 2013B Bonds of record (the "**Series 2013B 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 Series 2013B Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months.

Redemption and Purchase Provisions

Series 2013B Bonds Optional Redemption

The Series 2013B Bonds maturing on the Maturity Dates set forth in the table below are subject to redemption in whole or in part, at any time on or after the first optional redemption date set forth in the table below, at the option of the Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013B Bonds to be redeemed), at a redemption price equal to 100% of the principal amount being redeemed, plus accrued interest to the redemption date.

Maturity Date (June 1)	Principal Amount	First Optional Redemption Date (June 1)	CUSIP
2019	$ 67,900,000	2014	88880TNJ1
2019	60,085,000	2015	88880TNN2
2020	34,470,000	2015	88880TNK8
2020	143,145,000	2016	88880TNP7
2021	124,220,000	2016	88880TNL6
2021	65,385,000	2017	88880TNQ5
2022	70,450,000	2017	88880TNM4

Optional redemption of the Series 2013B Bonds may be made from Series B Surplus Pledged Revenues on deposit in the Series B Supplemental Account, from sources other than Series B Pledged Revenues provided by the State or from the proceeds of refunding obligations of the Corporation.

Series 2013B Bonds Mandatory Clean-Up Call

The Series 2013B Bonds are subject to mandatory redemption in full on any Distribution Date, and on any date after which there are no Series 2011B Bonds outstanding, at a redemption price equal to par plus accrued interest if, in each case, the amount on deposit in the Series B Pledged Accounts is greater than the outstanding par amount of all Series B Bonds plus accrued interest thereon.

Purchase of Series 2013B Bonds

The Corporation, at the direction of the State (which direction shall specify the maturities of the Series 2013B Bonds to be purchased), may cause the Trustee to purchase Series 2013B Bonds in the open market from Series B Surplus Pledged Revenues, at a price not exceeding 100% of the Outstanding principal amount of such Series 2013B Bonds being purchased at such time, plus accrued interest thereon.

Application of Series B Surplus Pledged Revenues

Series B Surplus Pledged Revenues may be applied by the Corporation, at the direction of the State, to purchase, redeem in accordance with their terms or defease Series 2013B 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 SERIES 2013B BONDS – Redemption and Purchase Provisions – Series 2013B Bonds Optional Redemption," "–Series 2013B Bonds Mandatory Clean-Up Call," and "–Purchase of Series 2013B Bonds." To the extent not used to purchase, redeem or defease Series B Bonds, all Series B Surplus Pledged Revenues will remain in the Series B Supplemental Account until (i) applied to the payment of principal of or interest on Series B Bonds to the extent amounts on deposit in the Series B Pledged Revenues Account and the Series B Debt Service Account are insufficient therefor, or (ii) there are no Series B Bonds Outstanding under the Series B Indenture. In addition, between April 15 and the next Distribution Date in each year, no amounts in the Series B Supplemental Account shall be applied or set aside to defease Series B Bonds or to pay the optional redemption or purchase price of Series B Bonds unless there is held in the Series B Pledged Revenues Account and the Series B Debt Service Account sufficient amounts to pay all principal of and interest on Series B Bonds, including the Series 2013B Bonds, scheduled to be paid in such year.

The State currently intends to continue to direct all or a significant portion of the Series B Surplus Pledged Revenues to purchase, redeem in accordance with their terms or defease Series B 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 "OUTSTANDING BONDS." See also "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE" for the projection of Series B Pledged Settlement Payments. This projection is based upon, among other things, the forecast of cigarette consumption shown in the IHS Global Report. The actual amounts of Series B Pledged Settlement Payments may be more or less than such projection of Series B Pledged Settlement Payments. See "APPENDIX F – IHS GLOBAL REPORT" for a discussion of the other consumption forecasts prepared by IHS Global. There can be no assurance of the actual amounts of Series B Surplus Pledged Revenues or the application thereof to the redemption, purchase or defeasance of Series B Bonds. See "BONDHOLDERS' RISKS."

Refunding Bonds

The Corporation may authorize, issue, sell and deliver Series B Bonds from time to time in such principal amounts as the Corporation may determine but solely to refund Series B Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefor as it may determine.

Events of Default and Remedies

Events of Default

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

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

(ii) the Corporation fails to observe or perform any other provision of the Series B 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 Series B 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 a Series B 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 "COVENANTS OF THE STATE," "APPENDIX H - DEFINITIONS AND SUMMARIES OF THE TRANSACTION DOCUMENTS — The Indentures" or "—The Series A Sale Agreement and the Series B Sale Agreement," 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 at least 25% of the principal amount of the Outstanding Series B 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 Series B Bonds in accordance with the Series B 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, if any, of and interest on the Series B 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 Series B 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 Series B Sale Agreement;

(ii) sue upon such Series B Bonds;

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

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

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

BOOK-ENTRY ONLY SYSTEM

The Depository Trust Company ("DTC"), New York, New York, will act as securities depository for the Series 2013 Bonds. The Series 2013 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 bond certificate will be issued for each CUSIP of each maturity of each Series of the Series 2013 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest securities depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 3.5 million issues of U.S. and non-U.S. equity issues, corporate and municipal debt issues, and money market instruments (from over 100 countries) that DTC's participants ("**Direct Participants**") deposit with DTC. DTC also facilitates the post-trade settlement among Direct Participants of sales and other securities transactions in deposited securities, through electronic computerized book-entry transfers and pledges between Direct Participants' accounts. This eliminates the need for physical movement of securities certificates. Direct Participants include both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. DTC is a wholly-owned subsidiary of The Depository Trust & Clearing Corporation ("**DTCC**"). DTCC is the holding company for DTC, National Securities Clearing Corporation and Fixed Income Clearing Corporation, all of which are registered clearing agencies. DTCC is owned by the users of its regulated subsidiaries. Access to the DTC system is also available to others such as both U.S. and non-U.S. securities brokers and dealers, banks, trust companies, and clearing corporations that clear through or maintain a custodial relationship with a Direct Participant, either directly or indirectly ("**Indirect Participants**"). DTC has a Standard &Poor's rating of AA+. 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 2013 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2013 Bonds on DTC's records. The ownership interest of each actual purchaser of each Series 2013 Bond ("**Beneficial Owner**") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2013 Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2013 Bonds, except in the event that use of the book-entry system for the Series 2013 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2013 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 Series 2013 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 2013 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2013 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct 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 2013 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2013 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the bond documents. For example, Beneficial Owners of Series 2013 Bonds may wish to ascertain that the nominee holding the Series 2013 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 Series 2013 Bonds of a particular Series and within a 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 Series 2013 Bonds unless authorized by a Direct Participant in accordance with DTC's MMI 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 2013 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 2013 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 2013 Bonds must make arrangements with the Direct Participant or Indirect Participant through whom such Beneficial Owner's ownership interest in the Series 2013 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 2013 BONDS, THE ADHERENCE TO SUCH PROCEDURES OR ARRANGEMENTS OR THE EFFECTIVENESS OF ANY ACTION TAKEN PURSUANT TO SUCH PROCEDURES OR ARRANGEMENTS.

Payments of principal of, premium, if any, and interest on the Series 2013 Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the 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, its nominee, the Trustee or the Corporation, subject to any statutory or regulatory requirements as may be in effect from time to time. Payments of principal of, premium, if any, and interest on the Series 2013 Bonds 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 Direct and Indirect Participants.

So long as Cede & Co. is the registered owner of the Series 2013 Bonds, as nominee for DTC, references in this Official Statement to Bondholders or registered owners of the Series 2013 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 2013 Bonds.

As long as the book-entry system is used for the Series 2013 Bonds, the Trustee and the Corporation will give any notice 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 any 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 AND OTHER INFORMATION REGARDING THE SERIES 2013 BONDS THAT MAY BE SO CONVEYED TO DIRECT PARTICIPANTS AND INDIRECT PARTICIPANTS.

For every transfer and exchange of a beneficial ownership interest in the Series 2013 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 depository with respect to the Series 2013 Bonds at any time by giving reasonable notice to the Corporation or Trustee. Under such circumstances, in the event that a successor depository is not obtained, such bond certificates are required to be printed and delivered.

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

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 TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DIRECT OR INDIRECT 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 DIRECT OR INDIRECT PARTICIPANT OR OTHER NOMINEES OF SUCH BENEFICIAL OWNERS; (3) PAYMENT OR THE TIMELINESS OF PAYMENT BY DTC TO ANY DIRECT OR INDIRECT PARTICIPANT, OR BY ANY DIRECT OR INDIRECT PARTICIPANT OR OTHER NOMINEES OF BENEFICIAL OWNERS TO ANY BENEFICIAL OWNER, OF ANY AMOUNT DUE IN RESPECT OF THE PRINCIPAL OR INTEREST ON THE SERIES 2013 BONDS; (4) DELIVERY OR TIMELY DELIVERY BY DTC TO ANY DIRECT OR INDIRECT PARTICIPANT, OR BY ANY DIRECT OR INDIRECT PARTICIPANT OR OTHER NOMINEES OF BENEFICIAL OWNERS TO ANY BENEFICIAL OWNERS, OF ANY NOTICE OR OTHER COMMUNICATION WHICH IS REQUIRED OR PERMITTED UNDER THE TERMS OF EACH OF THE SERIES A INDENTURE AND THE SERIES B INDENTURE TO BE GIVEN TO OWNERS OF THE SERIES 2013 BONDS; OR (5) ANY ACTION TAKEN BY DTC OR ITS NOMINEE AS THE REGISTERED OWNER OF SERIES 2013 BONDS.

None of the Corporation, the State, the Trustee or the Underwriters can give any assurance that DTC or Direct and Indirect Participants will distribute payments of principal, premium or interest on the Series 2013 Bonds paid to DTC or its nominee, or send any notice, 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 State Director of the Budget, three directors appointed by the Governor of the State and the State Comptroller or his appointee. There is currently one vacancy on the board.

The members of the Corporation are:

Name	Title
William J. Mulrow	Chairman
Kenneth M. Bialo	Vice Chairman
Cesar A. Perales	*Ex officio*, Secretary of State
Robert L. Megna	*Ex officio*, Director of the Budget of the State of New York
Naomi Bayer	Member
Andrew A. SanFilippo	Representing the State Comptroller

The officers of the Corporation are:

Name	Title
Darryl C. Towns	President and Chief Executive Officer
Marian Zucker	President, Finance & Development
C. Jason Kim	Senior Vice President and Counsel
Sheila Robinson	Senior Vice President and Chief Financial Officer

Financial Statements

The financial statements (the "**Financial Statements**") of the Corporation for its fiscal year ending October 31, 2012 and the accompanying report prepared by Deloitte & Touche LLP, the independent auditor of the Corporation, have been filed with the MSRB (as hereinafter defined) and are hereby included by reference herein. Deloitte & Touche LLP did not review this Official Statement and was not asked to consent to the incorporation by reference of the Corporation's Financial Statements in this Official Statement. Deloitte & Touche LLP has not been engaged to perform and has not performed, since the date of such report, any procedures on the financial statements addressed in the report. Deloitte & Touche LLP also has not performed any procedures relating to this Official Statement.

ESTIMATED SOURCES AND USES OF FUNDS

The expected sources and uses of funds of the Series 2013 Bonds is set forth below:

Sources of Funds:

	Series 2013A Bonds	Series 2013B Bonds
Initial Principal Amount	$660,090,000	$565,655,000
Original Issue Premium	45,692,197	42,347,730
Total Sources	$705,782,197	$608,002,730

Uses of Funds:

	Series 2013A Bonds	Series 2013B Bonds
Refunding Escrows for Refunded Bonds	$702,148,970	$605,012,393
Costs of Issuance*	802,677	691,407
Underwriters' Discount	2,830,550	2,298,930
Total Uses	$705,782,197	$608,002,730

* Includes legal fees, IHS Global fees, verification agent's fees, printing costs, rating agency fees and certain other expenses related to the issuance of the Series 2013 Bonds.

OUTSTANDING BONDS

Series A Bonds

After giving effect to the issuance of the Series 2013A Bonds and the application of the proceeds thereof, the following Series A Bonds will be outstanding under the Series A Indenture:

Serial Maturity Date (June 1)	Series 2011A Principal Amount	Series 2013A Principal Amount	Total
2014	$ 51,600,000	$ 0	$ 51,600,000
2015	54,000,000	0	54,000,000
2016	78,000,000	0	78,000,000
2017	81,000,000	0	81,000,000
2018	101,000,000	5,800,000	106,800,000
2019	0	85,735,000	85,735,000
2020	0	178,305,000	178,305,000
2021	0	189,345,000	189,345,000
2022	0	200,905,000	200,905,000
Total	**$365,600,000**	**$ 660,090,000**	**$ 1,025,690,000**

Retirement and Redemption of Series A Bonds

Since the issuance of the Series 2003A Bonds, $646,320,000 of the original principal amount of the Series 2003A Bonds have been redeemed by operation of the Series A Supplemental Account, representing 28.0% of the original principal amount of the Series 2003A Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS – Series A Pledged Accounts – *Series A Supplemental Account*."

Series B Bonds

After giving effect to the issuance of the Series 2013B Bonds and the application of the proceeds thereof, the following Series B Bonds will be outstanding under the Series B Indenture:

Serial Maturity Date (June 1)	Series 2011B Principal Amount	Series 2013B Principal Amount	Total
2014	$ 85,000,000	$ 0	$ 85,000,000
2015	89,000,000	0	89,000,000
2016	94,000,000	0	94,000,000
2017	98,000,000	0	98,000,000
2018	96,000,000	0	96,000,000
2019	0	127,985,000	127,985,000
2020	0	177,615,000	177,615,000
2021	0	189,605,000	189,605,000
2022	0	70,450,000	70,450,000
Total	**$462,000,000**	**$ 565,655,000**	**$ 1,027,655,000**

Retirement and Redemption of Series B Bonds

Since the issuance of the Series 2003B Bonds, $514,610,000 of the original principal amount of the Series 2003B Bonds have been redeemed by operation of the Series B Supplemental Account, representing 23.0% of the original principal amount of the Series 2003B Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS – Series B Pledged Accounts – Series B Supplemental Account."

TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE

Series A Bonds

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 A Bonds, (ii) the projected amount of estimated total available funds[1] to be received by the Corporation, which projection has been calculated based on the IHS Global Forecast (as hereinafter defined) and other structuring assumptions and (iii) the projected debt service coverage. The denominator of the coverage ratios does not include redemptions prior to maturity from the Series A Surplus Revenues and calculations of coverage ratios are based on the assumption that no such redemptions will occur. No assurances can be given that the Series A Pledged Settlement Payments will be received in the amounts projected using the IHS Global Forecast and other structuring assumptions. See "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" for the structuring assumptions used to calculate the projected amount of Series A Pledged Settlement Payments.

Year	Estimated Total Available Funds[1]	Outstanding Series 2011A Debt Service	Series 2013A Principal	Series 2013A Interest	Total Series A Debt Service[2]	Projected Debt Service Coverage
2014	$ 223,968,801	$ 67,602,250	$ 0	$ 31,763,217	$ 99,365,467	2.25x
2015	223,494,349	67,662,500	0	32,764,350	100,426,850	2.23x
2016	222,837,884	88,707,650	0	32,764,350	121,472,000	1.83x
2017	222,035,678	87,956,300	0	32,764,350	120,720,650	1.84x
2018	224,895,323	103,479,700	5,800,000	32,677,350	141,957,050	1.58x
2019	223,914,159	0	85,735,000	30,446,975	116,181,975	1.93x
2020	222,935,292	0	178,305,000	23,908,050	202,213,050	1.10x
2021	222,262,761	0	189,345,000	14,778,875	204,123,875	1.09x
2022	220,048,445	0	200,905,000	5,022,625	205,927,625	1.07x
Total	**$2,006,392,692**	**$ 415,408,400**	**$660,090,000**	**$ 236,890,142**	**$1,312,388,542**	

[1] Includes Series A Pledged Settlement Payments plus earnings on Series A Debt Service Reserve Account less Series A Operating Expenses.

[2] Assumes that the Series 2011A Bonds and Series 2013A Bonds are paid in full at maturity and that the Corporation does not exercise its right to redeem, purchase or defease the Series 2013A Bonds prior thereto. Assumes that the State does not direct the open market purchase of the Series 2011A Bonds prior to maturity.

The Series A Bonds are further secured by a pledge of all of the Corporation's interest under the Series A Contract, including, without limitation, the Series A Contract Payments required to be made by the State thereunder if the Series A Pledged Settlement Payments and amounts on deposit in the Series A Debt Service Reserve Account and the other Series A Pledged Accounts are inadequate to pay when due the principal of and interest on the Series A Bonds. The State's obligation to make Series A Contract Payments under the Series A 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 2013A BONDS — The Series A Sale Agreement," "—Series A Pledged Accounts," "HISTORY OF APPROPRIATIONS" and "SUMMARY OF THE SERIES A CONTRACT".

Series B Bonds

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 B Bonds, (ii) the projected amount of estimated total available funds[1] to be received by the Corporation, which projection has been calculated based on the IHS Global Forecast and other structuring assumptions and (iii) the projected debt service coverage. The denominator of the coverage ratios does not include redemptions prior to maturity from the Series B Surplus Revenues and calculations of coverage ratios are based on the assumption that no such redemptions will occur. No assurances can be given that the Series B Pledged Settlement Payments will be received in the amounts projected using the IHS Global Forecast and other structuring assumptions. See "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" for the structuring assumptions used to calculate the projected amount of Series B Pledged Settlement Payments.

Year	Estimated Total Available Funds[1]	Outstanding Series 2011B Debt Service	Series 2013B Principal	Series 2013B Interest	Total Series B Debt Service[2]	Projected Debt Service Coverage
2014	$ 221,835,504	$ 105,975,000	$ 0	$ 27,418,555	$ 133,393,555	1.66x
2015	221,473,698	105,625,000	0	28,282,750	133,907,750	1.65x
2016	220,894,251	106,050,000	0	28,282,750	134,332,750	1.64x
2017	220,143,621	105,250,000	0	28,282,750	133,532,750	1.65x
2018	223,080,323	98,400,000	0	28,282,750	126,682,750	1.76x
2019	222,150,774	0	127,985,000	25,083,125	153,068,125	1.45x
2020	221,172,621	0	177,615,000	17,443,125	195,058,125	1.13x
2021	220,500,824	0	189,605,000	8,262,625	197,867,625	1.11x
2022	219,180,841	0	70,450,000	1,761,250	72,211,250	3.04x
Total	**$1,990,432,457**	**$521,300,000**	**$565,655,000**	**$193,099,680**	**$1,280,054,680**	

[1] Includes Series B Pledged Settlement Payments plus earnings on Series B Debt Service Reserve Account less Series B Operating Expenses.

[2] Assumes that the Series 2011B Bonds and Series 2013B Bonds are paid in full at maturity and that the Corporation does not exercise its right to redeem, purchase or defease the Series 2013B Bonds prior thereto. Assumes that the State does not direct the open market purchase of the Series 2011B Bonds prior to maturity.

The Series B Bonds are further secured by a pledge of all of the Corporation's interest under the Series B Contract, including, without limitation, the Series B Contract Payments required to be made by the State thereunder if the Series B Pledged Settlement Payments and amounts on deposit in the Series B Debt Service Reserve Account and the other Series B Pledged Accounts are inadequate to pay when due the principal of and interest on the Series B Bonds. The State's obligation to make Series B Contract Payments under the Series B 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 2013B BONDS — "The Series B Sale Agreement," "— Series B Pledged Accounts," "HISTORY OF APPROPRIATIONS" and "SUMMARY OF THE SERIES B CONTRACT".

SUMMARY OF THE SERIES A CONTRACT

The State and the Corporation have entered into the Series A Contract to provide additional security for the Series A Bonds, including the Series 2013A Bonds. The Series A 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 of and interest on the Series A Bonds, including the Series 2013A Bonds, scheduled to be paid on such date, if the amounts on deposit in the Series A Pledged Accounts are insufficient therefor.

Terms used herein and not previously defined have the meanings ascribed to them in the Series A Contract. The following summary describes certain terms of the Series A 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 Series A Contract. See "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT."

Payments by the State

Pursuant to the Series A 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 Series A Bonds, including the Series 2013A Bonds, secured by the Series A 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 Series A Collateral pledged therefor under the Series A Indenture, including receipts from Series A Pledged Settlement Payments or from any other Series A Ancillary Contract (as defined in the Series A Indenture) or amounts in the Series A Debt Service Account, the Series A Debt Service Reserve Account or the Series A 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 Series A Indenture, including mandatory sinking fund payments, if any) of and interest on the Series A Bonds, including the Series 2013A Bonds, coming due on such next succeeding Distribution Date (the "**Series A 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 Series A 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 Series A Contract or the payments made thereunder. (Section 1.2)

Notwithstanding anything in the Series A Contract to the contrary, (i) the obligation of the State to fund or to pay the amounts therein provided for is subject to annual appropriation being made by the State Legislature, (ii) 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 (iii) the amounts paid to the Corporation pursuant to the Series A Contract shall be applied by the Corporation solely for deposit under the Series A Indenture to pay the Series A Scheduled Debt Service. (Section 1.3)

The Series A 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 Series A Contract and pledged therefor under the Series A Indenture. (Section 1.4)

Duties of the Corporation

The Corporation has agreed to deposit under the Series A Indenture all amounts received pursuant to the Series A Contract, which amounts shall be held, administered and applied by the Trustee, as provided in the Series A 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 Series A Indenture for the benefit of the owners of any of its Series A Bonds, including the Series 2013A Bonds, of all or any part of the benefits or rights of the Corporation under the Series A 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 Series A Scheduled Debt Service 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 or other similar document relating to the sale or issuance of the Series A Bonds, including the Series 2013A Bonds, and (B) the payments to be made by the State as provided in the Series A Contract or any funds established under the Series A Indenture, or information necessary to enable the Corporation to make any reports required by law or governmental regulations (including the Rule, as defined herein) in connection with any Series A Bond, including any Series 2013A Bond. (Section 4.3)

The Corporation and the State have both complied with their respective covenants above in each year since the issuance of the Series 2003A Bonds. The Governor of New York has included in the Executive Budget, and the

State has appropriated, an amount sufficient to pay debt service on the Series A Bonds for each year since the Series A Bonds were issued.

Neither the Corporation nor the State will terminate the Series A Contract for any reason whatsoever. In addition, the Series A Contract may not be amended, changed, modified or altered so as to adversely affect the rights of the owners of any Series A Bonds, including the Series 2013A Bonds, the payments to be made by the State as provided therein or the funds required by the Series A Indenture without the consent of such owners or the Trustee given in accordance with the provisions of the Series A Indenture. (Sections 4.4 and 4.5)

Events of Default by the State and Remedies

Pursuant to the Series A 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, 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 Series A Contract, nor may they include any amendment, change, modification or alteration that is referred to under the Series A Contract. (Section 5.2)

Events of Default by the Corporation and Remedies

Pursuant to the Series A Contract, if the Corporation fails 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 Series A 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 Series A Contract that is prohibited thereunder. (Section 6.2)

Miscellaneous

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

Nothing in the Series A 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 Series A Bonds, including the Series 2013A Bonds, the Trustee or any other trustee acting on their behalf, any right, remedy or claim under or by reason of the Series A 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 Series A Contract shall be subject to any personal liability or accountability by reason of the issuance or execution and delivery thereof. (Section 7.9)

SUMMARY OF THE SERIES B CONTRACT

The State and the Corporation have entered into the Series B Contract to provide additional security for the Series B Bonds, including the Series 2013B Bonds. The Series B 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 of and interest on the Series B Bonds, including the Series 2013B Bonds, scheduled to be paid on such date, if the amounts on deposit in the Series B Pledged Accounts are insufficient therefor.

Terms used herein and not previously defined have the meanings ascribed to them in the Series B Contract. The following summary describes certain terms of the Series B 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 Series B Contract. See "APPENDIX A – THE SERIES A CONTRACT AND THE SERIES B CONTRACT."

Payments by the State

Pursuant to the Series B 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 Series B Bonds, including the Series 2013B Bonds, secured by the Series B 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 Series B Collateral pledged therefor under the Series B Indenture, including receipts from Series B Pledged Settlement Payments or from any other Series B Ancillary Contract (as defined in the Series B Indenture) or amounts in the Series B Debt Service Account, the Series B Debt Service Reserve Account or the Series B 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 Series B Indenture, including mandatory sinking fund payments, if any) of and interest on the Series B Bonds, including the Series 2013B Bonds, coming due on such next succeeding Distribution Date (the "**Series B 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 Series B 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 Series B Contract or the payments made thereunder. (Section 1.2)

Notwithstanding anything in the Series B Contract to the contrary, (i) the obligation of the State to fund or to pay the amounts therein provided for is subject to annual appropriation being made by the State Legislature, (ii) 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 (iii) the amounts paid to the Corporation pursuant to the Series B Contract shall be applied by the Corporation solely for deposit under the Series B Indenture to pay the Series B Scheduled Debt Service. (Section 1.3)

The Series B 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 Series B Contract and pledged therefor under the Series B Indenture. (Section 1.4)

Duties of the Corporation

The Corporation has agreed to deposit under the Series B Indenture all amounts received pursuant to the Series B Contract, which amounts shall be held, administered and applied by the Trustee, as provided in the Series B 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 Series B Indenture for the benefit of the owners of any of its Series B Bonds, including the Series 2013B Bonds, of all or any part of the benefits or rights of the Corporation under the Series B 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 Series B Scheduled Debt Service 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 the Series B Bonds, including the Series 2013B Bonds, and (B) the payments to be made by the State as provided in the Series B Contract or any funds established under the Series B Indenture, or information necessary to enable the Corporation to make any reports required by law or governmental regulations (including the Rule, as defined herein) in connection with any Series B Bond, including any Series 2013B Bond. (Section 4.3)

The Corporation and the State have both complied with their respective covenants above in each year since the issuance of the Series 2003B Bonds. The Governor of New York has included in the Executive Budget, and the State has appropriated, an amount sufficient to pay debt service on the Series B Bonds for each year since the Series B Bonds were issued.

Neither the Corporation nor the State will terminate the Series B Contract for any reason whatsoever. In addition, the Series B Contract may not be amended, changed, modified or altered so as to adversely affect the rights of the owners of any Series B Bonds, including the Series 2013B Bonds, the payments to be made by the State as provided therein or the funds required by the Series B Indenture without the consent of such owners or the Trustee given in accordance with the provisions of the Series B Indenture. (Sections 4.4 and 4.5)

Events of Default by the State and Remedies

Pursuant to the Series B 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, 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 Series B Contract, nor may they include any amendment, change, modification or alteration that is referred to under the Series B Contract. (Section 5.2)

Events of Default by the Corporation and Remedies

Pursuant to the Series B Contract, if the Corporation fails 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 Series B 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 Series B Contract that is prohibited thereunder. (Section 6.2)

Miscellaneous

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

Nothing in the Series B 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 Series B Bonds, including the Series 2013B Bonds, the Trustee or any other trustee acting on their behalf, any right, remedy or claim under or by reason of the Series B 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 Series B Contract shall be subject to any personal liability or accountability by reason of the issuance or execution and delivery thereof. (Section 7.9)

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BONDHOLDERS' RISKS

The Series 2013 Bonds differ from many other tax-exempt securities in a number of respects, and more specifically differ from tobacco revenue bonds that are payable solely from payments under the MSA. The Series 2013 Bonds have two primary sources of Pledged Revenues as well as a pledge of the amounts in the Pledged Accounts. The first are the Pledged Settlement Payments to be made by the PMs under the MSA. The second are payments to be made by the State pursuant to the Series A Contract and the Series B Contract if the Series A Pledged Settlement Payments or the Series B Pledged Settlement Payments, respectively, and the amounts in Pledged Accounts are insufficient to pay the Series A Bonds or the Series B Bonds, respectively. Each source of the Pledged Revenues has different risk factors. Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2013 Bonds, as well as other information contained in this Official Statement.

The discussion of the risks facing the domestic tobacco industry and potentially impacting the Pledged Settlement Payments has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-5450; fax: (202) 343-1028; e-mail: publicinfo@sec.gov). Because the Series 2013 Bonds are payable from Pledged Revenues that also include payments, if any, to be made by the State pursuant to the Series A Contract and the Series B Contract, the following discussion lists risks associated with the Series A Contract Payments and the Series B Contract Payments as well as risks related to the Pledged Settlement Payments.

The list of risks set forth herein is not a complete list of the risks associated with the Pledged Settlement Payments or the risks associated with the State payments under the Series A Contract or the Series B Contract, nor does the order of presentation necessarily reflect the relative importance of the various and separate risks. See also APPENDIX A herein.

Potential purchasers of the Series 2013 Bonds are advised to consider the following factors, among others, and to review the other information in this Official Statement in evaluating the Series 2013 Bonds. Any one or more of the risks discussed, and other risks, could lead to a decrease in the market value and/or the liquidity of the Series 2013 Bonds, or, in certain circumstances, in combination could lead to a complete loss of a Bondholder's investment. There can be no assurance that other risk factors will not become material in the future. Further information regarding these risk factors can be found under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" below and "APPENDIX G - CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" herein.

Series A Bonds Secured Solely by the Series A Pledged Revenues and Moneys in the Series A Pledged Accounts

Investors in the Series 2013A Bonds must look solely to the Series A Pledged Revenues for repayment of their investment. The Series 2013A Bonds do not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them. No owner of any Series 2013A Bond has the right to compel the exercise of the taxing power of the State to pay any amounts owing on the Series 2013A Bonds. The Corporation has no taxing power.

Series B Bonds Secured Solely by the Series B Pledged Revenues and Moneys in the Series B Pledged Accounts

Investors in the Series 2013B Bonds must look solely to the Series B Pledged Revenues for repayment of their investment. The Series 2013B Bonds do not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the purview of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them. No owner of any Series 2013B Bond has the right to compel the exercise of the taxing power of the State to pay any amounts owing on the Series 2013B Bonds. The Corporation has no taxing power.

The Obligations of the State Pursuant to each of the Series A Contract and the Series B Contract are Subject to Annual Legislative Appropriation

Each of the Series A Contract and the Series B 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 of and interest on the Series 2013 Bonds, as the same shall become due in the event that amounts on deposit in each of the Series A Pledged Accounts and the Series B Pledged Accounts are insufficient therefor. The obligation of the State to fund or to pay the amounts provided for by each of the Series A Contract and the Series B 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. There can be no assurance that the State Legislature will make any such appropriations. See "HISTORY OF APPROPRIATIONS", "SUMMARY OF THE SERIES A CONTRACT" and "SUMMARY OF THE SERIES B CONTRACT" above.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments

The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material, including without limitation, the NPM Adjustment. Such adjustments, offsets and recalculations could significantly reduce the Pledged Settlement Payments available to the Corporation. Any such adjustments could trigger the Offset for Miscalculated or Disputed Payments and lead to significant reductions in Pledged Settlement Payments. For additional information regarding the MSA and the payment adjustments, see *"Disputed MSA Payments and Potential for Significant Future Year Offsets to MSA Payments"* below and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments".

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

The Settling States and one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Fund Payments totaling over $8.5 billion for the sales years 2003 through 2012 according to NAAG; including, with respect to April 2006 through April 2013 payments due, moneys withheld outright, deposited to the Disputed Payments Account or, as in the case of the largest OPM (Philip Morris for the payment years prior to 2011) moneys actually paid by the PM to the states, but with the PM asserting a reservation of right to dispute such amount paid pursuant to the MSA. This total includes amounts that the OPMs have indicated that they have filed dispute notices with respect to significant additional amounts that may lead to claimed reductions in their MSA payments due in future years.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments that arise in prior years may result in the application of offsets against subsequent Annual Payments and Strategic Contribution Fund Payments and such offsets may materially adversely affect the amount and timing of the payment of Pledged Settlement Payments. The future diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts, or the application of offsets against future payments could adversely affect the amount and/or timing of Pledged Settlement Payments. Amounts held in the Disputed Payments Account with respect to a sales year could be released to the PMs if, in the future, any Settling State is found to have not diligently enforced its Qualifying Statute during such sales year, or to those Settling States which, in the future, are found to have diligently enforced their Qualifying Statutes, or pursuant to a settlement of the disputes among Settling States (which could include the State) and the PMs. As discussed below, the State is expected to receive approximately $92.4 million with respect to the 2003 NPM Adjustment pursuant to the decision by a panel of three former federal judges arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") that the State diligently enforced its Qualifying Statute in 2003; however, no assurance can be given as to the timing of such payment or as to amounts withheld in the Disputed Payments Account with respect to the NPM Adjustment in subsequent years. Amounts held in the Disputed Payments Account could also be released pursuant to a settlement of the disputes among the Settling States and the PMs, as was the case in April 2013 in connection with the partial settlement (which the State did not join) regarding the NPM Adjustment, as discussed below. See "—NPM Adjustment" below. Such amounts released from the Disputed Payments Account to the State could be used to optionally redeem, purchase, pay or defease Bonds pursuant to the Indenture.

The cash flow assumptions used to prepare the coverage tables herein do not factor in an offset for miscalculated or disputed payments or any release of funds currently held in the Disputed Payments Account to the State other than the release related to the 2003 NPM Adjustment dispute and the Arbitration Panel's decision that the State diligently enforced its Qualifying Statute. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged Settlement Payments available to pay principal and interest on the Series 2013 Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments — *Offset for Miscalculated or Disputed Payments"* and "— Potential Payment Decreases Under the Terms of the MSA - *NPM Adjustment – Application of the NPM Adjustment"*.

NPM Adjustment

One of the adjustments under the MSA is the "**NPM Adjustment**," which operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share by PMs (who are subject to the payment obligations and marketing restrictions of the MSA) to non-participating manufacturers ("**NPMs**") (who are not subject to such obligations and restrictions), during a calendar year as a result of such PMs' participation in the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a market share loss for the applicable year must exist (as described herein); (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a "significant factor" contributing to the market share loss for the year in question; and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Fund Payments that could otherwise have been received by the State in such year. No assurance can be made as to the magnitude of the effect of the NPM Adjustment on the amount and/or timing of Pledged Settlement Payments available to the Corporation to pay debt service on the Series 2013 Bonds.

Results of 2003 NPM Adjustment Arbitration; Future NPM Adjustment Arbitrations. The PMs have disputed MSA payments in sales years 2003 through 2012 on the basis that certain Settling States, including the State, did not diligently enforce their respective Qualifying Statutes in each of those years. After some Settling States settled their disputes with the PMs in March 2013, the State was one of 15 contested states that continued in arbitration proceedings with the PMs regarding the 2003 NPM Adjustment. The Arbitration Panel released its decision on September 11, 2013. The Arbitration Panel unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003 and therefore is not subject to the NPM Adjustment for 2003 pursuant to the MSA. The 2003 NPM Adjustment was allocated among those six states (which did not include the State), comprising an aggregate allocable share of 14.6792685%, that were determined by the Arbitration Panel to have failed to diligently enforce their respective Qualifying Statutes during sales year 2003. Proceedings to determine state diligent enforcement claims for sales years 2004 through 2012 have not yet been scheduled. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in additional sales years. A future determination that the State failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of future Pledged Settlement Payments up to the amount of the State's Pledged Settlement Payments for such future sales year or years, plus interest due on all or a portion of such amount, if any. The State's Attorney General's office maintains that the State has been and is diligently enforcing its Qualifying Statute. For a more complete description of the 2003 NPM Adjustment arbitration and the 2004 through 2012 NPM Adjustment claims, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—2003 through 2012 NPM Adjustment Claims Generally," "—Ongoing 2004 through 2012 NPM Adjustment Claims," and "—2003 NPM Adjustment; Arbitration Results." A copy of the Arbitration Final Award Re: State of New York in the 2003 NPM Adjustment Proceedings is attached hereto as APPENDIX E.

On September 24, 2013, the Pennsylvania Attorney General's office filed a motion with the Arbitration Panel to amend the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. The Arbitration Panel denied the motion on October 3, 2013. On November 4, 2013, Pennsylvania filed a motion in the Court of Common Pleas of Philadelphia County to vacate the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. In addition, on December 4, 2013, the Indiana Attorney General filed an appeal of the Arbitration Panel's determination with respect to Indiana's non-diligent enforcement in the Marion County Superior Court. It is not known if any of the other states that were determined to have not diligently enforced their respective Qualifying Statutes in sales year 2003 will appeal any decision by the Arbitration Panel or take any other legal action, or when the amounts withheld by the PMs or deposited into the Disputed Payments Account pursuant to the 2003 NPM Adjustment will be paid out by the MSA Escrow Agent.

Stipulated Partial Settlement and Award. On December 17, 2012, terms of a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") were agreed to by 19 jurisdictions (which did not include the State), the OPMs and certain SPMs regarding claims related to the 2003 through 2012 NPM Adjustments and the determination of future NPM Adjustments. Three additional jurisdictions (Oklahoma, Connecticut, and South Carolina) have joined the NPM Adjustment Settlement Term Sheet as of the date hereof. On March 12, 2013, the Arbitration Panel issued a Stipulated Partial Settlement and Award (the "**NPM Adjustment Stipulated Partial Settlement and Award**"), in which it ruled that the NPM Adjustment Settlement Term Sheet was binding on the signatory jurisdictions (the "**Term Sheet Signatories**") and directed PricewaterhouseCoopers LLP, the independent auditor under the MSA (the "**MSA Auditor**"), to implement the terms of the NPM Adjustment Settlement Term Sheet (including to release to the Term Sheet Signatories certain funds from the MSA's Disputed Payments Account). In connection with the April 2013 Payment, the MSA Auditor implemented the provisions of the NPM Adjustment Settlement Term Sheet relating to the distributions from the Disputed Payments Account to 20 of the Term Sheet Signatories (Connecticut and South Carolina did not opt into the settlement until May 2013) and the credits to be allocated to the PMs in April 2013. The MSA Auditor had noted that, by implementing such distributions and credits with respect to the MSA payments due in April 2013, it was not committing to implement any provision of the NPM Adjustment Settlement Term Sheet other than those provisions relating to such distributions and credits with respect to the MSA payments that were due in April 2013. Under the NPM Adjustment Settlement Term Sheet, OPMs have received certain reductions in April 2013 and will receive reductions to future MSA payments to reflect a percentage of the Term Sheet Signatories' aggregate share of the OPMs' 2003 through 2012 NPM Adjustment claims, and each of the Term Sheet Signatories has received its allocable share of over $4.7 billion from the Disputed Payments Account under the MSA in connection with the April 2013 MSA Payment. The NPM Adjustment Settlement Term Sheet also details the determination of NPM Adjustments for 2013 onward for the Term Sheet Signatories.

Non-signatory jurisdictions, including the State ("**Term Sheet Non-Signatories**"), have objected to the NPM Adjustment Settlement Term Sheet and the jurisdiction of the Arbitration Panel and had attempted to instruct the MSA Auditor not to take any action to implement the NPM Adjustment Stipulated Partial Settlement and Award until proceedings initiated by Term Sheet Non-Signatories in objection to the NPM Adjustment Stipulated Partial Settlement and Award have been concluded. Two states, Colorado and Ohio, filed motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment; both such motions were denied. As noted above, the MSA Auditor implemented the NPM Adjustment Stipulated Partial Settlement and Award as it related to the April 2013 MSA payments, over the objections of the Term Sheet Non-Signatories. Fourteen Term Sheet Non-Signatories filed motions to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award, including Connecticut and South Carolina, which subsequently became Term Sheet Signatories in May 2013. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts. For a discussion of the terms of NPM Adjustment Settlement Term Sheet, the NPM Adjustment Stipulated Partial Settlement and Award and subsequent developments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Potential Payment Decreases Under the Terms of the MSA—NPM Adjustment Settlement and Award." No assurance can be given as to the impact or the magnitude of the effect of the NPM Adjustment Stipulated Partial Settlement and Award on Term Sheet Non-Signatories such as the State, as to whether or not the NPM Adjustment Stipulated Partial Settlement and Award will be revised or reversed and any consequences thereto, or as to any final settlement or resolution of disputes concerning the NPM Adjustment Stipulated Partial Settlement and Award and the effect of such factors on the amount and/or timing of Pledged Settlement Payments available to the Corporation to pay debt service on the Series 2013 Bonds.

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

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

All of the judgments rendered to date on the merits have rejected challenges to the MSA, Qualifying Statutes and Complementary Legislation presented in the cases. In the most recent decision, *VIBO Corporation, Inc. d/b/a/ General Tobacco v. Conway*, *et al.*, 669 F.3d 675 (6th Cir. 2012) ("***VIBO***"), a three-judge panel of the U.S. Court of Appeals for the Sixth Circuit (the "**Sixth Circuit**") ruled on February 22, 2012 that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order dismissing plaintiffs' federal antitrust, federal constitutional and common law challenges to the enforceability of the MSA. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired. In *Grand River Enters. Six Nations, Ltd. v. King*, 2012 WL 263100 (S.D.N.Y. 2012) ("***Grand River***"), the U.S. District Court for the Southern District of New York (the "**Southern District**") on January 30, 2012 denied the plaintiffs' motion to amend the Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated Section 1 of the Sherman Antitrust Act of 1890 (the "**Sherman Act**") and the Commerce Clause of the Constitution of the United States. Plaintiffs had appealed to the U.S. Court of Appeals for the Second Circuit (the "**Second Circuit**") both the Southern District's March 22, 2011 dismissal and January 30, 2012 denial, but on June 1, 2012 withdrew both appeals, which withdrawals were ordered by the Second Circuit on August 10, 2012. In *Freedom Holdings v. Cuomo,* 624 F.3d 38 (2d Cir. 2010) ("***Freedom Holdings***"), the Second Circuit affirmed the judgment of the Southern District that New York State's Qualifying Statute did not violate federal antitrust laws or the Commerce Clause of the U.S. Constitution. The U.S. Supreme Court denied plaintiff's petition for certiorari. These cases are discussed more fully herein under "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Litigation Challenging the MSA, the Qualifying Statute and Related Legislation."

The MSA and related state legislation may continue to be challenged in the future. A determination by a court having jurisdiction over the State and the Corporation that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged Settlement Payments available to the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT." For a description of the opinions of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, addressing such matters, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS."

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

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

The tobacco companies are defendants in over 7,800 tobacco-related lawsuits, which are extremely costly to defend, could result in substantial judgments, liabilities and bonding difficulties, and may negatively impact their ability to continue to operate.

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

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

Any of the foregoing results could potentially lower the volume of cigarette sales and thus the amounts of payments under the MSA. See "APPENDIX G - CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY — Civil Litigation".

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

The case of *Engle v. R.J. Reynolds Tobacco Co., et al.* (Circuit Court, Dade County, Florida, filed May 5, 1994) ("***Engle***") was certified in 1996 as a class action on behalf of Florida residents, and survivors of Florida residents, who were injured or died from medical conditions allegedly caused by addiction to smoking and a multi-phase trial resulted in verdicts in favor of the class. During a three-phase trial, a Florida jury awarded compensatory damages to three individuals and approximately $145 billion in punitive damages to the certified class. In 2006, the Florida Supreme Court issued a ruling that, among other things, vacated the punitive damages award and determined that the case could not proceed further as a class action.

However, the Florida Supreme Court ruling in *Engle* permitted members of the *Engle* class to file individual claims, including claims for punitive damages. The PMs are currently defendants in over 5,000 cases (involving nearly 6,500 plaintiffs) pending in various state and federal courts in Florida that were filed by members of the *Engle* class (the "**Engle Progeny Cases**"). The Florida Supreme Court held that these individual plaintiffs are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. According to Lorillard, various intermediate state and federal Florida appellate courts have issued rulings that address the scope of the preclusive effect of the findings from the first phase of the *Engle* trial, including whether those findings relieve plaintiffs from the burden of proving certain legal elements of their claims, and these courts have come to differing conclusions, as further discussed herein. Following review of one of those cases, the Florida Supreme Court ruled on March 14, 2013 that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. On August 9, 2013, Philip Morris, Reynolds American and Liggett Group filed a petition for writ of certiorari with the U.S. Supreme Court with respect to that ruling. In two other cases, the United States Court of Appeals for the Eleventh Circuit ruled that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. Reynolds American moved for rehearing of the cases and on October 31, 2013 the Eleventh Circuit vacated its opinion and issued a new opinion that again concluded that the use of phase I *Engle* findings does not violate a tobacco manufacturer's due process rights. It is not possible to predict the final outcomes of any of the Engle Progeny Case litigation, but such outcomes may adversely affect the operations of the defendants and thus payments under the MSA. See "APPENDIX G — CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation — *Engle Progeny Cases*".

A December 2008 decision by the United States Supreme Court could limit the ability of cigarette manufacturers to contend that certain claims asserted against them in product liability litigation are barred. The Supreme Court's decision also could encourage litigation involving cigarettes labeled as "lights" or "low tar" and medical monitoring cause of action

In December 2008, the United States Supreme Court in a purported "lights" class action, *Good v. Altria Group, Inc.*, issued a decision that neither the Federal Cigarette Labeling and Advertising Act nor the Federal Trade Commission's ("**FTC**") regulation of cigarettes' tar and nicotine disclosures preempts (or bars) some of plaintiffs' claims. The decision also more broadly addresses the scope of preemption based on the Federal Cigarette Labeling and Advertising Act, and could significantly limit cigarette manufacturers' arguments that certain of plaintiffs' other claims in smoking and health litigation, including claims based on the alleged concealment of information with respect to the hazards of smoking, are preempted. In addition, the Supreme Court's ruling could encourage litigation against cigarette manufacturers regarding the sale of cigarettes labeled as "lights" or "low tar", and it may limit cigarette manufacturers' ability to defend such claims with regard to the use of these descriptors prior to the FDA's ban thereof in June 2010. According to Lorillard's Form 10-Q filed with the SEC for the six-month period ended June 30, 2013, there are approximately 16 such "lights" class actions and two class action cases that seek court-supervised medical monitoring programs pending in various courts.

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

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

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

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

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

Under the State Settlement Agreements, the PMs are obligated to pay billions of dollars each year. Annual payments under the State Settlement Agreements are required to be paid in perpetuity and are based, among other things, on domestic market share and unit volume of domestic shipments, with respect to the MSA, payments are based on data from the year preceding the year in which payment is due, and, with respect to the Previously Settled State Settlements, payments are based on data from the year in which payment is due. If the volume of cigarette sales by the PMs were materially reduced, these payment obligations could adversely affect the financial condition of the PMs and potentially the ability of PMs to make payments under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT".

Failures by PMs to make payments coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA could adversely affect the Pledged Settlement Payments actually received by the Corporation

If a PM were to discontinue making payments under the MSA for any reason, the Pledged Settlement Payments would be adversely affected. Any attempts to enforce payments under the MSA from a PM in breach could be costly and time consuming as well as likely to include litigation. For example, VIBO Corporation, Inc., d/b/a General Tobacco ("**General Tobacco**") ceased production of cigarettes in 2010 and has defaulted upon certain of its MSA payments. General Tobacco has stated that it will be unable to make any back payments it owes under the MSA. Two Settling States brought suit on behalf of all of the Settling States seeking full payment by General Tobacco of its MSA obligations. The ability of the Settling States to enforce and collect such payments in instances such as this is limited by the ability of the defaulting PM to meet its obligations and may be costly. Failure by other PMs to make payments coupled with an inability on the part of the Settling States to enforce and collect defaulted payments under the MSA could adversely affect the payments actually received by the Corporation.

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

In August 2006, a final judgment and remedial order was entered in *United States of America v. Philip Morris USA, Inc., et al.* (U.S. District Court, District of Columbia, filed September 22, 1999) (the "***DOJ Case***") and in June 2010 the U.S. Supreme Court denied all petitions for review of the case. The district court based its final judgment and remedial order on the government's only remaining claims, which were based on the tobacco industry defendants' alleged violations of RICO. Although the verdict did not award monetary damages to the plaintiff U.S. government, the final judgment and remedial order imposed a number of requirements on the defendants. Such requirements include, but are not limited to, corrective statements by defendants related to the health effects of smoking. The remedial order placed certain prohibitions on the manner in which defendants market their cigarette products and enjoined any use of "lights" or similar product descriptors. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on two grounds; that the Tobacco Control Act extinguished the court's jurisdiction, or that the court should decline to move forward with an injunctive remedy in deference to the FDA's authority. On June 1, 2011, the trial court denied defendants' motion. The defendants appealed the trial court's ruling to the U.S. Court of Appeals for the District of Columbia Circuit. On July 27, 2012, the U.S. Court of Appeals for the District of Columbia Circuit affirmed the district court's denial of the defendants' motion to vacate.

On November 27, 2012, the district court released its order on the required text of the corrective statements that the defendants must put on their websites and ordered the parties to engage in negotiations with the special master on a number of issues related to the implementation of the corrective statements remedy, which negotiations are ongoing. According to Altria, unresolved issues will be decided by the special master and the court. Further proceedings are pending before the district court to determine whether the corrective statements will have to be displayed at retail points of sale. On January 30, 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements. On January 25, 2013, defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements, which motion the Court of Appeals granted on February 15, 2013. It is possible that the remedial order, including the prohibitions on the use of the descriptors relating to low tar cigarettes and the stark text required in the corrective statements, will negatively affect the PMs' sales of and profits from cigarettes, as well as result in significant compliance costs. See "APPENDIX G — CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Civil Litigation".

Declines in Cigarette Consumption May Materially Adversely Affect Pledged Settlement Payments available for the Series 2013 Bonds.

Cigarette consumption in the U.S. has declined significantly over the last several decades. According to a preliminary report issued by the Centers for Disease Control ("**CDC**") on June 18, 2013, the smoking rate for adults in the United States fell in 2012 to 18%, after hovering at 20% to 21% for more than seven years, and approximately 19% in 2010 and 2011. Continuing declines in cigarette consumption could adversely impact the amount and timing of the Pledged Settlement Payments available to the Corporation. The following factors, among others, may negatively impact cigarette consumption in the U.S.

A deterioration in general economic conditions in the U.S. could lead to a decrease in cigarette consumption and adversely affect payments under the MSA

The volume of cigarette sales in the U.S. is adversely affected by general economic downturns as smokers tend to reduce expenditures on cigarettes, especially premium brands, in times of economic hardship. To the extent that such conditions are experienced over the life of the Series 2013 Bonds, payments under the MSA could be adversely affected. In addition, consumers may become more price-sensitive, which may result in some consumers switching to lower priced, deep discount NPM brands or counterfeit brands. Reductions in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

The regulation of tobacco products by the Food and Drug Administration may adversely affect overall consumption of cigarettes in the U.S.

The Family Smoking Prevention and Tobacco Control Act ("**FSPTCA**"), signed by President Obama on June 22, 2009, granted the Food and Drug Administration ("**FDA**") broad authority over the manufacture, sale, marketing and packaging of tobacco products. The legislation, among other things:

- establishes a Tobacco Products Scientific Advisory Committee ("**TPSAC**") to, among other things, evaluate the issues surrounding the use of menthol as a flavoring or ingredient in cigarettes within one year of the committee's establishment;

- grants the FDA the regulatory authority to consider and impose broad additional restrictions through a rule making process, including a ban on the use of menthol in cigarettes upon a finding that such a prohibition would be appropriate for the public health;

- requires larger and more severe health warnings on cigarette packs and cartons;

- bans the use of descriptors on tobacco products, such as "low tar" and "light";

- requires the disclosure of ingredients and additives to consumers;

- requires pre-market approval by the FDA for claims made with respect to reduced risk or reduced exposure products;
- allows the FDA to require the reduction of nicotine or any other compound in cigarettes;
- allows the FDA to mandate the use of reduced risk technologies in conventional cigarettes;
- allows the FDA to place more severe restrictions on the advertising, marketing and sales of cigarettes; and
- permits inconsistent state regulation of the advertising or promotion of cigarettes and eliminates the existing federal preemption of such regulation.

Since the passage of the FSPTCA, the FDA has taken additional actions, including, among others, prohibiting fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban), prohibiting misleading marketing terms ("Light," "Low, and "Mild") for tobacco products, rejecting applications for the introduction of new tobacco products into the market and requiring warning labels for smokeless tobacco products.

In August 2009, a group of tobacco manufacturers (including R.J. Reynolds and Lorillard) and a tobacco retailer filed a complaint against the United States of America in the United States District Court for the Western District of Kentucky, Commonwealth Brands, Inc. v. U.S., in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. In March 2012, the United States Court of Appeals for the Sixth Circuit affirmed the district court's earlier decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. The Sixth Circuit further affirmed the district court's grant of summary judgment to plaintiffs on the FSPTCA's restriction of tobacco advertising to black and white text, as well as the district court's decision to uphold the constitutionality of the color graphic and non-graphic warning label requirement. On May 31, 2012, the Sixth Circuit denied the plaintiffs' motion for rehearing en banc, and on October 30, 2012, the plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. The U.S. Supreme Court denied such petition on April 22, 2013. See "APPENDIX G—CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case.

On June 22, 2011, the FDA issued a final regulation for the imposition of larger, graphic health warnings on cigarette packaging and advertising, which was scheduled to take effect September 22, 2012 (but which the FDA is currently enjoined from enforcing, as described below). On August 16, 2011, five tobacco companies (including Reynolds Tobacco and Lorillard) filed a lawsuit against the FDA in the U.S. District Court for the District of Columbia, R. J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration, challenging the FDA's final regulation specifying nine new graphic "warnings" pursuant to the FSPTCA and seeking a declaratory judgment that the final regulation violates the plaintiffs' rights under the First Amendment to the U.S. Constitution and the Administrative Procedure Act ("**APA**"). On February 29, 2012, the district court granted the plaintiffs' motion for summary judgment and entered an order permanently enjoining the FDA, until 15 months following the issuance of new regulations that are substantively and procedurally valid and permissible under the United States Constitution and federal law, from enforcing against plaintiffs the new textual and graphic warnings required by the FSPTCA. On August 24, 2012, the Court of Appeals for the District of Columbia Circuit affirmed the district court's decision invalidating the graphic warning rule. On October 9, 2012, the FDA filed a motion for rehearing en banc with the Court of Appeals, and on December 5, 2012, the Court of Appeals denied the FDA's petition for a rehearing en banc. On March 19, 2013, the FDA announced that it would not file a petition for a writ of certiorari with the U.S. Supreme Court, but instead would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA. The FDA has not provided a timeline for the revised labels. See "APPENDIX G—CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—Regulatory Issues" for a discussion of this case.

The FDA has yet to issue guidance with respect to many provisions of the FSPTCA, which may result in less efficient operation by the PMs in the near term as they may be reluctant to increase production, research or development prior to final regulations from the FDA. According to Lorillard, the FDA has indicated that it intends to regulate electronic cigarettes under the FSPTCA through the issuance of deeming regulations that would include electronic cigarettes under the definition of a "tobacco product" under the FSPTCA subject to the FDA's jurisdiction. In letters to the Commissioner of the FDA dated September 24, 2013 and October 23, 2013, the attorneys general of 41 states requested that the FDA "take all available measures" to issue proposed regulations that will address the advertising, ingredients, and sale to minors of electronic cigarettes by the FDA's previously stated deadline of October 31, 2013. The letter asked the FDA to regulate electronic cigarettes like other tobacco products, and to move quickly to ensure that all tobacco products are tested and regulated to ensure that tobacco companies do not continue to sell or advertise to young people. In addition, fifteen public health organizations sent a letter to President Obama, dated September 19, 2013, asking for his leadership in ensuring that the FDA moves forward promptly with rules that would assert the FDA's authority over all tobacco products, including e-cigarettes. It is likely that regulations promulgated by the FSPTCA, including regulation of menthol short of an outright ban thereof, could result in a decrease in cigarette sales in the U.S., and an increase in costs to PMs, potentially resulting in a material adverse effect on the PMs' financial condition, results of operations and cash flows. Additionally, the ability of the PMs to gain efficient market clearance for new cigarette products or establish a new brand name could be affected by FDA rules and regulations. The negative impact of the foregoing factors could be to reduce consumption of cigarettes in the U.S. thereby reducing payments under the MSA which could have an adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

Concerns that mentholated cigarettes may pose greater health risks could result in further FDA regulation which could materially adversely affect the volume of cigarettes sold in the U.S. and thus payments under the MSA

Some plaintiffs and constituencies, including public health agencies and non-governmental organizations, have claimed or expressed concerns that mentholated cigarettes may pose greater health risks than non-mentholated cigarettes, including concerns that mentholated cigarettes may make it easier to start smoking and harder to quit, and increase the incidents of smoking among youth. Such plaintiffs and constituencies may seek restrictions or a ban on the production and sale of mentholated cigarettes. On November 8, 2013, twenty-seven states (including the State) sent a letter to the FDA in support of a ban on menthol flavored cigarettes. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 31.1% of the U.S. domestic cigarette market in 2012 and 31.4% in the six months ended June 30, 2013. The FSPTCA directs the TPSAC to evaluate issues surrounding the use of menthol as a flavoring or ingredient in cigarettes. In addition, the legislation permits the FDA to ban menthol upon a finding that such a prohibition would be appropriate for the public health. The TPSAC or the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At the March 18, 2011 meeting, TPSAC presented its report and recommendations on menthol. The report's findings included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." The FDA submitted a draft report on its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011, adding that after peer review, the results and the preliminary scientific assessment would be available for public comment in the Federal Register. At the July 21, 2011 meeting, TPSAC considered revisions to its report, and the voting members unanimously approved the final report for submission to the FDA with no change in its recommendation. On January 26, 2012, the FDA stated that its report had been submitted to the peer review panel and comments had been received from the panel on the report. On July 23, 2013, the FDA released its Independent Preliminary Scientific Evaluation of the Public Health Effects of Menthol Versus Non-menthol Cigarettes (the "**Preliminary Evaluation**") and peer comments for 60 days of public comment (such public comment period was subsequently extended for an additional 60 days to November 22, 2013), and issued an Advance Notice of Proposed Rulemaking seeking additional information to help the FDA make informed decisions about menthol in cigarettes. The Preliminary

Evaluation found that although there is little evidence to suggest menthol cigarettes are more toxic than regular cigarettes, the mint flavor of menthol masks the harshness of tobacco, which makes it easier to become addicted and harder to quit, and increases the incidents of smoking among youth. The FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. During the public comment period, the FDA will consider all comments, data and research submitted to determine what regulatory action, if any, with respect to menthol cigarettes is appropriate, including the establishment of product standards. In the meantime it will conduct and support research on the differences between menthol and non-menthol cigarettes as they relate to menthol's likely impact on smoking cessation. The FDA is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations. If the FDA determines that the regulation of menthol is warranted, the FDA could promulgate regulations that, among other things, could result in a ban on or a restriction on the use of menthol in cigarettes. A ban or any material restriction on the use of menthol in cigarettes could adversely affect the overall sales volume of cigarettes by the PMs, thereby reducing payments under the MSA.

Payments under the MSA are determined in part by the volume of cigarettes sold by PMs in the U.S. cigarette market, which is expected to continue to decline, negatively impacting such payments

Payments under the MSA are determined in part by the volume of cigarettes sold by the PMs in the U.S. cigarette market. Price increases, restrictions on advertising and promotions, funding of smoking prevention campaigns, increases in regulation and excise taxes, health concerns, a decline in the social acceptability of smoking, smoking bans in public places, increased pressure from anti-tobacco groups and other factors have reduced U.S. cigarette consumption. U.S. cigarette consumption is expected to continue to decline for the reasons stated above and others such as the raising of the minimum age to possess or purchase tobacco products. On October 30, 2013, the New York City Council voted to ban the sale of both cigarettes and e-cigarettes to anyone under 21 years old. A similar bill was introduced in the District of Columbia on November 5, 2013 and referred to a committee for further consideration. Reductions in consumption could lead to reductions of payments under the MSA and could have an adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

In the U.S., tobacco products are subject to substantial and increasing federal and state excise taxation, which has a negative effect on consumption. On April 2, 2009, Congress increased the federal excise tax per pack of cigarettes to $1.01 per pack (an increase of $0.62), and significantly increased taxes on other tobacco products. The federal excise tax rate for snuff increased $0.925 per pound to $1.51 per pound. The federal excise tax on small cigars, defined as those weighing three pounds or less per thousand, increased by $48.502 per thousand to $50.33 per thousand. All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2012 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), the current nationwide average state cigarette tax is $1.51 per pack. In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. According to Lorillard, for the nine months ended September 30, 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American, as of September 30, 2013 and December 31, 2012, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.30 and $1.26, respectively. According to Philip Morris, between the end of 1998 (the year that the MSA was executed) and October 21, 2013, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.47 per pack. As of October 21, 2013, Massachusetts, Minnesota, Oregon and Puerto Rico have enacted legislation to increase their cigarette taxes during 2013.

Legislation introduced by Senator Tom Harkin on January 22, 2013, the Healthy Lifestyles and Prevention America Act (or the HeLP America Act), would double the federal excise tax on cigarettes and roll-your-own tobacco and increase the taxes on smokeless tobacco products (making the excise taxes on smokeless tobacco products comparable to those on cigarettes). Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products, including pipe tobacco, cigars and smokeless tobacco, so that the tax rates on such products would approximate those of cigarettes. Similar bills have not been introduced in the U.S. House of Representatives. On April 10, 2013, President Obama released a proposed budget which, if approved by the U.S. Congress, would increase the federal excise tax: on a pack of cigarettes from $1.01 to $1.95; for snuff from $1.51 per pound to $2.93 per pound; and for chewing tobacco from $0.5033 per pound to $0.98 per pound.

In addition to federal and state excise taxes, certain city and county governments also impose substantial excise taxes on tobacco products sold. Increased excise taxes are likely to result in declines in overall sales volume and shifts by consumers to less expensive brands, deep discount brands, counterfeit brands or pipe tobacco for roll-your-own consumers. Reductions in consumption will lead to reductions of payments under the MSA and could have a negative effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

Increased restrictions on smoking in public places could adversely affect U.S. tobacco consumption and therefore amounts to be paid under the MSA

In recent years, federal, state and many local and municipal governments and agencies, as well as private businesses, have adopted legislation, regulations, insurance provisions or policies which prohibit, restrict, or discourage smoking generally, smoking in public buildings and facilities, stores, restaurants and bars, and smoking on airline flights and in the workplace. Other similar laws and regulations are currently under consideration and may be enacted by state and local governments in the future. Restrictions on smoking in public and other places may lead to a decrease in the number of people who smoke or a decrease in the number of cigarettes smoked or both. Smoking bans have recently been extended by many state and local governments to outdoor public areas, such as beaches and parks, and others may do so in the future. Increased restrictions on smoking in public and other places have caused a decrease, and may continue to cause a decrease, in the volume of cigarettes that would otherwise be sold in the U.S. absent such restrictions, which may have a material adverse effect on payments under the MSA. See "APPENDIX G – CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY- Regulatory Issues—*State and Local Regulation*".

Several of the PMs and their competitors have developed alternative tobacco and cigarette products, including electronic cigarettes, sales of which would not result in payments under the MSA

Certain of the major cigarette makers have developed and marketed alternative cigarette products. For example, numerous manufacturers have developed and are marketing **"electronic cigarettes"** or **"e-cigarettes,"** which are battery powered devices that vaporize liquid nicotine which is then inhaled. The manufacturers of e-cigarettes have taken the position that e-cigarettes do not constitute "cigarettes" within the meaning of the MSA because they do not contain or burn tobacco. There are currently over 250 e-cigarette brands on the market. Altria's Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand with distribution in Indiana initiated in August 2013. MarkTen is a disposable e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria stated that the MarkTen's "Four Draw" technology is designed to give users a "more consistent experience" that closely resembles the draw of a traditional cigarette. Lorillard has boosted distribution of its blu eCigs to more than 127,000 stores since acquiring the brand in 2012. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013, with a plan to quickly expand sales nationwide. Reynolds American has stated that it is targeting existing smokers with VUSE and expects some smokers to give up cigarettes in favor of VUSE.

The CDC in February 2013 reported results of a survey that indicated that 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time, which results were approximately double the estimates in 2010. A report released by the CDC and the FDA in September 2013 showed a doubling, to 10%, of the number of high school students who have tried e-cigarettes. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. No assurance can be given that regulation of e-cigarettes by the FDA will stop these trends.

In addition, Philip Morris developed an alternative cigarette, called Accord, in which the tobacco is heated rather than burned. Reynolds Tobacco has developed and is marketing dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased recently. Reynolds Tobacco and Philip Morris are both marketing their versions of "**snus**", a smokeless, spitless tobacco product that originated in Sweden. In May 2006, Reynolds Tobacco introduced Camel Snus. Philip Morris manufactures Marlboro Snus and Marlboro Smokeless Tobacco Stick, and a subsidiary of Altria (Philip Morris's parent company) manufactures Copenhagen and Skoal smokeless products. In January 2012, Altria announced that it entered into an agreement with Okono, an affiliate of

Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible tobacco products. In May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve nicotine discs, a mint-flavored, chewable, disposable tobacco product that contains tobacco-derived nicotine, and on June 11, 2013, Altria announced that it intends to expand its distribution of Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of the year.

It has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes and other alternatives to cigarettes. The manufacturers of e-cigarettes have taken the position that such products do not constitute "cigarettes" within the meaning of the MSA. While such alternative cigarette products continue to be deemed not to constitute "cigarettes" under the MSA and gain market share of the domestic cigarette market, payments under the MSA could decrease, and thus amounts of Pledged Settlement Payments available to the Corporation may decrease. See "APPENDIX G—CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY".

U.S. tobacco companies are subject to significant limitations on advertising and marketing cigarettes that could negatively impact sales volume

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

"**Electronic cigarettes**" are not currently subject to the advertising restrictions to which tobacco products are subject. Therefore, electronic cigarettes, which can currently be marketed more extensively than traditional cigarettes and other tobacco products, could gain market share to the detriment of the domestic cigarette market. See "APPENDIX G—CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY—E-Cigarettes."

Smoking cessation products may reduce cigarette sales volumes and adversely affect payments under the MSA

Large pharmaceutical companies have developed and increasingly expanded their marketing of smoking cessation products. Companies such as GlaxoSmithKline, Johnson & Johnson, Novartis and Pfizer are very well capitalized public companies that have entered this market and have the capability to fund significant investments in research and development and marketing of these products. Smoking cessation products now can be obtained both in prescription and over-the-counter forms. From Nicorette gum in 1984, to nicotine patches, nicotine inhalers and tablets, as well as other non-pharmaceutical smoking cessation products, this market has evolved into a $1 billion business in the U.S., according to some estimates. Studies have shown that these programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. In 2004, it was estimated that over 50 percent of all smokers had quit smoking, and it is likely that many of those former smokers were aided by smoking cessation products. Results of a study by the CDC, released in November 2011 found that, in 2010, 52.4% of smokers had attempted to quit and 6.2% had recently quit. To the extent that these products, new products or products used in combination become more effective and more widely available, or that more smokers avail themselves of these products, sales volumes of cigarettes in the U.S. may decline, adversely affecting payments under the MSA. See "APPENDIX G— CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY— Smoking Cessation Products".

The U.S. cigarette industry is subject to significant law, regulation and other requirements that could materially adversely affect the businesses, results of operations or financial condition of tobacco product manufacturers

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

The availability of counterfeit cigarettes could adversely affect payments by the PMs under the MSA

Sales of counterfeit cigarettes in the U.S. could adversely impact sales by the PMs of the brands that are counterfeited and potentially damage the value and reputation of those brands. Smokers who mistake counterfeit cigarettes for cigarettes of the PMs may attribute quality and taste deficiencies in the counterfeit product to the actual branded products brands and discontinue purchasing such brands. Most significantly, the availability of counterfeit cigarettes together with substantial increases in excise taxes and other potential price increases of branded products could result in increased demand for counterfeit products that could have an adverse effect on the sales volume of the PMs, resulting in lower payments under the MSA.

A decline in the overall consumption of cigarettes could have an adverse effect on the payments by PMs under the MSA and the amount and/or timing of Pledged Settlement Payments available to the Corporation. See "APPENDIX G— CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY" for a further discussion of the foregoing factors and events.

Other Risks Relating to the MSA and Related Statutes

Severability

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

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. See "COVENANTS OF THE STATE – Amendments Affecting State Covenants." The Corporation is not a party to the MSA; accordingly, the Corporation has no right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Bondholders will presumably be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the MSA would not have a material adverse effect on the receipt of Pledged Settlement Payments by the Corporation. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Amendments and Waivers".

Reliance on State Enforcement of the MSA and State Non-Impairment

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. Failure by the State to enforce the MSA may have a material adverse effect on the receipt of Pledged Settlement Payments by the Corporation. In the Series A Sale Agreement and the Series B Sale Agreement, the State has covenanted that it will take all actions as may be required by law to preserve, maintain, defend and protect the interests of the Corporation and the interests of the Trustee on behalf of the Bondholders to the Pledged Settlement Payments. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS". It is also possible that the State could attempt to claim some or all of the Pledged Settlement Payments for itself or otherwise interfere with the security for the Bonds. In that event, the Bondholders, the Trustee or the Corporation may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS".

General Economic Conditions and Lack of Access to Favorable Financing May Materially Adversely Impact the Ability of the PMs to Continue to Operate, Leading to Reduced Sales of Volumes of Cigarettes and Payments under the MSA.

The ability of the PMs to continue their operations selling cigarettes in the U.S. generally is dependent on the health of the overall economy and the ability to access the capital markets on favorable terms. To the extent that market conditions materially adversely impact their operations, the PMs may sell fewer cigarettes, potentially resulting in reduced payments under the MSA.

Adverse changes in financial market conditions or the credit ratings of the PMs could result in lack of access to financing, losses, higher costs and decreased profitability for the PMs, potentially affecting the volume of cigarette sales

Adverse changes in the liquidity in the financial markets could result in additional realized or unrealized losses associated with the value of the investments of the PMs, which would negatively impact the PMs consolidated results of operations, cash flows and financial position. Changes in financial market conditions could negatively impact the PMs' interest rate risk, foreign currency exchange rate risk and the return on corporate cash, thus increasing costs, lowering income and reducing profitability. If these losses negatively affect the overall volume of cigarette sales, payments under the MSA may decrease.

The outstanding notes issued by certain of the PMs are rated investment grade. If their credit ratings fall below investment grade, certain debt securities may adjust interest payments upwards or require posting of additional collateral. Additionally, if credit ratings fall below investment grade, the PMs affected may not be able to sell additional debt securities or borrow money in such amounts, at the times, at the lower interest rates or upon the more favorable terms and conditions that might be available if its debt was rated investment grade. Furthermore, future debt security issuances or other borrowings may be subject to further negative terms, including limitations on indebtedness or similar restrictive covenants. If these conditions negatively affect the overall volume of cigarette sales, payments under the MSA may decrease.

Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of Pledged Settlement Payments

If one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of Pledged Settlement Payments.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Corporation, the Trustee, the Bondholders, or the beneficial owners of the Series 2013 Bonds to collect any Pledged Settlement Payments or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying the 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 determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to reject the MSA and stop making payments under it.

Furthermore, payments previously made to the Bondholders or the beneficial owners of the Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the Corporation, the Trustee, the Bondholders, or the beneficial owners of the Series 2013 Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy (including provisions regarding the termination of that PM's obligations) (see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Termination of MSA"), such provisions may be unenforceable. NAAG actively monitors any bankruptcy related activity of the PMs with the goals of preventing the debtors from using bankruptcy law to avoid their MSA or state law payment obligations to the state and ensuring that states can continue to perform their regulatory duties despite the bankruptcy filing, but there can be no assurance that the actions of NAAG will be successful. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in or elimination of Pledged Settlement Payments. Regardless of any specific adverse determination in a PM bankruptcy proceeding, the fact of a PM bankruptcy proceeding could have an adverse effect on the timing of receipt, amount and value of the Pledged Settlement Payments and thus could have an adverse effect on the liquidity and market value of the Series 2013 Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS — Bankruptcy Considerations".

Rating Agency Actions With Respect to Unenhanced Tobacco Settlement Bonds Highlight the Importance to Investors of the State Appropriations

In recent years, Rating Agencies (defined below) have revised their assumptions regarding their ratings of unenhanced tobacco settlement bonds on account of the continuing decline in MSA payments resulting from cigarette volume decline, withholdings by PMs of MSA payments and disputes relating to MSA payments. S&P revised its assumptions for all tobacco settlement securitizations in October 2011 and then placed 86 classes from 23 tobacco settlement securitizations on CreditWatch Negative. On January 27, 2012, S&P lowered its ratings on 87 classes from 22 tobacco settlement securitizations, among other actions. In September 2011, Moody's downgraded 60 tranches from 13 tobacco settlement securitizations as a result of updated cash flow modeling assumptions. In July 2012, Fitch placed 150 tranches of tobacco settlement bonds on negative watch. None of such recent rating actions affected the ratings of the Series 2011 Bonds, because such ratings are based on the Series A Contract and the Series B Contract.

The Series 2013 Bonds are enhanced by annual appropriations made pursuant to the Series A Contract and Series B Contract. The Rating Agency actions with respect to unenhanced tobacco settlement bonds described in the preceding paragraph highlight the potential importance to investors of the annual appropriations made pursuant to the Series A Contract and Series B Contract. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS — The Series A Contract" and "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS — The Series B Contract."

Limited Resources of the Corporation

The Series 2013A Bonds are payable only from the assets of the Corporation, including Series A Contract Payments, pledged under the Series A Indenture. In the event that such assets of the Corporation have been exhausted, no amounts will thereafter be available to be paid on the Series 2013A Bonds. The Series 2013A 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 2013A Bonds. Investors in the Series 2013A Bonds must look solely to the assets of the Corporation pledged under the Series A Indenture for repayment of their investment. The Corporation's only sources of funds for payments on the Series 2013A Bonds are the Series A Pledged Revenues. The proceeds of the Series 2013A Bonds will be applied to establish an irrevocable escrow to refund the Series 2003A-1C Refunded Bonds, and will not be available to pay debt service on Series 2013A Bonds. The Corporation has no taxing power and no assets are available to pay Series 2013A Bonds other than the assets acquired pursuant to the Series A Sale Agreement, pledged under the Series A Indenture and payments received under the Series A Contract. No assets of the State are pledged to secure or will be available to pay debt service on the Series 2013A Bonds.

The Series 2013B Bonds are payable only from the assets of the Corporation, including Series B Contract Payments, pledged under the Series B Indenture. In the event that such assets of the Corporation have been exhausted, no amounts will thereafter be available to be paid on the Series 2013B Bonds. The Series 2013B 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 2013B Bonds. Investors in the Series 2013B Bonds must look solely to the assets of the Corporation pledged under the Series B Indenture for repayment of their investment. The Corporation's only sources of funds for payments on the Series 2013B Bonds are the Series B Pledged Revenues. The proceeds of the Series 2013B Bonds will be applied to establish an irrevocable escrow to refund the Series 2003B-1C Refunded

Bonds, and will not be available to pay debt service on Series 2013B Bonds. The Corporation has no taxing power and no assets are available to pay Series 2013B Bonds other than the assets acquired pursuant to the Series B Sale Agreement, pledged under the Series B Indenture and payments received under the Series B Contract. No assets of the State are pledged to secure or will be available to pay debt service on the Series 2013B Bonds.

Limited Remedies

The Trustee is limited under the terms of the Series A Sale Agreement to enforcing the terms of the agreement and to receiving the Series A Pledged Settlement Payments and applying them in accordance with the Series A Indenture. If a Series A Event of Default occurs, the Trustee cannot sell its rights under the Series A 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 Series A Sale Agreement do not include the repurchase by the State of the Series A 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 2013A Bondholders are no greater than those afforded to the Trustee. The Trustee is limited under the terms of the Series B Sale Agreement to enforcing the terms of the agreement and to receiving the Series B Pledged Settlement Payments and applying them in accordance with the Series B Indenture. If a Series B Event of Default occurs, the Trustee cannot sell its rights under the Series B 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 Series B Sale Agreement do not include the repurchase by the State of the Series B 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 2013B Bondholders are no greater than those afforded to the Trustee.

Limited Liquidity of the Bonds; Price Volatility

The Underwriters are under no obligation to make a secondary market. There can be no assurance that a secondary market for the Series 2013 Bonds will develop, or if a secondary market does develop, that it will provide Bondholders with liquidity or that it will continue for the life of the Series 2013 Bonds. Tobacco settlement revenue bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2013 Bonds must be prepared to hold such securities for an indefinite period of time or until redemption or final payment of such securities.

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

The Series 2013 Bonds will be assigned ratings by S&P and Fitch (collectively, the "**Rating Agencies**"). Any rating assigned to the Series 2013 Bonds by a Rating Agency will reflect such Rating Agency's assessment of the likelihood of the payment of principal or and interest on the Series 2013 Bonds. The rating of the Series 2013 Bonds will not be a recommendation to purchase, hold or sell such Bonds and such rating will not address the marketability of such Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if, in such Rating Agency's judgment, circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, the Series 2013 Bonds.

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 2013 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 are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy Considerations

General. The enforceability of the rights and remedies of the State (and thus the Corporation, the Trustee and the Series 2013 Bondholders as collateral assignees) 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 the payment or of nonpayment under the MSA and the risk that the State (and, thus, the Corporation) 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 required under the MSA, Pledged Settlement Payments 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 may be liquidated under Chapter 7 of the Bankruptcy Code, in which event its operations will cease and its assets will 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 should 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 bankruptcy-related risks include:

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 material 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 of 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 LLP will render an opinion to the Corporation and the Rating Agencies, subject to all the facts, assumptions and qualifications stated therein (there being no precedent directly on point), that in a case commenced under the Bankruptcy Code by or against an OPM, a court, exercising reasonable judgment after full consideration of all relevant factors in a properly presented and argued case, would (a) hold that the MSA is an executory contract pursuant Section 365 of the Bankruptcy Code and (b) approve a decision by an OPM to assume or reject the MSA as an executory contract.

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.

If a bankrupt PM determines to reject the MSA and a court approves such a decision, the State (and thus the Corporation, the Trustees 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 Trustees 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.

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 that alters the timing or the amount of payments to be made by the PM under the MSA to the State (and, thus, to the Corporation, the Trustees and Bondholders).

MSA and Qualifying Statute Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA or otherwise could be made according to or subject to different terms and conditions that could reduce the amount available to pay the principal of and interest on the Series 2013 Bonds.

Certain smokers, smokers' rights organizations, consumer groups, cigarette wholesalers, cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes, taxpayers, taxpayers' groups and other parties have filed lawsuits against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA, Qualifying Statutes and Complementary Legislation violate and are void or unenforceable under certain provisions of law, such as the United States Constitution, the federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law and unfair competition laws. Certain of the lawsuits have sought, among other relief, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA or a determination that the MSA is void or unenforceable. To date, all of the judgments on the merits have rejected the challenges presented in the cases. In the most recent decision, *VIBO*, the Sixth Circuit ruled that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order dismissing plaintiffs' federal antitrust, federal constitutional and common law challenges to the enforceability of the MSA. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired. In *Grand River*, the U.S. district court for the Southern District of New York denied the plaintiffs' motion to amend the Southern District's dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated Section 1 of the Sherman Antitrust Act and the Commerce Clause of the Constitution of the United States. Plaintiffs had appealed to the Second Circuit both the Southern District's dismissal and denial, but subsequently withdrew both appeals. In another recent decision, *Freedom Holdings*, the Second Circuit affirmed the district court's judgment, after a bench trial, in favor of defendants on similar challenges to the Qualifying Statute and Complementary Legislation, and the U.S. Supreme Court has denied the plaintiffs' petition for certiorari. These cases are discussed more fully herein. A determination by a court in a future case that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term, 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 the Pledged Settlement Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statute and Related Legislation".

The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the United States Constitution or state constitutions or are preempted by federal antitrust laws. The lawsuits have sought, among other relief, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date, such challenges have not been ultimately successful. The Qualifying Statutes and related legislation may continue to be challenged in the future. Although a determination that a Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of the PMs under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statute and Related Legislation".

In rendering the opinion described below, Hawkins Delafield & Wood LLP considered the claims asserted in the federal actions as well as other federal and State constitutional and statutory claims described under the caption "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" that it believes are representative of the legal theories that an opponent of the MSA or the State's Qualifying Statute would advance in an attempt to invalidate the MSA or the State's Qualifying Statute. Subject to the qualifications and assumptions set forth in such opinion, Hawkins, Delafield & Wood LLP will render opinions to the Corporation and the Rating Agencies that, subject to certain qualifications and assumptions expressed therein, a court exercising reasonable judgment, after full consideration of all relevant factors in a properly presented and argued case applying existing legal rules, would hold that the MSA is a valid and enforceable agreement among the states and the tobacco companies that are party thereto and that the State's Qualifying Statute is valid, enforceable and constitutional in all material respects and, as such, is enforceable against the NPMs. This opinion as to the enforceability of the MSA, the State's Qualifying Statute and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, reorganization, receivership, moratorium and other similar laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law, and the availability of any specific remedy.

Limitations on Certain Opinions

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

Enforcement of Rights to Tobacco Assets

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 2013 Bonds. In that event, the Bondholders, the Trustees or the Corporation could assert claims based on contractual or constitutional rights.

Contractual Remedies. Under State law, settlements are treated as contracts and may be enforced according to their terms. The Consent Decree coupled with the MSA is a court-approved settlement of lawsuits that establishes the State's right to receive the Pledged Settlement Payments. The Series A Sale Agreement and the Series B Sale Agreement obligate the State to take all necessary action to protect the Corporation's interest in the Pledged Settlement Payments. Thus, if the State violates the provisions of the MSA, the Trustees, as assignees of the Corporation's rights under the Series A Sale Agreement and the Series B Sale Agreement, could seek to compel the State to enforce its payment rights under the MSA. As interested parties, the Corporation on its own behalf and the Trustees on behalf of the Bondholders could also seek to enforce the State's rights under the MSA, although, as third parties to the MSA, their rights to do so are uncertain.

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

Constitutional Rights. Bondholders may also have constitutional claims under the Due Process Clauses of the United States Constitution and State Constitution in the event the State attempts to claim some or all of the Pledged Settlement Payments for itself, or otherwise interferes with the security for the Series 2013 Bonds.

No Assurance as to the Outcome of Litigation or Arbitration Proceedings

With respect to all matters of litigation mentioned above that have been brought and may in the future be brought against the PMs, or involving the enforceability or constitutionality of the MSA and/or the State's related legislation, Qualifying Statute or the enforcement of the right to the Pledged Settlement Payments or otherwise filed in connection with the tobacco industry or involving arbitration with respect to the NPM Adjustment, the outcome of such litigation or arbitration proceedings, in general, cannot be predicted with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and arbitration panels and (ii) the courts or panels, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation or arbitration and any such adverse outcome could have a material and adverse impact on the amount of Pledged Settlement Payments available to the Corporation to pay the principal of and interest on the Series 2013 Bonds.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA and related information. This summary is not complete and is subject to, and qualified in its entirety by reference to, the MSA, as amended. A copy of the MSA in its original form is attached hereto as APPENDIX C, but several amendments have been made to the MSA which are not included in APPENDIX C. Except for those amendments pursuant to which certain tobacco companies became SPMs (as defined below), such amendments involve technical and administrative provisions not material to the summary below. In addition, the following includes certain information related to litigation challenges to the MSA and disputes regarding the NPM Adjustment, both of which are referenced under "BONDHOLDERS' RISKS" herein.

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 (the "**SPMs**") to become parties to the MSA. The three OPMs together with the 52 SPMs are referred to as the "**PMs**". The settlement represents the resolution of a large potential financial liability of the PMs for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by states. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking-related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to NAAG, as of June 28, 2013, the most recent posting by NAAG, 55 PMs were parties to the MSA. The chart below identifies each of the PMs which was a party to the MSA as of June 28, 2013 (the most current reference date cited by NAAG):

OPMs

- **Lorillard Tobacco Company**
- **Philip Morris USA Inc. (formerly Philip Morris Incorporated)**
- **R.J. Reynolds Tobacco Company (formerly R.J. Reynolds Tobacco Company and Brown & Williamson Tobacco Corporation)**

SPMs

- **Bekenton, S.A.**[*]
- **Canary Islands Cigar Co.**
- **Caribbean-American Tobacco Corp. (CATCORP)**
- **The Chancellor Tobacco Company, UK Ltd.**
- **Commonwealth Brands, Inc.**
- **Daughters & Ryan, Inc.**
- **M/s. Dhanraj International**[*]
- **Eastern Company S.A.E.**
- **Ets L Lacroix Fils NV S.A. (Belgium)**
- **Farmer's Tobacco Co. of Cynthiana, Inc.**
- **General Jack's Incorporated**
- **General Tobacco (VIBO Corporation d/b/a General Tobacco)**[**]
- **House of Prince A/S**
- **Imperial Tobacco Limited/ITL (USA) Limited**
- **Imperial Tobacco Limited/ITL (UK)**
- **Imperial Tobacco Mullingar (Ireland)**
- **Imperial Tobacco Polska S.A. (Poland)**
- **Imperial Tobacco Production Ukraine**
- **Imperial Tobacco Sigara ve Tutunculuk Sanayi Ve Ticaret S.A. (Turkey)**
- **International Tobacco Group (Las Vegas), Inc.**
- **Japan Tobacco International USA, Inc.**
- **King Maker Marketing**
- **Konci G&D Management Group (USA) Inc.**
- **Kretek International**
- **Liberty Brands, LLC**[*]
- **Liggett Group, LLC**
- **Lignum-2, Inc.**
- **Mac Baren Tobacco Company A/S**
- **Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)**
- **NASCO Products Inc.**
- **OOO Tabaksfacrik Reemtsma Wolga (Russia)**
- **P.T. Djarum**
- **Pacific Stanford Manufacturing Corporation**
- **Peter Stokkebye Tobaksfabrik A/S**
- **Planta Tabak-manufaktur Gmbh & Co.**
- **Poschl Tabak GmbH & Co. KG**
- **Premier Manufacturing Incorporated**
- **Reemtsma Cigarettenfacbriken GmbH (Reemtsma)**
- **Santa Fe Natural Tobacco Company, Inc.**
- **Scandinavian Tobacco Group Lane Ltd. (formerly Lane Limited and Tobacco Exporters International (USA) Ltd.)**
- **Sherman's 1400 Broadway N.Y.C. Inc.**
- **Societe National d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)**
- **Tabacalera del Este, S.A. (TABESA)**
- **Top Tobacco, LP**
- **U.S. Flue-Cured Tobacco Growers, Inc.**
- **Van Nelle Tabak Nederland B.V. (Netherlands)**
- **Vector Tobacco Inc. (formerly Vector Tobacco Inc. and Medallion Company, Inc.)**
- **Virginia Carolina Corporation, Inc.**
- **Von Eicken Group**
- **Wind River Tobacco Company, LLC**
- **VIP Tobacco USA, LTD. (formerly Winner Sales Company)**
- **ZNF International, LLC**

[*] Has filed for bankruptcy relief.

[**] Ceased production of cigarettes and other tobacco products.

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. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "— Subsequent Participating Manufacturers".

Scope of Release

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

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

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

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

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

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

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Fund Payments.[*] See "– Initial Payments", "– Annual Payments" and "– Strategic Contribution Fund Payments" below. These payments (with the exception of the upfront Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "– Adjustments to Payments" and "– Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and most of the PMs[†] have made the Annual Payments for 2000 through, and including, 2013 (subject to certain withholdings and payments into the Disputed Payments Account under the MSA described in "BONDHOLDERS' RISKS — Potential Payment Decreases Under the Terms of the MSA"). See "– Payments Made to Date" below. Strategic Contribution Fund Payments began April 15, 2008 and will continue through April 15, 2017.

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

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

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.7 billion, was paid in December 2002 and January 2003, in the approximate amount of $2.14 billion after taking into account various adjustments.

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

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

Annual Payments

The OPMs and the other PMs are required to make Annual Payments on each April 15 in perpetuity. Most of the PMs made the first fourteen Annual Payments due April 15 in each of the years 2000 through 2013. The scheduled base amounts of Annual Payments and the appropriate amounts actually paid after application of adjustments discussed herein are set forth in the following table:

Annual Payments

	Base	**Adjusted**			**Adjusted**
Year	**Amount**	**Payment****	**Year**	**Base Amount**	**Payment****
2000*	**$4,500,000,000**	**$3,500,000,000**	**2010***	**$8,139,000,000**	**$5,700,000,000**
2001*	**5,000,000,000**	**4,100,000,000**	**2011***	**8,139,000,000**	**5,400,000,000**
2002*	**6,500,000,000**	**5,200,000,000**	**2012***	**8,139,000,000**	**5,500,000,000**
2003*	**6,500,000,000**	**5,100,000,000**	**2013***	**8,139,000,000**	**6,700,000,000*****
2004*	**8,000,000,000**	**6,200,000,000**	**2014**	**8,139,000,000**	
2005*	**8,000,000,000**	**6,300,000,000**	**2015**	**8,139,000,000**	
2006*	**8,000,000,000**	**5,800,000,000**	**2016**	**8,139,000,000**	
2007*	**8,000,000,000**	**6,000,000,000**	**2017**	**8,139,000,000**	
2008*	**8,139,000,000**	**6,200,000,000**	**Thereafter**	**9,000,000,000**	
2009*	**8,139,000,000**	**6,300,000,000**			

* The Annual Payments from 2000 through 2013 have been made. Subsequent adjustments to Annual Payments for a given year may impact Annual Payments due in subsequent years.

** Amounts are approximated.

*** Includes adjustments resulting from the NPM Adjustment Settlement Term Sheet.

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

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

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

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

Application of these adjustments resulted in a material reduction of the Annual Payments due to the State from the scheduled base amounts for the years 2000 through 2013, as discussed below under the caption "– Payments Made to Date".

Strategic Contribution Fund Payments

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

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

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

Application of these adjustments resulted in a material reduction of the Strategic Contribution Fund Payments due to the State from the scheduled base amounts for the years 2008 through 2013, as discussed below under the caption "- Payments Made to Date".

Adjustments to Payments

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

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

Volume Adjustment. Each of the Initial Payments was, and each of the Annual Payments and Strategic Contribution Fund Payments is, increased or decreased by an adjustment which accounts for fluctuations in the number of cigarettes shipped by the OPMs in or to the 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 Fund Payments, after application of the Inflation Adjustment) multiplied by a ratio, the numerator of which is the Actual Volume and the denominator of which is the Base Volume.

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

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

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

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

$$\text{NPM Adjustment} = 50\% + \\ [50\% / (\text{Base Aggregate Participating Manufacturer Market Share} - 16\tfrac{2}{3}\%)] \\ \text{x [market share loss} - 16\tfrac{2}{3}\%]$$

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute. Any Settling State that adopts and diligently enforces the Model Statute or a Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a pro rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment for any given year will not exceed 65% of the amount of such state's allocated payment for the subsequent year. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts the Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See "BONDHOLDERS' RISKS —Potential Payment Decreases Under the Terms of the MSA" above and "– MSA Provisions Relating to Model/Qualifying Statutes" below. See also "- 'Most Favored Nation' Provisions" and "- Potential Payment Decreases Under the Terms of the MSA" below. For a discussion of recent developments regarding disputes with respect to the NPM Adjustment, including arbitration decisions regarding the 2003 NPM Adjustment and the NPM Adjustment Stipulated Partial Settlement and Award, and objections thereto, see "- NPM Adjustment – 2003 NPM Adjustment; Arbitration Results" and "-NPM Adjustment Settlement and Award" below.

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

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

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

Claims-Over is state-specific and would apply only to MSA payments owed to the Settling State of the Releasing Party.

Subsequent Participating Manufacturers

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

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

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, most PMs have made Annual Payments since 2000 and Strategic Contribution Fund Payments since 2008, and the MSA Escrow Agent has disbursed to the State its allocable portions thereof and certain other amounts under the MSA totaling approximately $11.56 billion to date (which includes amounts allocated to the State, The City of New York and all other counties in the State), according to NAAG as of October 29, 2013. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Fund Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The following table sets forth the State's Share of unadjusted payments due to the State pursuant to the MSA and the State's Share of the amounts actually received by the State in the years indicated, which may reflect adjustments attributable to prior years' payments.

Payments Made to Date[*]

	State's Share of Unadjusted MSA Base Payment Amount	State's Share of Actual MSA Payments	
Up-Front Payment:	$156,746,000	$161,266,000	
Initial Payment Years Ending December 1:			
2000	$161,449,000	$140,460,000	
2001	166,292,000	126,514,000	
2002	171,281,000	126,960,000	
2003	176,419,000	139,777,000	
Annual and Strategic Contribution Fund Payments Years Ending December 1:			
2000	$293,899,000	$225,846,000	
2001	326,555,000	265,835,000	
2002	424,521,000	358,489,000	
2003	424,521,000	334,037,000	
2004	522,488,000	410,564,000	[**]
2005	522,488,000	414,080,000	[***]
2006	522,488,000	377,434,000	[***]
2007	522,488,000	399,953,000	[***]
2008	578,812,000	448,302,000	[***]
2009	578,812,000	490,967,000	[***]
2010	578,812,000	410,189,000	[***]
2011	578,812,000	387,470,000	[***]
2012	578,812,000	395,100,000	[***]
2013	578,812,000	394,908,000	[***]

[*] Rounded to the nearest $1,000.

[**] $228,530,000 of such amount constituted Series A Pledged Settlement Payments and Series B Pledged Settlement Payments (which excluded Unsold Settlement Payments consisting primarily of certain amounts owed to the State pursuant to the MSA during calendar year 2004).

[***] The State's Share of MSA payments (100% of the State's allocable share under the MSA of the Strategic Contribution Fund Payments and 51.176% of the State's allocable share under the MSA of the Annual Payments) constitutes Series A Pledged Settlement Payments and Series B Pledged Settlement Payments.

The terms of the MSA relating to such payments and various adjustments thereto are described above under the captions "– Initial Payments", "– Annual Payments", "– Strategic Contribution Fund Payments" and "– Adjustment to Payments". One or more of the PMs are disputing or have disputed the calculations of some of the Annual Payments for the years 2000 through 2013 and Strategic Contribution Fund Payments in years 2008 through 2013, as described further herein. In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial Payments and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

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

State-Specific Finality and Final Approval

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

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

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

Disbursement of Funds from Escrow

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

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

Advertising and Marketing Restrictions; Educational Programs

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

In addition, the OPMs have agreed under the MSA to provide funding for the organization and operation of a charitable foundation (the "**Foundation**") and educational programs to be operated within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. Each OPM may be required to pay its Relative Market Share of $300,000,000 on April 15 of each year on and after 2004 (as may be adjusted) in perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the OPMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

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

Termination of MSA

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

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

Severability

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

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

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

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

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

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

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

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

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

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

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

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

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 State Qualifying Statute constitutes a Model Statute under the MSA.

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

New York 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.

Statutory Enforcement Framework and Enforcement Agencies for New York

State Statutory Enforcement Provisions. The State's statutory framework for enforcing laws relating to the manufacture, distribution, sale, possession and taxation of cigarettes within the State of New York includes the New York Qualifying Statute and Complementary Legislation (as amended, including the Allocable Share Release Amendments previously described herein), *N.Y. Pub. Health Law §§ 1399-nn–1399-pp*;

- Imposition of Cigarette Excise and Use Taxes (including New York cigarette tax stamping requirements and tax rates), *N.Y. Tax Law §§ 471, 471-a*;

- Imposition of Tobacco Products Excise and Use Taxes (including tobacco products such as cigars, roll-your-own, other smoking tobacco, snuff and pipe tobacco), *N.Y. Tax Law §§ 471-b, 471-c;*

- Public Health Laws regulating the Sales of Tobacco Products, *N.Y. Pub. Health Law §§ 1399-cc (prohibiting sale of tobacco products, rolling papers, and other accessories to minors), 1399-dd (prohibiting sale of tobacco products and herbal cigarettes in vending machines), 1399-ll (prohibiting sale of bidis), 1399-mm (prohibiting sale of gutka)*;

- Public Health Law banning the retail shipment of cigarettes to New York State residents, *N.Y. Pub. Health Law § 1399-ll*;

- Fire Safe Cigarettes (requiring self-extinguishing cigarettes), *N.Y. Exec. Law § 156-c*; and

- Various implementing regulations promulgated by the Office of the New York Attorney General and the New York State Department of Taxation and Finance.

Federal Laws. In addition to State laws, rules and regulations, state enforcement agencies have certain shared enforcement powers under various federal laws relating to tobacco control, including the Jenkins Act (regulating and restricting the mail order and internet sales of tobacco and other controlled products), as amended by the Prevent All Cigarette Trafficking ("**PACT**") Act of 2010, and the Family Smoking Prevention and Tobacco Control Act of 2009 ("**FSPTCA**") (amending the FDA's Food, Drug and Cosmetics Act).

This statutory enforcement framework is administered and enforced by the Office of the New York Attorney General's Tobacco Compliance Bureau and by the New York State Department of Taxation and Finance's office, including its Transaction Desk Audit Bureau - Cigarette Tax Unit and its Criminal Investigations Division ("**CID**"), among other agencies and divisions.

Attorney General Tobacco Compliance Bureau. The Tobacco Compliance Bureau of the Office of the New York Attorney General (the "**Bureau**") is responsible for enforcing the MSA, maintaining files of compliant NPMs by manufacturer and brand-name, and for receiving and approving the annual compliance certifications from PMs and NPMs. Senior officers or directors of the tobacco products manufacturers must file with the Bureau, under penalty of perjury, annual certifications of compliance. New York State licensed cigarette stamping agents must file with the State Department of Taxation and Finance a monthly report of all sales of cigarettes, including the NPM brands, and such sales must bear New York cigarette tax stamps. Tobacco products distributors that are appointed to pay the tobacco products tax must file monthly reports for sales of roll-your-own. Cigarette and roll-your-own brands and manufacturers that are not properly certified and, in the case of cigarettes, do not bear New York cigarette tax stamps, may not be sold in New York. The State's Qualifying Statute provides an automatic statutory enforcement mechanism that complements the Model Statute and which allows the State to immediately ban the stamping and selling of cigarettes from non-compliant NPMs without the delay of waiting for two known violations and then obtaining a judgment. Consequently, litigation is not necessary to enforce NPM escrow compliance.

The Bureau and its predecessor units have been responsible since inception for pursuing non-compliant NPMs. The Qualifying Statute requires that an NPM deposit funds into an escrow account for the benefit of New York for all "units sold" in the State during the preceding year. As noted above, a "unit sold" is defined as a cigarette upon which State excise tax has been paid and which bears the State's excise tax stamp. The State believes there currently are no non-compliant NPMs for which licensed distributors have reported sales of units sold in the State of New York and that the market share of all NPMs for which licensed distributors have reported sales of units sold in the State has been de minimis (approximately 1% or less) in each year from and including 2003 to 2012. The State estimates that the market share of NPMs in New York in each year since 2004 has been less than 0.5% and believes that all NPMs currently certified are in compliance with their NPM escrow obligations under the New York Qualifying Statute.

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

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

Department of Taxation and Finance Transaction Desk Audit Bureau Actions. The New York State Department of Taxation and Finance's Transaction Desk Audit Bureau - Cigarette Tax and Registration and Bond

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

Internet Sales Prohibition. New York State Public Health Law prohibits the sale of cigarettes over the Internet to NYS consumers. In February 2011, the Bureau filed suits against six Internet sites for violating NYS Public Health Law § 1399-ll. Prior to enactment of the PACT Act in 2010, New York, on behalf of all states, including the State, entered into voluntary compliance agreements with several major national package delivery firms, including FedEx, UPS and DHL, prohibiting the private package delivery to consumers of cigarettes into New York and in other states nationwide. The PACT Act broadens this prohibition to include a prohibition of the delivery of cigarettes by U.S. Mail except to licensed distributors. Because NY law prohibits internet sales to NYS consumers, Jenkins Act reports are not relevant to internet enforcement in New York.

Nation or Tribal Reservation Cigarette Sales. Under federal case law, Indian nations and tribes are exempt from the State's taxes on cigarettes that they purchase on their own reservation for their own personal consumption. But the State has authority to tax "[o]n reservation cigarette sales to persons other than reservation Indians." *Dep't of Taxation & Finance of N.Y. v. Milhelm Attea & Bros.,* 512 U.S. 61, 64 (1994). For a number of years, the State sought, unsuccessfully, to tax Indian cigarette sales to non-tribal members. In 2010, the NYS Legislature amended the Tax Law to facilitate the collection of the cigarette excise tax required under NYS Tax Law§ 471(1) as to sales of cigarettes to non-Indians and non-nation or tribal members on reservations. With limited exceptions, the 2010 amendments require stamping agents to prepay the tax and affix tax stamps on all cigarette packs sold in New York, including those intended for resale to qualified Indians on the reservation.

Several Indian tribes and nations challenged these amendments and corresponding regulations. In May 2011, the Court of Appeals for the Second Circuit affirmed the denial of the preliminary injunction by the District Court for the Western District of New York as to four Indian nations and tribes and vacated the injunction issued by the District Court for the Northern District of New York as to the remaining challenging Indian nation. *Oneida Nation of New York v. Cuomo*, 645 F.3d 154 (2nd Cir. 2011). In State court, the Seneca Nation was granted a temporary restraining order (a "**TRO**") in Supreme Court, Erie County, in its challenge to the promulgation of the permanent regulations under the State Administrative Procedures Act (SAPA), pending the outcome of the motion and cross-motions for summary judgment. On June 8, 2011, State Supreme Court, Erie County denied the Seneca Nation's motion for summary judgment, granted the State's summary judgment motion and lifted the TRO. *Seneca Nation of Indians v. New York State Dept. of Taxation and Finance,* 91 Misc.3d 1242 (A) (N.Y.Sup. June 8, 2011). On June 9, 2011, the Appellate Division, Fourth Department issued a TRO enjoining enforcement of the 2010 amendments until a decision on the Seneca Nation's motion for a preliminary injunction pending appeal of the Supreme Court's June 8th Order. On June 10, 2011, the TRO was extended to enjoin enforcement against any Indian nation or tribe in the State. On June 21, 2011, the Appellate Division vacated the TRO. On September 20, 2011, the New York Court of Appeals denied motion for leave to appeal and the motion for a stay. On November 18, 2011, the State Supreme Court, Erie County, modified its judgment to note that the State had complied with necessary legislation and affirmed judgment so modified. On February 21, 2012, the Court of Appeals of New York denied motion for leave to appeal.

On June 21, 2011, the New York State Department of Taxation and Finance began implementing the Indian tax exemption coupon and prior approval systems. Wholesale dealers (including agents) are required to collect the cigarette excise tax and prepaid sales tax on all cigarettes sold for resale on an Indian reservation to non-Indians and non-members of such Indian nation or tribe. All packs of cigarettes sold by wholesale dealers to Indian nations and tribes and reservation cigarette sellers are required to have State tax stamps affixed to them. Wholesale dealers may sell stamped packs of cigarettes to Indian nations and tribes and reservation cigarette sellers exempt from tax to the extent Indian tax exemption coupons are provided or to the extent prior approval is received from the Tax Department. These systems continue to be available.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview. Certain smokers, smokers' rights organizations, consumer groups, cigarette importers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA and Settling States' Qualifying Statutes and Complementary Legislation are void or unenforceable under certain provisions of law, such as the U.S. Constitution, state constitutions, federal antitrust laws, state consumer protection laws, bankruptcy laws, federal cigarette advertising and labeling law, and unfair competition laws as described below in this subsection. Certain of the lawsuits have further sought, among other relief, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco related diseases should be paid directly to Medicaid recipients.

Qualifying Statute and Related Legislation. Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments and Strategic Contribution Fund Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—*NPM Adjustment* and —MSA Provisions Relating to Model/Qualifying Statutes" and "BONDHOLDERS' RISKS—Potential Payment Decreases Under the Terms of the MSA." A Settling State may avoid the effect of this adjustment by adopting and diligently enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute, which is a Qualifying Statute under the MSA. See "—MSA Provisions Relating to Model/Qualifying Statutes—*New York Qualifying Statute*" above. The Model Statute, in its original form, required an NPM to make escrow deposits approximately in the amount that the NPM would have had to pay to all of the states had it been a PM and further authorized the NPM to obtain from the applicable Settling State the release of the amount by which the escrow deposit in that state exceeded that state's allocable share of the total payments that the NPM would have made as a PM. Allocable Share Release Amendments have been enacted in the State and all other Settling States except Missouri, amending the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the statute to the excess above the total payment that the NPM would have paid had it been a PM.

In addition, at least 45 Settling States (including the State) have passed legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making escrow payments required by the states' respective Qualifying Statutes, as well as other legislation to assist in the regulation of tobacco sales. Pursuant to the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold in the State, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, is required to certify annually to the Attorney General that it is either a PM that has made all payments calculated by the MSA Auditor to be due under the MSA (except to the extent the PM is disputing any of the payments), or an NPM in full compliance with the State's Qualifying Statute. See "—MSA Provisions Relating to Model/Qualifying Statutes—*New York Complementary Legislation*" above.

The Qualifying Statutes and related legislation (including those of the State), like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the U.S. Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits have sought, among other relief, injunctions against the enforcement of the Qualifying Statutes and the related legislation. To date, such challenges have not been ultimately successful. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Challenges to the Qualifying Statutes and related legislation are described below under "*Litigation*" in this subsection.

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

A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, and thereby potentially increase their market share at the expense of the PMs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—MSA Provisions Relating to Model/Qualifying Statutes".

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

Litigation. All of the judgments rendered to date on the merits have rejected the challenges to the MSA and Settling States' Qualifying Statutes and Complementary Legislation presented in the cases. In *VIBO*, a tobacco manufacturer who became a party to the MSA in 2004 (General Tobacco)[*] sued the attorneys general of the Settling States, the OPMs, and other SPMs in the U.S. District Court for Western Kentucky in 2008. It alleged that the MSA and the refusal of the PMs to waive the PMs' most-favored nation rights and the Settling States' refusal to settle with the plaintiff on terms that the plaintiff preferred violated the federal antitrust laws and the Equal Protection, Commerce, Due Process, and Compact Clauses of the U.S. Constitution, and that the settling governmental entities fraudulently induced it to enter into the MSA. The plaintiff alleged that MSA participants, such as itself that were not in existence when the MSA was executed in 1998 but subsequently became participants, were unlawfully required to pay significantly more sums to the states than companies that joined the MSA within 90 days after its execution. In 2009, the district court granted motions to dismiss on all claims. First, the district court held that the PMs' involvement in the creation of the MSA, and their assertion of influence on the Settling States by refusing to give up any most favored nation protections that they held under the MSA (and thus deterring the Settling States from providing the plaintiff the settlement terms that the plaintiff desired) was protected from antitrust liability by the *Noerr-Pennington* ("**NP**") doctrine. The judicially created NP doctrine protects from antitrust liability persons or entities that petition or lobby the federal or state government to take actions that may impose restraints on trade. Second, the district court held that the attorneys general's involvement in and enforcement of the MSA, and their refusal to grant the plaintiff certain settlement terms, were sovereign acts of the states and immune from antitrust attack under the state action exemption. Third, the district court ruled that plaintiff had waived all of its federal constitutional challenges based on the Equal Protection, Due Process, and Commerce Clauses when it became a party to the MSA because the MSA provides in Section XV that all parties agree to waive "for the purposes of performance of the [MSA] any and all claims that the provisions of the [MSA] violate the state or federal constitutions". The district court further held that plaintiffs' Compact Clause claim should be dismissed because the MSA does not enhance state power to the detriment of the federal government power. Plaintiff appealed the dismissal of its claims to the U.S. Court of Appeals for the Sixth Circuit. On February 22, 2012, a three judge panel of the U.S. Court of Appeals for the Sixth Circuit ruled that the MSA does not amount to an unlawful conspiracy or anti-competitive behavior by the government and, accordingly, affirmed the district court's order and dismissed plaintiffs' appeal in this case. The time period for the plaintiffs to file a petition for certiorari to the U.S. Supreme Court expired.

In *Grand River*, certain cigarette manufacturers and distributors who were NPMs brought suit in 2002 against 31 states, including the State, and their attorneys general, alleging, among other things, that the Escrow Statutes contravened the Commerce Clause of the U.S. Constitution, the Sherman Act, and in the case of plaintiff Grand River, the Constitution's Indian Commerce Clause. The district court had dismissed all claims against the states other than the State for lack of personal jurisdiction, and dismissed all claims except the antitrust claim against the State. On interlocutory appeal, the Second Circuit reversed the district court's dismissal against the non-New York defendants, reversed the dismissal of the dormant Commerce Clause claim, and affirmed the dismissal of the plaintiffs' other constitutional claims. As to the Commerce Clause claim, the Second Circuit held that the plaintiffs "state a possible claim that the practical effect of the challenged statutes and the MSA is to control prices outside of the enacting states by tying both the SPM settlement and NPM escrow payments to national market share, which in turn affects interstate pricing decisions." On remand, the Southern District on March 22, 2011 granted summary judgment to the defendants on all of plaintiffs' Sherman Act and Commerce Clause claims. Plaintiffs appealed to the Second Circuit and petitioned the Southern District to amend its dismissal of plaintiffs' Sherman Act and Commerce Clause claims. On January 30, 2012 the Southern District denied the plaintiffs' motion to amend the

[*] General Tobacco ceased production of cigarettes and other tobacco products in 2010.

Southern District's March 22, 2011 dismissal by summary judgment of plaintiffs' claims that the MSA and related legislation violated the Sherman Act and the Commerce Clause. Plaintiffs then appealed this denial to the Second Circuit. On June 1, 2012 plaintiffs withdrew both appeals before the Second Circuit, which withdrawals were ordered by the Second Circuit on August 10, 2012. The case is now closed before the Second Circuit.

In *Freedom Holdings*, two cigarette importers who were NPMs sought in 2002 to enjoin the enforcement of the State's Qualifying Statute and Contraband Statute, claiming that the MSA and the legislation violated Section 1 of the Sherman Act, and the Commerce Clause of the U.S. Constitution. The Southern District dismissed the plaintiffs' complaint for failure to state a claim. On appeal, a three judge panel of the Second Circuit reversed the district court's dismissal. The Court held that, accepting the allegations of the complaint as true, the complaint alleged an "express market-sharing agreement among private tobacco manufacturers", and that the MSA, Escrow Statutes, and complementary legislation allowed the originally settling defendants to "set supracompetitive prices that effectively cause other manufacturers either to charge similar prices or to cease selling". The Court additionally held that, at the pleading stage, the defendants had not established that the legislation was protected by the state action exemption articulated under *Parker v. Brown* ("***Parker***") and its progeny, or as protected petitioning of government under the NP doctrine. The Court upheld the dismissal of the plaintiffs' Commerce Clause claim—although reserving the dormant Commerce Clause issue that plaintiffs had not asserted—and permitted the plaintiffs to amend to add allegations in their Fourteenth Amendment Equal Protection claim. The Second Circuit issued a subsequent opinion denying a motion for rehearing. The plaintiffs thereafter amended their complaint and brought a motion for a preliminary injunction against the State's Qualifying Statute and Contraband Statute. The district court granted an injunction against the Allocable Share Release Amendment, but otherwise denied the motion. The plaintiffs appealed and the Second Circuit affirmed the district court's denial of the broader preliminary injunction on the ground that plaintiffs had not established irreparable injury. After remand from the Second Circuit, the district court in *Freedom Holdings* conducted an evidentiary hearing and bench trial, and issued judgment for defendants on all of the plaintiffs' claims. The court held that the MSA and its implementing legislation were not illegal per se and not pre-empted by the Sherman Act, that even if it were necessary to reach the issue of state action exemption, that it shielded the defendants' conduct, and that the MSA and the legislation did not contravene the dormant Commerce Clause. On October 18, 2010, the Second Circuit affirmed the dismissal of the plaintiffs' claims. The U.S. Supreme Court has denied plaintiffs' petition for a writ of certiorari.

In *S&M Brands v. Caldwell*, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana in 2005 seeking, among other relief: (1) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid as violations of the U.S. Constitution and the Federal Cigarette Labeling and Advertising Act; and (2) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. Following the state defendant's motion to dismiss the complaint for lack of jurisdiction, the U.S. District Court for the Western District of Louisiana (the "**Western District**") allowed the case to proceed on claims that the MSA and Louisiana's Complementary Legislation are violations of the federal antitrust laws and of the Compact Clause, Commerce Clause, Due Process Clause and First Amendment of the U.S. Constitution, and the Federal Cigarette Labeling and Advertising Act, and dismissed the claims that alleged violation of the Tenth Amendment of the U.S. Constitution. In September 2009, the Western District granted defendant's motion for summary judgment and dismissed with prejudice all claims by the plaintiffs. In August 2010, the Fifth Circuit affirmed the Western District's order granting summary judgment for the defendants. The Fifth Circuit held that the district court correctly concluded that the MSA did not violate the Compact Clause because the MSA only increases states' power vis-à-vis the PMs and does not result in an accompanying decrease of the power of the federal government. The Fifth Circuit also ruled that the Escrow Statute did not violate the federal antitrust laws for the reasons set forth in its prior decision in *Xcaliber Int'l Ltd. v. Caldwell*, and held that the MSA did not violate federal antitrust laws after adopting the rationales of the Sixth Circuit and other circuits that previously considered the issue. In addition, the Fifth Circuit affirmed the dismissal of plaintiffs' Commerce Clause and Due Process Clause claims because plaintiffs had failed to show that the Louisiana Escrow Statute and the MSA had the effect of increasing cigarette prices outside of Louisiana. With respect to plaintiffs' First Amendment challenge to the MSA and the Escrow Statute, the Fifth Circuit found that the only statute applicable to plaintiffs as NPMs was the Escrow Statute, which the court determined did not compel or abridge plaintiffs' speech. Similarly, the Fifth Circuit found that the MSA and Escrow Statute did not violate the Federal Cigarette Labeling and Advertising Act because plaintiffs are not compelled to join the MSA and the Escrow Statute does not have any connection with cigarette packaging, advertising, or promotion. The U.S. Supreme Court denied plaintiffs' petition for writ of certiorari.

In the other decisions upholding the MSA or accompanying legislation, the decisions were rendered either on motions to dismiss or motions for summary judgment. Courts rendering those decisions include the U.S. Courts of Appeals for the Tenth Circuit in *KT & G Corp. v. Edmondson*, and *Hise v. Philip Morris Inc.*; the Eighth Circuit in *Grand River Enterprises v. Beebe*; the Third Circuit in *Mariana v. Fisher*, and *A.D. Bedell Wholesale Co. v. Philip Morris Inc*; the Fourth Circuit in *Star Sci., Inc. v. Beales*; the Sixth Circuit in *S&M Brands v. Cooper, S&M Brands, Inc. v. Summers and Tritent Inter'l Corp. v. Commonwealth of Kentucky*; the Ninth Circuit, in *Sanders v. Brown*; and multiple lower courts.

In January 2011, an international arbitration tribunal rejected claims brought against the United States challenging MSA-related legislation in various states under NAFTA.

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

The MSA and related state legislation may be challenged in the future. A determination by a court having jurisdiction over the State and the Corporation that the MSA or related State legislation is void or unenforceable could have a materially adverse effect on the payments by the PMs under the MSA and the amount and/or the timing of Pledged Settlement Payments available to the Corporation and could ultimately result in the complete cessation of the Pledged Settlement Payments available to the Corporation. A determination by any court that the MSA or State legislation enacted pursuant to the MSA is void or unenforceable could also lead to a decrease in the market value and/or liquidity of the Series 2013 Bonds. See "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS" for a further discussion of these matters as well as a description of the opinions of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, addressing such matters.

Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments. The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments". Such adjustments, offsets and recalculations could reduce the Pledged Settlement Payments available to the Corporation below the respective amounts required to pay the Series 2013 Bonds and could lead to a decrease in the market value and/or the liquidity of the Series 2013 Bonds. See "NPM Adjustment—2003 Adjustment Claims; Arbitration Results" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination of the Arbitration Panel with respect to the State's diligent enforcement of its Qualifying Statute in 2003, and see "NPM Adjustment—NPM Adjustment Settlement and Award" below for a discussion of a recent settlement entered into by 22 jurisdictions not including the State, and the OPMs and certain SPMs regarding disputes with respect to the NPM Adjustment.

Growth of NPM Market Share and Other Factors. Should a decline in consumption occur, but be accompanied by a material increase in the relative aggregate market share of the NPMs, shipments by PMs would decline at a rate greater than the decline in consumption. This would result in greater reductions of Annual Payments and Strategic Contribution Fund Payments by the PMs due to application of the Volume Adjustment, even for Settling States (including the State) that have adopted enforceable Qualifying Statutes and are diligently enforcing such statutes and are thus exempt from the NPM Adjustment. One SPM has introduced a cigarette with reportedly no nicotine. If consumers used this product to quit smoking, it could reduce the size of the cigarette market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low, and new cigarette manufacturers, whether SPMs or NPMs, are less likely than OPMs to be subject to frequent litigation.

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM would have been required to make had it been a PM. The State and all the other Settling States except Missouri have enacted Allocable Share Release Amendments that amend this provision in their Model/Qualifying Statutes, by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM. NPMs have unsuccessfully challenged Allocable Share Release Amendments in several states, and it is possible that NPMs will challenge similar legislation in other states. See "— Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation". To the extent that either: (1) other jurisdictions do not enforce Allocable Share Release Amendments (or, in the case of Missouri, which did not enact an Allocable Share Release Amendment, to the extent that such state continues not to enact an Allocable Share Release Amendment); or (2) a jurisdiction's Allocable Share Release Amendment is invalidated, NPMs could concentrate sales in such jurisdiction to take advantage by limiting the amount of its escrow payment obligations to only a fraction of the payment it would have been required to make had it been a PM. Because the price of cigarettes affects consumption, NPM cost advantage is one of the factors that has resulted and could continue to result in increases in market share for the NPMs.

A significant loss of market share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

NPM Adjustment. The following discussion describes how the NPM Adjustment works under the MSA. See "— 2003 Adjustment Claims; Arbitration Results" for a discussion of arbitration proceedings with respect to the 2003 NPM Adjustment and the recent determination of the Arbitration Panel with respect to the State's diligent enforcement of its Qualifying Statute in 2003, and see "—NPM Adjustment Settlement and Award" below for a discussion of a recent settlement entered into by 22 jurisdictions, not including the State, the OPMs and certain of the SPMs, and the calculation and application of the NPM Adjustment under such settlement.

Description of the NPM Adjustment. The NPM Adjustment, measured by domestic sales of cigarettes by NPMs, operates in certain circumstances to reduce the payments of the PMs under the MSA in the event of losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) a Market Share Loss (as defined in the MSA) for the applicable year must exist, which means that the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997 (a condition that has existed for every year since 2000); (2) a nationally recognized firm of economic consultants must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question; and (3) the Settling States in question must be found to not have diligently enforced their Qualifying Statutes.*

Application of the NPM Adjustment. The entire NPM Adjustment is ultimately applied to a subsequent year's Annual Payment and Strategic Contribution Fund Payment due to those Settling States: (1) that have been found to have not diligently enforced their Qualifying Statutes throughout the year; or (2) that have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**". If the PMs' actual aggregate market share is between 0% and 16 2/3% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the PMs' market share loss is greater than 16 2/3%, then the NPM Adjustment will equal 50% plus an amount determined by formula as set forth in the footnote below.†

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

† If the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16 2/3%, the NPM Adjustment will be calculated as follows:

$$\text{NPM Adjustment} = 50\% + \left[50\% / (\text{Base Aggregate Participating Manufacturer market share} - 16\ 2/3\%)\right] \times \left[\text{market share loss} - 16\ 2/3\%\right]$$

The MSA further provides that in no event will the amount of an NPM Adjustment applied to any Settling State in any given year exceed the amount of Annual Payments and Strategic Contribution Fund Payments to be received by such Settling State in such year.

Regardless of how the NPM Adjustment is calculated, it is always subtracted from the total Annual Payments and Strategic Contribution Fund Payments due from the PMs and then ultimately allocated on a Pro Rata (as defined in the MSA) basis only among those Settling States: (1) that have been proven to have not diligently enforced their Qualifying Statute; or (2) that have enacted the Model Statute or a Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction.[**] However, the practical effect of a decision by a PM to claim an NPM Adjustment for a given year and pay its portion of the amount of such claimed NPM Adjustment into the Disputed Payments Account, or withhold payment of such amount, would be to reduce the payments to all Settling States on a pro rata basis until a resolution is reached regarding the diligent enforcement dispute for all Settling States for such year, or until a settlement is reached for some or all such disputes for such year. If the PMs make a claim for an NPM Adjustment for any particular year and the State is determined to be one of a few states (or the only state) not to have diligently enforced its Model Statute or Qualifying Statute in such year, the amount of the NPM Adjustment applied to the State in the year following such determination could be as great as the amount of Annual Payments and Strategic Contribution Fund Payments that could otherwise have been received by the State in such year, and could have a material adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation.

As previously noted, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The “diligent enforcement” exemption afforded a Settling State is based on actual enforcement efforts for the calendar year preceding each Annual Payment. A final resolution of “diligent enforcement” for a sales year does not preclude a PM from disputing “diligent enforcement” in a subsequent year. If the other preconditions to an NPM Adjustment exist for a given year, an NPM Adjustment would apply, absent the protection of the Settling State “diligently enforcing” its Qualifying Statute. The State has enacted the Model Statute, which is a Qualifying Statute. No provision of the MSA, however, attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. The State’s Attorney General’s office maintains that the State has been and is diligently enforcing its Qualifying Statute. Furthermore, the MSA does not explicitly state which party bears the burden of proving or disproving whether a Settling State has diligently enforced its Qualifying Statute, or whether any diligent enforcement dispute would be resolved in state courts or through arbitration. However, regarding the 2003 NPM Adjustment dispute, the State’s MSA court has determined that the 2003 NPM Adjustment dispute was to be determined by a panel of arbitrators, and such panel of arbitrators has determined that, when contested, a state bears the burden of proving its diligence. As discussed further below, New York was a contested state in the 2003 NPM Adjustment arbitration and the Arbitration Panel (as defined below) unanimously determined that the State diligently enforced its Qualifying Statute during sales year 2003. The decision that the State diligently enforced its Qualifying Statute during sales year 2003 may not necessarily indicate that the State will be determined in future arbitrations to have diligently enforced its Qualifying Statute in subsequent sales years. Any determination that the State failed to diligently enforce its Qualifying Statute could result in a complete loss or substantial reduction in the amount of the future Pledged Settlement Payments up to the amount of the State’s Pledged Settlement Payments for sales years 2004 through 2012 or thereafter, plus interest, if any. The State’s Attorney General’s office maintains that the State has been and is diligently enforcing its Qualifying Statute.

The MSA provides that arbitration, if required by the MSA, will be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. Regardless of the forum in which a diligent enforcement dispute is heard, no assurance can be given as to how long it will take to resolve such a dispute with finality.

The models presented in the Table of Projected Pledged Settlement Payments and Debt Service for the 2013 Bonds do not include any NPM Adjustments (other than the assumed release of the 2003 NPM Adjustment amount to the State in April 2014) or withholdings or Disputed Payments Account deposits relating to PM claims of

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

entitlement to NPM Adjustments, based on the assumptions that the State has and will diligently enforce its Qualifying Statute and that such Qualifying Statute is not held to be unenforceable. If the assumptions are not realized and future NPM Adjustments, withholdings or Disputed Payments are taken against MSA payments to the State, it could have a material adverse effect on the payments by PMs under the MSA, and could have a material adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation. See "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS".

Settlement of 1999 through 2002 NPM Adjustment Claims. In June 2003, the OPMs, certain SPMs and the Settling States settled all NPM Adjustment claims for the payment years 1999 through 2002, subject, however, under limited circumstances, to the reinstatement of a PM's right to an NPM Adjustment for the payment years 2001 and 2002. In connection therewith, such PMs and the Settling States agreed prospectively that PMs claiming an NPM Adjustment for any year will not make such a deposit into the Disputed Payments Account or withhold payment with respect thereto unless and until the selected economic consultants determine that the disadvantages of the MSA were a significant factor contributing to the market share loss giving rise to the alleged NPM Adjustment. If the selected economic consultants make such a "significant factor" determination regarding a year for which one or more PMs have claimed an NPM Adjustment, such PMs may, in fact, either make a deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment. As discussed below under "Ongoing 2004 through 2012 NPM Adjustment Claims," the Settling States have since agreed that no "significant factor" determination will be necessary for certain years. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments".

2003 through 2012 NPM Adjustment Claims Generally. Pursuant to the provisions of the MSA, domestic tobacco product manufacturers have participated in proceedings regarding the 2003 NPM Adjustment, results of which were released on September 11, 2013, as discussed below. In addition, PMs have disputed payments attributable to sales years 2004 through 2012 which could lead to offsets against the Pledged Settlement Payments paid in future years. According to NAAG, one or more of the PMs are disputing or have disputed the calculations of some Annual Payments and Strategic Contribution Fund Payments totaling over $8.5 billion for the sales years 2003 through 2012 (payment years 2006 through 2015 for the OPMs and payment years 2004 through 2013 for the SPMs) as part of the NPM Adjustment. A discussion of the arbitration and the decisions of the Arbitration Panel with respect to the 2003 NPM Adjustment appears below under "2003 NPM Adjustment Claims; Arbitration Results," and a discussion of certain states settlement of claims regarding the 2003 through 2012 NPM Adjustments appears below under "NPM Adjustment Settlement and Award."

As part of the NPM Adjustment proceedings, an independent economic consulting firm jointly selected by the MSA parties or otherwise selected pursuant to the MSA's provisions is required to determine whether the disadvantages of the MSA were a "significant factor" contributing to the participating manufacturers' collective loss of market share for the year in question. If the firm determines that the disadvantages of the MSA were such a "significant factor," each Settling State may avoid a downward adjustment to its share of the PMs' annual payments for that year by establishing that it diligently enforced its Qualifying Statute during the entirety of that year. Any potential downward adjustment would then be reallocated to any states that do not establish such diligent enforcement. According to the Form 10-Q of Altria (Philip Morris's parent company) filed with the SEC for the six-month period ended June 30, 2013, Philip Morris (the largest PM) believes that the MSA's arbitration clause requires a state to submit its claim to have diligently enforced a qualifying escrow statute to binding arbitration before a panel of three former federal judges in the manner provided for in the MSA. A number of states have taken the position that this claim should be decided in state court on a state-by-state basis. According to Reynolds American, as of September 30, 2013, 47 of the 48 courts that had addressed the question whether the dispute concerning the 2003 NPM Adjustment (discussed below) is arbitrable had ruled that arbitration is required under the MSA.

Once a significant factor determination in favor of the PMs for a particular year has been made by an economic consulting firm, or the states' agreement not to contest that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share in a particular year has become effective, a PM has the right under the MSA to pay the disputed amount of the NPM Adjustment for that year into the MSA's Disputed Payments Account or withhold it altogether.

2003 NPM Adjustment Claims; Arbitration Results. An independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for 2003. Following the "significant factor" determination with respect to 2003, 38 Settling States filed declaratory judgment actions in state courts seeking a declaration that such Settling States diligently enforced their Qualifying Statutes during 2003. The OPMs and SPMs responded to these actions by filing motions to compel arbitration in accordance with the terms of the MSA, including motions to compel arbitration in 11 states and territories that did not file declaratory judgment actions. Courts in all but one of the 46 MSA states and the District of Columbia and Puerto Rico have ruled that the question of whether a state diligently enforced its Qualifying Statute during 2003 is subject to arbitration. Several of these rulings may be subject to further review, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013. The Montana state courts have ruled that the diligent enforcement claims of that state must be litigated in state court, rather than in arbitration. In June 2012, following the denial of the OPMs' petition to the United States Supreme Court for writ of certiorari, the PMs and Montana entered into a consent decree pursuant to which Montana will not be subject to the 2003 NPM Adjustment.

The OPMs and approximately 25 other PMs have entered into an agreement regarding arbitration with 45 states and territories, including the State, concerning the 2003 NPM Adjustment. The agreement provides for a partial liability reduction for the 2003 NPM Adjustment for states that entered into the agreement by January 30, 2009 and are determined in the arbitration not to have diligently enforced a Qualifying Statute during 2003. Based on the number of states that entered into the agreement by January 30, 2009 (45), the partial liability reduction for those states is 20%. This partial liability reduction would be effectuated by the PMs jointly reimbursing such states 20% of their respective amounts of the NPM Adjustment. The selection of a three-judge panel arbitrating the 2003 NPM Adjustment claims (the "**Arbitration Panel**") was completed in July 2010.

Following the completion of discovery, the PMs determined to continue to contest the 2003 diligent enforcement claims of 33 states (including the State), the District of Columbia and Puerto Rico and to no longer contest such claims by 12 states and four U.S. territories (the "**non-contested states**"). Eighteen of these contested states, the District of Columbia and Puerto Rico, as well as two non-contested states, subsequently entered into the NPM Adjustment Settlement Term Sheet with the OPMs and certain of the SPMs as discussed below, leaving 15 states contested in the arbitration proceedings. As a result, Montana and the non-contested states that did not enter into the NPM Adjustment Settlement Term Sheet (which do not include the State) are not subject to the 2003 NPM Adjustment, and their share of any such NPM Adjustment, along with the shares of those states found by the Arbitration Panel to have diligently enforced their respective Qualifying Statutes during sales year 2003 (which include the State), will be reallocated in accordance with the MSA to those states found by the Arbitration Panel to have not diligently enforced their respective Qualifying Statutes during 2003.

A common issues hearing was held in April 2012 and state specific evidentiary hearings began in May 2012 and were completed in May 2013. On September 11, 2013, the Arbitration Panel released its decisions with respect to each of the fifteen contested states that are Term Sheet Non-Signatories, including the State. The Arbitration Panel determined that six states (Indiana, Kentucky, Maryland, Missouri, New Mexico and Pennsylvania, which have an aggregate allocable share of 14.6792685%) did not diligently enforce their respective Qualifying Statutes during 2003, and nine states (including the State) were found by the Arbitration Panel to have diligently enforced their respective Qualifying Statutes during 2003. As a result, those nine states, including the State, that were determined to have diligently enforced their respective Qualifying Statutes, as well as 15 other jurisdictions that were either not contested or were not subject to the arbitration proceedings, are not subject to the 2003 NPM Adjustment, and their share of the 2003 NPM Adjustment will be reallocated in accordance with the MSA to the six states found by the Arbitration Panel to have not diligently enforced their respective Qualifying Statutes during 2003.

The Arbitration Panel's decision relating to the State defined diligent enforcement as "an ongoing and intentional consideration of the requirements of a Settling State's Qualifying Statute, and a significant attempt by the Settling State to meet those requirements, taking into account a Settling State's competing laws and policies that may conflict with its MSA contractual obligations." The Arbitration Panel considered various factors in deciding whether or not a state met the diligent enforcement standard, including, in no particular order, (i) such state's collection rate of amounts to be deposited by NPMs into escrow accounts, (ii) the number of lawsuits against manufacturers brought by such state, (iii) how the state gathered reliable data, (iv) resources allocated to enforcement, (v) prevention of non-compliant NPMs from future sales, (vi) legislation enacted by the state, (vii) actions short of legislation taken by the state, and (viii) efforts made to be aware of NAAG and other states' enforcement efforts. The Arbitration Panel stated that such factors were not necessarily given equal weight, but were considered as a whole. Where certain terms defined in the Model Statute were disputed, the Arbitration Panel relied on the plain meaning of the defined terms and did not penalize states for a rational interpretation of the terms in enforcing their Qualifying Statutes. The Arbitration Panel did not penalize states that provided rational reasons for implementing policies and legislation with respect to enforcement of their Qualifying Statutes, finding that a good faith effort to address an issue where there is no evidence of intentional escrow evasion was an indication of diligent enforcement. The Arbitration Panel also stated that although the Settling States are required under the MSA to diligently enforce their Qualifying Statutes, the Settling States are not required "to elevate those obligations above other statutory or rational policy considerations." A copy of the Arbitration Final Award Re: State of New York in the 2003 NPM Adjustment Proceedings is attached hereto as APPENDIX E.

On September 24, 2013, the Pennsylvania Attorney General's office filed a motion with the Arbitration Panel to amend the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. The Arbitration Panel denied the motion on October 3, 2013. On November 4, 2013, Pennsylvania filed a motion in the Court of Common Pleas of Philadelphia County to vacate the Arbitration Panel's final award in which it determined that Pennsylvania did not diligently enforce its Qualifying Statute in 2003. In addition, on December 4, 2013, the Indiana Attorney General filed an appeal of the Arbitration Panel's determination with respect to Indiana's non-diligent enforcement in the Marion County Superior Court. It is not known if any of the other states that were determined to have not diligently enforced their respective Qualifying Statutes in sales year 2003 will appeal any decision by the Arbitration Panel or take any other legal action, or when the amounts withheld by the PMs or deposited into the Disputed Payments Account pursuant to the 2003 NPM Adjustment will be paid out by the MSA Escrow Agent.

The State has reported that the Disputed Payments Account currently contains approximately $390.4 million deposited by certain of the PMs related to the 2003 NPM Adjustment, of which the State's share is approximately $50 million. The State is entitled to payment of approximately $92.4 million, which includes the $50 million referred to in the prior sentence, as a result of funds withheld from the State because of the PMs' claimed NPM Adjustment for 2003. It is not known the method by which such funds will be disbursed to the states determined to have diligently enforced their Qualifying Statutes (including the State). The State expects that, in the absence of an injunction preventing the MSA Auditor from directing the disbursement of funds or the MSA Escrow Agent from disbursing the money in the Disputed Payments Account related to the 2003 NPM Adjustment, and in the absence of any delays resulting from challenges of the Arbitration Panel's decisions by states that were determined to have not diligently enforced their Qualifying Statutes in 2003, the State's share of the money in the Disputed Payments Account will be paid in April 2014 by reallocating from the six non-diligently enforcing states the 2014 Annual Payments and Strategic Contribution Fund due from the PMs. However, some states may take legal action to prevent the distribution of the disputed payments until all the 2003 NPM Adjustment disputes have been resolved with finality. See "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

Ongoing 2004 Through 2012 NPM Adjustment Claims. An independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for sales years 2004 and 2005 (as well as 2003, as discussed above). A different independent economic consulting firm, jointly selected by the MSA parties, determined that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales year 2006. Following the firm's determination for 2006, the OPMs and the Settling States agreed that the Settling States would not contest that the disadvantages of the MSA were a significant factor contributing to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009. Accordingly, the OPMs and the Settling States have agreed that no "significant factor" determination by an independent economic consulting firm will be necessary with respect to the PMs' collective loss of market share for the sales years 2007, 2008 and 2009 (the "**significant factor agreement"**). This agreement became effective for sales years 2007, 2008 and 2009 on February 1, 2010, 2011 and 2012, respectively. The OPMs and the Settling States have agreed to extend the significant factor agreement to apply to the PMs' collective loss of market share for sales years 2010, 2011 and 2012. This agreement became effective for sales year 2010 on February 1, 2013 and will become effective for sales year 2011 on February 1, 2014. If the MSA Auditor determines that the PMs collectively lost market share for sales year

2012, this agreement will become effective for sales year 2012 on February 1, 2015. Proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled.

Altria, Philip Morris's parent company, has indicated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that Philip Morris's approximate share of disputed NPM Adjustments for sales years 2003 to 2012 is $2.261 billion (plus an asserted claim for interest on such moneys at the prime rate, but not reflecting the partial liability reduction for the 2003 NPM Adjustment pursuant to the agreement regarding arbitration or the NPM Adjustment Settlement Term Sheet described below). Philip Morris further reports that it has made its full MSA payment due in each year from 2006 to 2010 to the Settling States (subject to a right to recoup the NPM Adjustment amount in the form of a credit against future MSA payments), even though it had the right to deduct the disputed amounts of the 2003 - 2007 NPM Adjustments, as described above, from such MSA payments. Philip Morris paid its share of the amount of the disputed 2008, 2009 and 2010 NPM Adjustments into the Disputed Payments Account in connection with its MSA payments due in 2011, 2012 and 2013, respectively.

Philip Morris has further indicated that it will deposit the allocable share of the 2011-2012 NPM Adjustments for the Term Sheet Signatories into the Disputed Payments Account in connection with its April 2014–2015 MSA payments and then, following such deposit, authorize the release of such share to the Term Sheet Signatories.

Reynolds American, Reynolds Tobacco's parent company, has reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that Reynolds Tobacco has disputed a total of approximately $4.7 billion for the payment years 2003 through 2012 in connection with the NPM Adjustment. Reynolds Tobacco reports that it placed its share of the 2004 NPM Adjustment and 2005 NPM Adjustment (net of certain slight adjustments to reflect revised MSA Auditor calculations) into the Disputed Payments Account in connection with its MSA payments due in 2007 and 2008, respectively. In April 2009, Reynolds Tobacco retained approximately $406.5 million of its 2009 MSA payment to reflect its share of the 2006 NPM Adjustment as calculated by the MSA Auditor. Based on revised calculations by the MSA Auditor, in April 2010, Reynolds Tobacco withheld an additional amount, bringing the total amount withheld with respect to the 2006 NPM Adjustment to approximately $420 million. Again based on revised calculations by the MSA Auditor, in April 2011, Reynolds Tobacco paid approximately $1 million extra to account for a downward adjustment in its share of the 2006 NPM Adjustment. In connection with its MSA payments due in April 2010, 2011 and 2012, Reynolds Tobacco placed its share of the 2007 NPM Adjustment, 2008 NPM Adjustment and 2009 NPM Adjustment, respectively, into the Disputed Payments Account (with the last two of such payments being reduced to adjust for a downward revision by the MSA Auditor to Reynolds Tobacco's share of the 2007 NPM Adjustment and 2008 NPM Adjustment). In connection with its MSA payment due in April 2013, Reynolds Tobacco placed its share of the 2010 NPM Adjustment (net of certain small adjustments to reflect revised MSA Auditor calculations of Reynolds Tobacco's share of the 2008 and 2009 NPM Adjustments) into the Disputed Payments Account. Reynolds Tobacco's 2013 payment into the Disputed Payments Account was reduced by approximately $1.2 million to adjust for a downward revision by the MSA Auditor to its share of the 2008 NPM Adjustment, and by approximately $319,000 to adjust for a downward revision to its share of the 2009 NPM Adjustment. In addition, Reynolds Tobacco placed approximately $419 million into the Disputed Payments Account in April 2013 to reflect its share of the 2006 NPM Adjustment that it previously retained.

In addition to the NPM Adjustment claims described above, Reynolds Tobacco has reported that it has filed dispute notices with respect to its 2011 and 2012 Annual Payments relating to the NPM Adjustments potentially applicable to those years. The amount at issue for those two years is approximately $841 million.

The approximate maximum principal amounts of the PMs' aggregate share of the disputed NPM Adjustment for the sales years 2003 through 2012 (payment years 2004 through 2013), as reported by NAAG, and without regard to the effects of the NPM Adjustment Settlement Term Sheet and the Stipulated Partial Settlement and Award, are as follows:

OPM and SPM Maximum Potential NPM Adjustment Amounts
Sales Years 2003-2012 (Payment Years 2004-2013)[1]

Sale Year for which NPM Adjustment wa calculated	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
MSA Payment Year for which NPM Adjustment was calculated	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
MSA Payment Year by which deduction for NPM Adjustment may be asserted by OPMs[2]	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Potential OPM NPM Adjustment*	$1,061,158,548	$1,061,288,734	$702,715,077	$646,394,781	$702,104,158[3]	$821,644,318[3]	$779,388,450[3]	$779,818,190[3]	$663,895,464[3]	$715,833,950[3]
Potential SPM NPM Adjustment*	86,407,516	76,107,191	50,630,561	53,949,637	47,254,505[3]	66,765,407[3]	68,573,096[3]	63,143,527[3]	50,767,997[3]	53,091,832[3]
Total*	**$1,147,566,065**	**$1,137,395,925**	**$753,345,638**	**$700,344,418**	**$749,358,662**	**$888,409,725**	**$847,961,547**	**$842,961,718**	**$714,663,460**	**$768,925,782**

[1] Payments are subject to adjustments from disputes for up to four years following the payment due date under the MSA under the Offset for Miscalculated or Disputed Payment provisions.
[2] For SPMs the times vary and may be as short as one year after the sales year.
[3] Includes MSA Annual Payment and Strategic Contribution Fund Payment.
* Rounded.

The foregoing amounts may be recalculated by the MSA Auditor if it receives information that is different from or in addition to the information on which it based these calculations, including, among other things, if it receives revised sales volumes from any PM. Disputes among the manufacturers could also reduce the foregoing amounts.

Philip Morris has reported its expectation of receiving, outside of the amount covered by the NPM Adjustment Settlement Term Sheet discussed below, its share of any adjustments for 2003 - 2007 in the form of a credit against future MSA payments and its share of any adjustment for 2008 - 2010 in the form of a withdrawal from the Disputed Payments Account. Any adjustments made in the form of a credit against future MSA payments could lead to material reductions in the Pledged Settlement Payments. However, Altria, Philip Morris's parent company, noted in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that there is no certainty that the PMs would ultimately receive any adjustment from the Term Sheet Non-Signatories (as defined below) as a result of the NPM Adjustment proceedings described herein.

Altria has further stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that it continues to reserve all rights regarding the NPM Adjustments with respect to the Term Sheet Non-Signatories and intends to continue to pursue vigorously the disputed NPM Adjustments for sales years 2004 - 2012 against the Term Sheet Non-Signatories States. No proceedings to determine state diligent enforcement claims for the years 2004 through 2012 have yet been scheduled. Philip Morris believes that the MSA requires state claims of diligent enforcement for 2004 - 2012 to be determined in a national arbitration, although a number of Term Sheet Non-Signatories have reserved rights to contend that such claims for those years are to be determined either in separate arbitrations for each state or in state court on a state-by-state basis.

NPM Adjustment Settlement and Award. On December 17, 2012, terms of a settlement agreement (the "**NPM Adjustment Settlement Term Sheet**") were agreed to by 19 jurisdictions (which do not include the State), the OPMs and certain SPMs regarding claims related to the 2003 through 2012 NPM Adjustments and the determination of future NPM Adjustments. The 19 jurisdictions (which do not include the State) that signed the NPM Adjustment Settlement Term Sheet on December 17, 2012 are Alabama, Arizona, Arkansas, California, the District of Columbia, Georgia, Kansas, Louisiana, Michigan, Nebraska, Nevada, New Hampshire, New Jersey, North Carolina, Puerto Rico, Tennessee, Virginia, West Virginia and Wyoming. On April 12, 2013, Oklahoma joined the NPM Adjustment Settlement Term Sheet and on May 24, 2013, Connecticut and South Carolina joined the NPM Adjustment Settlement Term Sheet, bringing the total number of jurisdictions that have joined the settlement to 22, representing approximately 46% Allocable Share. Such jurisdictions that joined the NPM Adjustment Settlement Term Sheet are collectively referred to herein as "**Term Sheet Signatories**" which term, where appropriate, includes any additional jurisdictions that subsequently sign the NPM Adjustment Settlement Term Sheet). Additional jurisdictions were permitted to join the settlement up to the end date of the last individual state-specific diligent enforcement hearings (the last diligent enforcement hearing for the jurisdictions that did not sign on to the NPM Adjustment Settlement Term Sheet occurred in May 2013), although they will have different and potentially less favorable payment obligations as detailed in the NPM Adjustment Settlement Term Sheet. After such time, additional jurisdictions may join the settlement only if the signatory PMs, in their sole discretion, agree.

The NPM Adjustment Settlement Term Sheet was subject to approval by the Arbitration Panel. On March 12, 2013, the Arbitration Panel issued its Stipulated Partial Settlement and Award (the "**NPM Adjustment Stipulated Partial Settlement and Award**"). As described herein, the NPM Adjustment Stipulated Partial Settlement and Award was implemented by the MSA Auditor as it relates to the April 2013 MSA payment, in particular, effecting certain reductions to the April 2013 MSA payment due by the PMs and releasing certain funds from the Disputed Payments Account to the Term Sheet Signatories at the time (the original 19 jurisdictions plus Oklahoma), as specified below. The MSA Auditor issued revised payment calculations reflecting the financial impact of Oklahoma's decision to join the settlement. The MSA Auditor has stated that, by implementing such reductions to the PM payments and releases from the Disputed Payments Account to the Term Sheet Signatories with respect to the MSA payments due in April 2013, it was not committing to implement any provision of the NPM Adjustment Settlement Term Sheet other than those provisions relating to such distributions and credits with respect to the MSA payments due in April 2013.

In the NPM Adjustment Stipulated Partial Settlement and Award, the Arbitration Panel, as a threshold matter, ruled that it has jurisdiction (i) to enter the NPM Adjustment Stipulated Partial Settlement and Award, (ii) to rule on the objections of those jurisdictions that did not join the settlement, including the State (the "**Term Sheet Non-Signatories**"), (iii) to determine how the 2003 NPM Adjustment Settlement will be allocated among the Term Sheet Non-Signatories in light of the settlement and (iv) to incorporate and direct the MSA Auditor to implement the provisions of the NPM Adjustment Settlement Term Sheet, including as they pertain to years beyond 2003. The Arbitration Panel noted that it was neither "approving" the NPM Adjustment Settlement Term Sheet nor assessing the merits of any NPM Adjustment dispute, but rendering the NPM Adjustment Settlement Term Sheet binding on the Term Sheet Signatories and directing the MSA Auditor to implement the settlement provisions contained therein.

In the NPM Adjustment Stipulated Partial Settlement and Award, the Arbitration Panel specifically directed the MSA Auditor (i) to release approximately $1.76 billion (plus accumulated earnings thereon) from the Disputed Payments Account to the Term Sheet Signatories, allocating such released amount among the Term Sheet Signatories as they direct in connection with the April 15, 2013 MSA payment and (ii) to apply a credit in the aggregate amount of approximately $1.65 billion to the OPMs' MSA payments, allocating such credit among the OPMs as they direct with 50% of the credit applied against the April 15, 2013 MSA payment and 12.5% to be applied against each of the April 15, 2014 through 2017 MSA payments. Under the NPM Adjustment Settlement Term Sheet, parallel provisions exist for SPMs, which stipulated a credit of approximately $31 million to the SPMs' April 2013 MSA payments.

In addition, while not ruling on years subsequent to the 2003 NPM Adjustment, the arbitration panel ruled that the reduction of the 2003 NPM Adjustment, in light of the NPM Adjustment Stipulated Partial Settlement and Award (for purposes of allocating the 2003 NPM Adjustment to the Term Sheet Non-Signatories), will be on a *pro rata* basis: the dollar amount of the 2003 NPM Adjustment will be reduced by a percentage equal to the aggregate allocable share of the Term Sheet Signatories. In addition, the arbitration panel directed the MSA Auditor to treat the Term Sheet Signatories as not being subject to the 2003 NPM Adjustment, resulting in a reallocation of the Term Sheet Signatories' share of the 2003 NPM Adjustment among those Term Sheet Non-Signatories that are found not to have diligently enforced their Qualifying Statutes during 2003. This framework creates an incentive for Term Sheet Non-Signatories to contest the diligent enforcement of Term Sheet Signatories for years 2004 onward. The arbitration panel concluded that the NPM Adjustment Settlement Term Sheet and the NPM Adjustment Stipulated Partial Settlement and Award do not legally prejudice or adversely affect the Term Sheet Non-Signatories, but that, should a Term Sheet Non-Signatory found by the arbitration panel to be non-diligent have a good faith belief that the *pro rata* reduction method did not adequately compensate it for a Term Sheet Signatory's removal from the reallocation pool, its relief, if any, is by appeal to its individual MSA state court. The arbitration panel further concluded that neither the NPM Adjustment Stipulated Partial Settlement and Award nor the NPM Adjustment Settlement Term Sheet constitutes an amendment to the MSA that would require the consent of any Term Sheet Non-Signatory.

Pursuant to the NPM Adjustment Settlement Term Sheet, including as implemented in April 2013 following the NPM Adjustment Stipulated Partial Settlement and Award, the OPMs and certain SPMs have received certain reductions in 2013 and will receive reductions to future MSA payments to reflect a percentage of the Term Sheet Signatories' aggregate share of the OPMs' and certain SPMs' aggregate 2003 through 2012 NPM Adjustment claims. The amount of such percentages is dependent on the number of jurisdictions that eventually join the final settlement. According to a Form 10-Q filed with the SEC by Altria (the parent company of Philip Morris) for the nine-month period ended September 30, 2013, the OPMs have agreed that, subject to certain conditions, Philip Morris will receive approximately 28% of the reductions, Reynolds Tobacco will receive approximately 60% of the reductions, and Lorillard will receive approximately 12% of the reductions. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Philip Morris reported that, based on the Term Sheet Signatories as of April 15, 2013, Philip Morris received all of its reduction under the NPM Adjustment Settlement Term Sheet through a credit of approximately $483 million against its MSA payment made in April 2013. Philip Morris also reports that it expects to receive an additional credit of $36 million to be applied to its MSA payment obligation in April 2014 as a result of the two additional states joining the NPM Adjustment Settlement Term Sheet after the date of the 2013 MSA payment. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Reynolds Tobacco reported that, based on the jurisdictions bound by the NPM Adjustment Settlement Term Sheet, Reynolds Tobacco will receive approximately $1.1 billion as credits with respect to their NPM Adjustment claims for the period from 2003 through 2012, to be applied against annual payments under the MSA over a five-year period, which commenced with the April 2013 MSA payment. In its Form 10-Q for the nine-month period ended September 30, 2013, Lorillard reported that it expects to receive credits over five years of approximately $220 million on its outstanding claims, with $164 million having occurred in April 2013 and the remainder occurring over the following four years.

In addition, as part of the NPM Adjustment Settlement Term Sheet, in April 2013, the 20 Term Sheet Signatories that had signed the Term Sheet by that time received their aggregate Allocable Share of over $4.7 billion from the Disputed Payments Account under the MSA in April 2013.

The NPM Adjustment Settlement Term Sheet provides that the Term Sheet Signatories will allocate the settlement amount for the 2003 NPM Adjustment among themselves (through the application of the credits to PMs or the receipt by the Term Sheet Signatories of amounts released from the Disputed Payments Account, or both) so as to fully compensate those Term Sheet Signatories whose diligent enforcement for 2003 was non-contested.

The NPM Adjustment Settlement Term Sheet also sets forth the terms by which NPM Adjustments for 2013 onward will be determined. For the two-year transition period of sales years 2013¬2014, the revised adjustment for SET-Paid NPM Sales, as described in the next succeeding paragraph, will apply (with certain exceptions). The revised adjustment for Non-SET-Paid NPM Sales, described in the second next succeeding paragraph, will not apply during this transition period. In addition, for each of those years, signatory PM payments will be adjusted based on a comparison of the Market Share Losses (as defined in the MSA) in 2013 or 2014 to the 2011 Market Share Loss. If the Market Share Loss is below the 2011 level, the adjustment is 25%, using the original NPM Adjustment formula. For Market Share Loss above the 2011 level, the adjustment is indexed upwards based on the number of cigarettes above the 2011 Market Share Loss starting at 30% and increasing to 50%.

Beginning in 2013, there will be a state-specific adjustment that applies to sales of SET-paid NPM cigarettes ("**SET-Paid NPM Sales**"). "**SET**" consists of state cigarette excise tax or other state tax on the distribution or sale of cigarettes (other than a state or local sales tax that is applicable to consumer products generally and is not in lieu of an excise tax) and, after 2014, any excise or other tax imposed by a state or federally recognized tribe on the distribution or sale of cigarettes. For SET-Paid NPM Sales of "**non-compliant NPM cigarettes**" (defined in the NPM Adjustment Settlement Term Sheet, with certain exceptions, as any cigarette sale for which escrow is not deposited, either by payment by the NPM or by collection upon a bond), the adjustment of PM payments due from signatory PMs will be three times the per-cigarette escrow deposit rate contained in the Model Statute for the year of the sale, including the inflation adjustment in the statute. There will be a proportional adjustment for each signatory SPM in proportion to the size of its MSA payment for that year. A Term Sheet Signatory will not be subject to this revised adjustment if (i) escrow was deposited on 96% of all NPM cigarettes sold in the Term Sheet Signatory jurisdiction during that year on which SET was paid, or (ii) the number of SET-paid NPM cigarettes sold in the Term Sheet Signatory jurisdiction during that year on which escrow was not deposited did not exceed 2 million cigarettes.

A data clearinghouse that will be established (the "**Data Clearinghouse**") will calculate the total FET-paid NPM volume in the Settling States and nationwide. "**FET**" means the federal excise tax. Beginning in 2015, for non-SET-Paid NPM Sales ("**Non-SET-Paid NPM Sales**"), the total NPM Adjustment liability, if any, of each Term Sheet Signatory for a year would be reduced by a percentage equal to the percentage represented by the fraction of the total SET-paid NPM volume in the Settling States divided by nationwide FET-paid NPM volume for that year.

In addition, the NPM Adjustment Settlement Term Sheet provides that, except in certain cases (primarily, if the dispute was noticed for arbitration by the PM over one year prior to the payment date and the arbitration has not begun despite good faith efforts by the PM), the PMs will not withhold payments or pay into the Disputed Payments Account based on a dispute arising out of the revised NPM Adjustment as set forth in the NPM Adjustment Settlement Term Sheet.

On September 11, 2013, as described above, the Arbitration Panel released its decisions with respect to fifteen of the Term Sheet Non-Signatories (including the State) regarding the 2003 NPM Adjustment. The arbitration process will continue with respect to sales years 2004 through 2012 for the Term Sheet Non-Signatories. The OPMs have previously reported that they continue to reserve all rights regarding the NPM Adjustment with respect to the Term Sheet Non-Signatories and pursue the disputed NPM Adjustments against the Term Sheet Non-

Signatories. Altria has stated in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that, except with respect to the Term Sheet Signatories, and except with respect to the non-contested states in regard to the 2003 NPM Adjustment (which does not include the State), Philip Morris intends to pursue vigorously the disputed NPM Adjustments for sales years 2004 – 2012 against the Term Sheet Non-Signatories (including the State) through the arbitration proceedings described herein. As noted above, proceedings with respect to diligent enforcement claims for the sales years 2004 through 2012 have not yet been scheduled. It is possible that other states (including the State) could enter into settlements with regard to the NPM Adjustments sales years 2004 and beyond.

Disputes Concerning the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award

Several states (including the State) have disputed the NPM Adjustment Settlement Term Sheet and Stipulated Partial Settlement and Award. On March 13, 2013, the Office of the Attorney General of the State of Illinois sent a letter, on behalf of itself and 23 other Term Sheet Non-Signatories, including the State (to which letter several additional Term Sheet Non-Signatories later joined), to the MSA Auditor, affirming their position that the arbitration panel lacked jurisdiction and that the NPM Adjustment Stipulated Partial Settlement and Award was inconsistent with the terms of the MSA, and informing the MSA Auditor that they object to and will contest any action by the MSA Auditor to release funds from the Disputed Payments Account or to reallocate the 2003 NPM Adjustment under the terms of the NPM Adjustment Stipulated Partial Settlement and Award.

Motions are pending in a number of Term Sheet Non-Signatory states including Colorado (*State v. R.J. Reynolds Tobacco Co.,* Case No 1997CV3432), Connecticut (*State v. Philip Morris Inc.*, UWY-CV-96-0148414-S), Maryland (*State v. Philip Morris Inc.*, Case No. 24C96122017), Massachusetts (*Commonwealth of Massachusetts v. Philip Morris*, No. 95-7378), New York (*State v. Philip Morris*, 400361/1997), Ohio (*State v. R.J. Reynolds Tobacco Co.*, Case No. 97CVH-05-5114), Pennsylvania (*Commonwealth of Pennsylvania v. Philip Morris, Inc.*, No. 2443), and South Carolina (*State v. Brown & Williamson Tobacco Corp.*, 97CP4001686) to vacate and/or modify the NPM Adjustment Stipulated Partial Settlement and Award. Connecticut and South Carolina subsequently became Term Sheet Signatories in May 2013. In addition, two states, Colorado (*State v. R.J. Reynolds Tobacco Co.*, Case No 1997CV3432) and Ohio (*State v. R.J. Reynolds Tobacco Co.*, Case No. 97CVH-05-5114) filed for preliminary injunctions. These motions for preliminary injunctions against the implementation of the NPM Adjustment Stipulated Partial Settlement and Award in connection with the April 2013 MSA payment were denied, and the MSA Auditor carried out such implementation over the objections of the Term Sheet Non-Signatories. The outcomes of the pending claims filed by the Term Sheet Non-Signatories cannot be predicted. No assurance can be given that other challenges to the NPM Adjustment Stipulated Partial Settlement and Award will not be commenced in other MSA courts.

No assurance can be given as to the impact or the magnitude of the effect of the NPM Adjustment Stipulated Partial Settlement and Award on Term Sheet Non-Signatories such as the State, as to whether or not the NPM Adjustment Stipulated Partial Settlement and Award will be revised or reversed and any consequences thereto, or as to any final settlement or resolution of disputes concerning the NPM Adjustment Stipulated Partial Settlement and Award and the effect of such factors on the amount and/or timing of Pledged Settlement Payments available to the Corporation to pay debt service on the Series 2013 Bonds.

Disputed or Recalculated Payments and Other Disputes under the Terms of the MSA

Disputes concerning Annual Payments and Strategic Contribution Fund Payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments or Strategic Contribution Fund Payments. The diversion of disputed payments to the Disputed Payments Account, the withholding of all or a portion of any disputed amounts or the application of offsets against future payments could also have a material adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Corporation. Furthermore, miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "—NPM Adjustment", have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. Amounts held in the Disputed Payments Account could be released to those Settling States which, in the future, are found to have diligently enforced their Qualifying Statutes, or pursuant to a settlement of the disputes among the Settling States and the PMs. The models used in the Collection Methodology and Assumptions and debt service coverage tables for the Series 2013 Bonds do not factor in an offset for miscalculated or disputed payments or any release of funds currently held in the Disputed Payments Account other than pursuant to the NPM Adjustment Stipulated Partial Settlement and Award. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Adjustments to Payments—Offset for Miscalculated or Disputed Payments," "—Potential Payment Decreases Under the Terms of the MSA—*NPM Adjustment—Application of the NPM Adjustment*" and "SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS."

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

For a discussion of litigation presenting challenges to the MSA and Settling States' Qualifying Statutes and Complementary Legislation, see "—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" above.

Other Disputes Related to MSA Payments

Certain PMs were in dispute regarding (i) whether a "roll-your-own" tobacco conversion of 0.0325 ounces for one individual cigarette should be used for purposes of calculating the downward Volume Adjustments to the MSA payments (as is currently the case), or, rather, a 0.09 ounce conversion; and (ii) whether the total domestic cigarette market and certain other calculations related to the PMs' MSA payments should be determined based on the "net" number of cigarettes on which federal excise tax is paid (as is currently the case), or, rather, the "adjusted gross" number of cigarettes.

In the "roll-your-own" dispute, the PMs contended that the 0.09 ounce conversion should be used, whereas the Settling States contended that the 0.0325 ounce conversion is required under the MSA. Altria, Philip Morris's parent company, had reported in its SEC filings that it believes that, for the years 2004-2012, the use of the 0.0325 ounce conversion method resulted in excess MSA payments by Philip Morris in those years of approximately $92 million in the aggregate. In the "net vs. gross" dispute, PMs contended that the MSA requires calculations based on a gross approach, while the Settling States contend that a net approach is required by the MSA.

Forty-three jurisdictions (including the State) entered into arbitration involving these two disputes. In an award dated January 21, 2013, the Arbitration Panel held that (i) the MSA Auditor is to use the market share for Liggett Group LLC (an SPM) on a net basis, but increase that calculation by a specified factor to avoid unfairness given the gross basis used for Liggett Group LLC in the MSA Auditor's March 30, 2000 calculation, and (ii) the MSA Auditor is to use the 0.0325 ounce conversion method for purposes of roll-your-own tobacco. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that it is unclear precisely which past and future MSA payments may be affected by this ruling.

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 Fund Payments (prior to adjustments). The allocation of the State's Share of the Annual Payments to be made pursuant to the MSA to the State, the City and the 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 Fund Payments.

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. State-Specific Finality for the State occurred on February 25, 2000.

SUMMARY OF THE IHS GLOBAL REPORT

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

Global Report forecasts future United States domestic cigarette consumption. The MSA payments are based in part on cigarettes shipped in and to the United States. Cigarette shipments and cigarette consumption may not match as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

General

IHS Global Inc. ("**IHS Global**"), formerly known as DRI•WEFA, Inc., has prepared a report dated December 5, 2013 on the consumption of cigarettes in the United States from 2013 through 2022 entitled, "*A Forecast of U.S. Cigarette Consumption (2013-2022) for the Tobacco Settlement Financing Corporation"* ("**IHS Global Report**"). IHS Global is an internationally recognized econometric and consulting firm of over 325 economists in more than 30 countries. IHS Global is a privately held company, which is a provider of financial, economic and market research information.

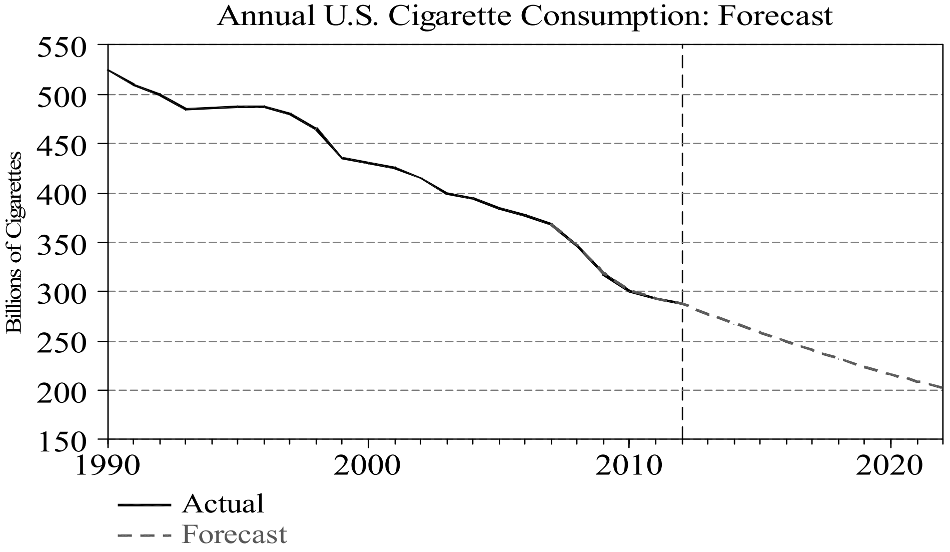
IHS Global has developed a cigarette consumption model based on historical United States data between 1965 and 2012. IHS Global constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, the level of real disposable income per capita, the impact of workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences), IHS Global employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.4% per year holding other recognized significant factors constant.

IHS Global's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2013 through 2022 (the "**IHS Global Forecast**"). The IHS Global Forecast indicates that the total United States cigarette consumption in 2022 will be 203 billion cigarettes (approximately 10 billion packs), or 204 billion including roll-your-own tobacco equivalents, a 30% decline from the 2012 level. Coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%. The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline for that year (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette), 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012. From 2012 through 2022 the average annual rate of decline is projected to be 3.4%. Total consumption of cigarettes in the United States is projected to fall from 290 billion in 2012 to 279 billion in 2013, 270 billion in 2014, and to 204 billion by 2022, as set forth in the following table. The IHS Global Report states that IHS Global believes the assumptions on which the IHS Global Forecast is based are reasonable.

IHS Global Forecast of Cigarette Consumption

Year	Consumption including Roll-Your-Own (billions)	Year	Consumption including Roll-Your-Own (billions)
2009	325.0	2016	251.4
2010	304.1	2017	242.4
2011	296.0	2018	233.8
2012	290.1	2019	225.6
2013	279.3	2020	218.0
2014	269.8	2021	210.9
2015	260.5	2022	204.2

The graph below illustrates total actual and projected cigarette consumption in the United States:



Comparison with Prior IHS Global Forecasts

In March 2008 IHS Global (then DRI.WEFA) presented a similar study, "*A Forecast of U.S. Cigarette Consumption (2008-2023) for the Tobacco Settlement Financing Corporation*." The current forecast differs from IHS Global's forecast in 2008. In the 2008 study, IHS Global projected consumption in 2022 of 278 billion cigarettes, reflecting an average decline rate of 1.85%. The current forecast projects an average decline rate of 3.4% through 2022, to an annual consumption level of 202.7 billion sticks (not including roll-your-own equivalents) in 2022. The new forecast was developed with consideration of the higher than projected cigarette consumption in 2011 and 2012, as well as a weaker than projected economic environment in 2013.

There was a confluence of factors which led to the dramatically reduced consumption through 2009, which was unanticipated in IHS Global projections in 2008. First, indoor smoking bans spread rapidly across the country in the latter half of the decade, and their impact on smoking and cigarette consumption proved to be larger than anticipated in 2008. IHS Global now estimates that their impact on decreased smoking and cigarette consumption was approximately 6 billion sticks in 2009. Second, the latter months of 2008 saw a very deep recession. IHS Global's model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion sticks. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009, decreased cigarette demand by about 10 billion in 2009 according to IHS Global's model of price elasticity. Fourth, the acceleration of state excise tax increases, prompted by the recession, similarly reduced consumption by a further 4 billion.

Over the longer term, IHS Global's model now includes new estimates of the negative impact of indoor smoking bans, which IHS Global anticipates will ultimately be enacted in all states. For instance, in 2011, legislation to establish indoor bans in Texas and Louisiana made significant advances before being defeated. IHS Global also assumes that more stringent restrictions on smoking will continue to be enacted, including their gradual extension to outdoor public places, as well as to private indoor residential spaces such as multi-family housing.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco, Firearms and Explosives) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980s, 1990s and 2000s, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2003 and 290 billion in 2012. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

The following table sets forth United States domestic cigarette consumption for the fifteen years ended December 31, 2012. The data in this table vary from statistics on cigarette shipments in the United States. While the IHS Global Report is based on consumption, payments made under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31	Consumption (Billions of Cigarettes)	Percentage Change
2012	288*	-1.87%
2011	293	-2.48
2010	301	-5.62
2009	319	-8.08
2008	348	-4.35
2007	368	-2.28
2006	377	-1.93
2005	384	-2.69
2004	395	-1.28
2003	400	-3.66
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

*290 with roll-your-own equivalents

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trend over time, (vi) workplace smoking bans, (vii) smoking bans in public places, (viii) nicotine dependence and (ix) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to be incorporated into current levels of consumption. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by IHS Global, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. IHS Global's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables, which are difficult to quantify.

SUMMARY OF SERIES A AND SERIES B PLEDGED SETTLEMENT PAYMENTS METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to calculate projections of the amount of Series A Pledged Settlement Payments and Series B Pledged Settlement Payments to be received by the Corporation (the "**Cash Flow Assumptions**"), as well as the methodology and assumptions used to structure the Series 2013 Bonds (the "**Structuring Assumptions**").

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2013 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow Assumptions, including the market share of the PMs, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Cash Flow Assumptions, the amount of Series A Pledged Settlement Payments and Series B Pledged Settlement Payments available to the Corporation to pay the principal of and interest on the Series 2013 Bonds could be adversely affected. See "BONDHOLDERS' RISKS" herein.

Cash Flow Assumptions

In projecting the amount of Series A Pledged Settlement Payments and Series B Pledged Settlement Payments to be received by the Corporation, the forecast of cigarette consumption in the United States developed by IHS Global as described in the IHS Global Report is applied to calculate Annual Payments and Strategic Contribution Fund 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. It was assumed that the PMs make all payments required to be made by them pursuant to the MSA, that the market share of the OPMs remains constant throughout the forecast period at 84.62051% based on sales year 2012 OPM cigarette shipments of 245,486,000,000 divided by total net market cigarette shipments of 290,102,238,941 as reported by NAAG (each measuring roll-your-own shipments at 0.0325 ounces per cigarette conversion rate) and the market share of the SPMs remains constant at 9.11% based on the NAAG reported market share for SPMs in sales year 2012 (measuring roll-your-own shipments at 0.09 ounces per cigarette conversion rate).[†] It was further assumed that each company that is currently a PM remains such throughout the term of the Series A Bonds and the Series B Bonds.

[†] The aggregate market share information utilized in the Cash Flow Assumptions may differ materially from the market share information utilized by the MSA Auditor in calculating adjustments to Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT-Adjustments to Payments."

In applying the consumption forecast from the IHS Global Report, it was assumed that United States consumption, which was forecasted by IHS Global, 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 IHS Global Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. IHS Global's forecast for United States cigarette consumption is set forth herein under "SUMMARY OF THE IHS GLOBAL REPORT." See APPENDIX F for a copy of the IHS Global Report.

Annual Payments and Strategic Contribution Fund Payments

In accordance with the Cash Flow Assumptions, the amount of Annual Payments and Strategic Contribution Fund Payments to be made by the PMs was calculated by applying the adjustments applicable to the Annual Payments and Strategic Contribution Fund 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 and Strategic Contribution Fund Payments set forth in the MSA. The inflation rate is compounded annually at the greater of 3.0% or the percentage increase in the CPI in the prior year as published by the Bureau of Labor Statistics (released each January). The calculations of Annual Payments and Strategic Contribution Fund Payments assume the minimum Inflation Adjustment provided in the MSA of 3.0% in every year except for calendar years 2000, 2004, 2005 and 2007, where actual CPI results of 3.387%, 3.256%, 3.416% and 4.081% respectively, were used. Thereafter, the Inflation Adjustment was assumed to be the minimum provided in the MSA, at a rate of 3.0% 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 forecast contained in the IHS Global Report for United States cigarette consumption to the OPM shipments as reported to MSAI. No add back or benefit was assumed from any Income Adjustment. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

Previously-Settled States Reduction. Next, with respect to the Annual Payments only, 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:

2013 through 2017	12.2373756%
2018 and after	11.0666667%

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

NPM Adjustment. Pursuant to the MSA, the NPM Adjustment will not apply to the Annual Payments and Strategic Contribution Fund Payments payable to any state that enacts and diligently enforces a Qualifying Statute so long as such statute is not held to be unenforceable. The PMs have disputed Annual Payments attributable to sales years 2003 through 2012 and Strategic Contribution Fund Payments attributable to sales years 2007 through 2012 and a portion of such payments have either been withheld or deposited in the Disputed Payments Account in each year since 2006. The Cash Flow Assumptions assume that the State has diligently enforced and will diligently enforce a Qualifying Statute that is not held to be unenforceable. Therefore, the NPM Adjustment is assumed not to reduce Annual Payments and Strategic Contribution Fund Payments throughout the period forecasted in the IHS Global Report. For a discussion of the State Model Statute, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Relating to Model/Qualifying Statutes."

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

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

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

Subsequent Participating Manufacturers. The Cash Flow Assumptions assume that the Market Share (as defined in the MSA) of the SPMs remains constant at 9.11% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate). Because the 9.11% Market Share exceeds the greater of (i) the SPM's 1998 Market Share or (ii) 125% of its 1997 Market Share, the SPMs are assumed to make Annual Payments and Strategic Contribution Fund Payments in each year. For purposes of calculating amounts owed by the SPMs under Section IX(i) of the MSA, relative market share is equal to (y) the SPM Market Share (9.11%) less the Base Share (3.53929%) divided by (z) the aggregate Market Share of the OPMs at 84.81% (measuring roll your own cigarettes at 0.09 ounces per cigarette conversion rate).

State's Share of Annual Payments. 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' 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. Series A Pledged Settlement Payments and Series B Pledged Settlement Payments each include fifty percent (50%) of the State's Share of the Annual Payments.

State's Share of Strategic Contribution Fund Payments. The amount of Strategic Contribution Fund 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 Fund 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 Fund Payments (which represents 5.4873402% of the Strategic Contribution Fund Payments under the MSA) to the State and 0% of the Strategic Contribution Fund Payments to the City of New York and all other counties located within the State. Series A Pledged Settlement Payments and Series B Pledged Settlement Payments each include fifty percent (50%) of the State's Share of the Strategic Contribution Fund Payments.

The following tables show the projection of Annual Payments and Strategic Contribution Fund Payments to be received by the Trustee through the year 2022, calculated in accordance with the Cash Flow Assumptions.

Projection of Annual Payments to be Received by Trustees[1]

Year	IHS Global Forecast of Cigarette Consumption	Estimated OPM Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Total Adjusted Annual Payments By OPMs	State's Allocation	OPM Annual Payments to State	Pledged Settlement Payments Allocation[2]	OPM Annual Payments to Trustees	SPM Annual Payments to Trustees	Total Annual Payments to Trustees
2013	279,295,119,986	236,340,954,937											
2014	269,774,433,914	228,284,501,828	$8,139,000,000	$4,806,475,055	$ (6,382,944,833)	$ (803,081,472)	$5,759,448,751	6.5310970%	$376,155,184	50.00%	$188,077,592	$14,076,379	$202,153,970
2015	260,485,395,316	220,424,069,992	8,139,000,000	5,194,839,649	(6,795,759,230)	(800,089,458)	5,737,990,961	6.5310970%	374,753,755	50.00%	187,376,877	14,023,935	201,400,812
2016	251,427,399,649	212,759,147,863	8,139,000,000	5,594,855,221	(7,222,051,245)	(796,873,911)	5,714,930,065	6.5310970%	373,247,625	50.00%	186,623,813	13,967,573	200,591,385
2017	242,414,080,963	205,132,031,623	8,139,000,000	6,006,870,935	(7,662,106,313)	(793,442,630)	5,690,321,991	6.5310970%	371,640,448	50.00%	185,820,224	13,907,429	199,727,653
2018	233,769,158,815	197,816,654,412	9,000,000,000	7,111,589,400	(8,980,018,499)	(789,227,182)	6,342,343,719	6.5310970%	414,224,619	50.00%	207,112,310	15,296,949	222,409,259
2019	225,599,306,356	190,903,283,595	9,000,000,000	7,594,937,100	(9,499,537,344)	(785,224,242)	6,310,175,514	6.5310970%	412,123,683	50.00%	206,061,841	15,219,364	221,281,205
2020	218,018,103,255	184,488,030,866	9,000,000,000	8,092,785,600	(10,027,988,269)	(781,837,574)	6,282,959,758	6.5310970%	410,346,195	50.00%	205,173,098	15,153,723	220,326,820
2021	210,863,510,392	178,433,777,897	9,000,000,000	8,605,569,600	(10,561,528,472)	(779,540,554)	6,264,500,574	6.5310970%	409,140,608	50.00%	204,570,304	15,109,201	219,679,505
2022	204,239,555,591	172,828,553,563	9,000,000,000	9,133,736,400	(11,104,568,090)	(777,894,629)	6,251,273,682	6.5310970%	408,276,747	50.00%	204,138,373	15,077,300	219,215,673

[1] MSA payment amounts are calculated based on the IHS Global Forecast of cigarette consumption for the prior year.

[2] The Series A Bonds and the Series B Bonds are each pledged 50% of the State’s Pledged Settlement Payments.

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

			Strategic Contribution Fund Payments									Total Payments		
Year	IHS Global Consumption Forecast	Estimated OPM Consumption	Base Strategic Contribution Payments	Inflation Adjustment	Volume Adjustment	Total Adjusted Strategic Contribution Fund Payments by OPMS	State's Allocation	OPM Strategic Contribution Fund Payments to State	Pledged Settlement Payments Allocation[2]	OPM Strategic Contribution Fund Payments to Trustees	SPM Strategic Contribution Fund Payments to Trustees	Total Annual Payments to Trustees	Total Strategic Contribution Fund Payments to Trustees	Total Payments to Trustees
2013	279,295,119,986	236,340,954,937												
2014	269,774,433,914	228,284,501,828	$861,000,000	508,462,345	$(675,232,277)	$694,230,068	5.4873402%	$38,094,766	50.00%	$19,047,383	$1,251,120	$202,153,970	$20,298,502	$222,452,473
2015	260,485,395,316	220,424,069,992	861,000,000	549,546,251	(718,902,654)	691,643,598	5.4873402%	37,952,837	50.00%	18,976,419	1,246,458	201,400,812	20,222,877	221,623,689
2016	251,427,399,649	212,759,147,863	861,000,000	591,862,679	(763,998,786)	688,863,893	5.4873402%	37,800,305	50.00%	18,900,153	1,241,449	200,591,385	20,141,601	220,732,987
2017	242,414,080,963	205,132,031,623	861,000,000	635,448,566	(810,550,871)	685,897,695	5.4873402%	37,637,540	50.00%	18,818,770	1,236,103	199,727,653	20,054,873	219,782,527
2018	233,769,158,815	197,816,654,412	-	-	-	-	5.4873402%	-	50.00%	-	-	222,409,259	-	222,409,259
2019	225,599,306,356	190,903,283,595	-	-	-	-	5.4873402%	-	50.00%	-	-	221,281,205	-	221,281,205
2020	218,018,103,255	184,488,030,866	-	-	-	-	5.4873402%	-	50.00%	-	-	220,326,820	-	220,326,820
2021	210,863,510,392	178,433,777,897	-	-	-	-	5.4873402%	-	50.00%	-	-	219,679,505	-	219,679,505
2022	204,239,555,591	172,828,553,563	-	-	-	-	5.4873402%	-	50.00%	-	-	219,215,673	-	219,215,673

[1] MSA payment amounts are calculated based on the IHS Global Forecast of cigarette consumption for the prior year.

[2] The Series A Bonds and the Series B Bonds are each pledged 50% of the State's Pledged Settlement Payments.

Interest Earnings

The Cash Flow Assumptions assume that each of the Series A Trustee and the Series B Trustee will receive ten days after April 15 its respective entitlement of the Annual Payments owed by the PMs in 2014 and each year thereafter. It is further assumed each of the Series A Trustee and the Series B Trustee will receive ten days after April 15 its respective entitlement of the Strategic Contribution Fund Payments owed by the PMs in the years 2014 through 2017. Earnings are assumed at 0% per annum on the Annual Payments and Strategic Contribution Fund Payments from the date of receipt by the Trustee until the applicable Distribution Date. No interest earnings have been assumed on the Annual Payments and Strategic Contribution Fund Payments prior to the time they are received by the applicable Trustee.

Moneys deposited in the Series A Debt Service Reserve Account and Series B Debt Service Reserve Account are assumed to be invested at rates increasing from 0.03% per annum for the first year to 0.75% per annum in the sixth year and thereafter except for $56,886,393 of the Series A Debt Service Reserve Account which is invested in a guaranteed investment contract at a rate of 3.813% per annum.

Structuring Assumptions

The Structuring Assumptions for the Series 2013 Bonds and the IHS Global Report were applied to the projections of Pledged Settlement Payments described above. See "SUMMARY OF THE IHS GLOBAL REPORT" and APPENDIX F.

The Structuring Assumptions are described below:

Issue Size. The objective in issuing the Series 2013 Bonds is to receive proceeds in an amount sufficient to: (i) refund (a) the Series 2003A-1C Refunded Bonds in the aggregate principal amount of $700,220,000 and (b) the Series 2003B-1C Refunded Bonds, in the aggregate principal amount of $603,265,000, and (ii) pay the costs of issuance incurred in connection with the issuance of the Series 2013 Bonds.

Debt Service Reserve Account. The Series A Debt Service Reserve Account was established with an initial deposit of $227,545,572 and must be maintained, to the extent of available funds, at that level. The Series B Debt Service Reserve Account was established with an initial deposit of $221,582,343.75 and must be maintained, to the extent of available funds, at that level.

Operating Expense Assumptions. Operating expenses of the Corporation have been assumed at the Series A Operating Cap of $703,947 in 2014 inflated at 3.00% per year thereafter. No arbitrage rebate expense was assumed. No Junior Payments have been assumed. Operating expenses of the Corporation have been assumed at the Series B Operating Cap of $683,443 in 2014 inflated at 3.00% per year thereafter. No arbitrage rebate expense was assumed. No Junior Payments have been assumed.

Issuance Date. The Series 2013 Bonds were assumed to be issued on December 12, 2013.

Interest Rates. The Bonds were assumed to bear interest at the rates set forth on the inside front cover hereof.

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2013 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow 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 Cash Flow Assumptions or Structuring Assumptions, the amount of Series A Pledged Settlement Payments and Series B Pledged Settlement Payments available to the Corporation to pay the principal of and interest on the Series 2013A Bonds and the Series 2013B Bonds, respectively, 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 respective Series 2013 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 a separate undertaking with respect to each Series of the Series 2013 Bonds (the "**Corporation Undertaking**" and the "**State Undertaking**", respectively, and each an "**Undertaking**") with the Trustee pursuant to which the Obligated Party will covenant for the sole benefit of the Holders of the applicable Series of the Series 2013 Bonds to provide the Corporation Annual Information or the State Annual Information, as applicable, to the Municipal Securities Rulemaking Board (the "**MSRB**"), through its Electronic Municipal Market Access System ("**EMMA**").

The Corporation has made timely filings of the Corporation Annual Information in each year except with respect to the fiscal year ended October 31, 2009 when it made a late filing of the required information. Also, on April 5, 2010, Fitch recalibrated the ratings on certain bonds that carried Fitch ratings. As part of that recalibration, Fitch upgraded state appropriation-backed debt of the State, including bonds issued by the Corporation in 2003. The rating change was not noted in the recalibration release by Fitch. The Corporation was not notified as to any such rating change, but the ratings on the Series 2003 Bonds were revised from "A+" to "AA-." The Corporation did not file notice of the rating change in a timely manner. On December 3, 2013, the Corporation filed a notice on EMMA noting the rating change, and stating that the Corporation did not timely file notice of the rating change. The Corporation has established procedures to ensure that future filings of continuing disclosure information will be in compliance with existing continuing disclosure obligations, including transmitting such filings to EMMA. Aside from the foregoing, the Corporation is in compliance with all existing continuing disclosure agreements. During the previous five years, the State has complied, in all material respects, with its continuing disclosure undertakings.

"Corporation Annual Information" means (A) the audited financial statements, if available, or if not available, unaudited financial statements, of the Corporation, prepared in accordance with generally accepted accounting principles in effect from time to time ("**GAAP**"), (B) financial information or operating data of the type included in this Official Statement under "TABLE OF PROJECTED PLEDGED SETTLEMENT PAYMENTS AND DEBT SERVICE"; and (C) information regarding amendments to the applicable Corporation Undertaking with respect to financial statements, financial information or operating data; together with (D) any additional information pursuant to a supplement to the applicable Corporation Undertaking.

"Listed Event" means any of the following with respect to the applicable Series of the Series 2013 Bonds:

(A) principal and interest payment delinquencies;

(B) non-payment related defaults, if material;

(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, the issuance by the Internal Revenue Service of proposed or final determinations of taxability, Notices of Proposed Issue (IRS Form 5701-TEB) or other material notices or determinations with respect to the tax status of the applicable Series of the Series 2013 Bonds, or other material events affecting the tax status of the applicable Series of the Series 2013 Bonds;

(G) modifications to rights of holders of the applicable Series of the Series 2013 Bonds, if material;

(H) calls, if material, and tender offers of the applicable Series of the Series 2013 Bonds;

(I) defeasances;

(J) release, substitution, or sale of property securing repayment of the applicable Series of the Series 2013 Bonds, if material;

(K) rating changes;

(L) bankruptcy, insolvency, receivership or similar event of the Corporation;

(M) the consummation of a merger, consolidation, or acquisition involving the Corporation or the sale of all or substantially all of the assets of the Corporation, other than in the ordinary course of business, the entry into a definitive agreement to undertake such an action or the termination of a definitive agreement relating to any such actions, other than pursuant to its terms, if material; and

(N) appointment of a successor or additional trustee or the change of name of a trustee, if material.

"MSRB" means the Municipal Securities Rulemaking Board established pursuant to Section 15B(b)(1) of the Securities Exchange Act of 1934, as amended and any successor thereto or to the function of the MSRB contemplated by each Undertaking.

"State Annual Information" means financial information and operating data of the type included in this Official Statement under "HISTORY OF APPROPRIATIONS" (under the headings State Debt Service Appropriation and Date of State Appropriation) and in the Annual Information Statement of the State set forth in APPENDIX B hereto, under the headings or sub-headings "Prior Fiscal Years," "Capital Program and Financing Plan," "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 then-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 concerning, and in judging the financial condition of, the State.

"**Subject Bonds**" means the Series 2013A Bonds and any Bonds issued in the future under the Series A Indenture or the Series 2013B Bonds and any Bonds issued in the future under the Series B Indenture, as applicable, and made expressly applicable to the applicable Undertaking.

Corporation Undertaking

Obligations of the Corporation. The Corporation will provide, (a) by no later than 180 days after the end of each fiscal year, commencing with the fiscal year ending October 31, 2013, the Corporation Annual Information with respect to such fiscal year to the MSRB, and copies of such Corporation Annual Information concurrently to the Trustee and (b) prompt notice of any change in its fiscal year and, in a timely manner, notice of any failure by it to provide the Corporation Annual Information to the MSRB by the date required. If not provided as part of the Corporation Annual Information by the date specified above, the Corporation will provide audited financial statements, when and if available, to the MSRB. In addition, the Corporation will provide to the MSRB, in a timely manner not in excess of ten business days after the occurrence of the event, notice of any of the Listed Events with respect to any outstanding Subject Bonds.

The Corporation will, for each Distribution Date, cause to be provided to the MSRB information as to the aggregate principal amount that has been applied to the defeasance, purchase or optional redemption of the Bonds, pursuant to either the Series A Indenture or the Series B 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 the applicable Series of the outstanding Subject Bonds, or by the Trustee on behalf of the Holders of the applicable Series of the outstanding Subject 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 the applicable Series of the outstanding Subject Bonds or by any Beneficial Owner thereof. A Beneficial Owner may not take any enforcement action pursuant to clause (ii) without the consent of the respective Holders of not less than 25% in aggregate principal amount of the applicable Series of the Subject Bonds at the time outstanding. The Trustee is not required to take any enforcement action except at the direction of the respective Holders of not less than 25% in aggregate principal amount of the applicable Series of the Subject Bonds, at the time outstanding that will 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 each Corporation Undertaking. Any failure by the Corporation or the Trustee to perform in accordance with the terms of each Corporation Undertaking will not constitute a default or any Event of Default under the Series A Indenture or Series B Indenture, as applicable, and the rights and remedies provided by the Series A Indenture and the Series B Indenture, as applicable, upon the occurrence of a default or an Event of Default will not apply to any such failure.

Amendments. Each 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 of the applicable Series of the Subject Bonds, 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) each 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 the applicable Series of the Subject 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 legal counsel expert in federal securities laws, 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 such Corporation Undertaking pursuant to the same procedures as are required for amendments to the Series A Indenture and the Series B Indenture, as applicable, with consent of Holders, and (5) the Corporation shall have delivered copies of such amendment or waiver to the MSRB.

In addition, the Corporation and the Trustee may amend a Corporation Undertaking, and any provision thereof may be waived, if the Trustee receives an opinion of legal counsel expert in federal securities laws, 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 of such Corporation Undertaking 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 a Corporation Undertaking with respect to Subject Bonds will terminate upon the legal defeasance pursuant to the Series A Indenture or the Series B

Indenture, as applicable, prior redemption, or payment in full of all of the applicable Series of the Subject Bonds. The Corporation shall give notice of any such termination to the MSRB.

The Corporation Undertaking, or any provision thereof, will be null and void to the extent set forth in the opinion of legal counsel expert in federal securities laws described in clause (1) in the event that the Corporation (1) delivers to the Trustee an opinion of legal counsel expert in federal securities laws, addressed to the Corporation and the Trustee, to the effect that those portions of the Rule which require the provisions of the applicable Corporation Undertaking, or any of such provisions, do not or no longer apply to any or all of the applicable Series of the Bonds, whether because such portions of the Rule are invalid, have been repealed, or otherwise, as specified in such opinion, and (2) delivers notice to such effect to the MSRB.

State Undertaking

Obligations of the State. The State is required to electronically file with the MSRB, by no later than 120 days after the end of each fiscal year, commencing with the fiscal year ending March 31, 2014 (a) the State Annual Information with respect to such fiscal year and (b) audited financial statements of the State for such fiscal year or, if not then available, unaudited financial statements, followed by audited financial statements when available. In addition, the State will file with the MSRB in a timely manner, notice of a failure by the State to comply with such disclosure requirements. The State and the Trustee will also notify the Corporation and the Trustee (unless such notice is from the Trustee) upon the occurrence of any of the Listed Events promptly upon becoming aware of the occurrence of any such event.

Enforcement. The sole and exclusive remedy for breach of a 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 a State Undertaking (i) in the case of enforcement of its obligations to provide information required thereunder, by any Holder of Outstanding Series 2013 Bonds of the applicable Series or by the Trustee on behalf of the Holders of Outstanding Series 2013 Bonds of the applicable Series or (ii) in the case of challenges to the adequacy of the information provided, by the Trustee on behalf of the Holders of Outstanding Series 2013 Bonds of the applicable Series; provided, however, that the Trustee will not be required to take any enforcement action except at the direction of the respective Holders of not less than 25% in aggregate principal amount of the Series 2013A Bonds or the Series 2013B Bonds, as applicable, at the time Outstanding. Failure by the State to perform its obligations under the State Undertaking will not constitute an Event of Default under the Series A Indenture or the Series B Indenture or any other agreement executed and delivered in connection with the issuance of the Series 2013 Bonds of the applicable Series.

Amendments. Without the consent of any Holders of Series 2013 Bonds of the applicable Series, the State and the Trustee at any time and from time to time may amend the applicable State Undertaking for any of the following purposes: (i) to comply with or conform to any changes in the Rule or any formal authoritative interpretations thereof by the Securities and Exchange Commission or its staff (whether required or optional), which are applicable to the applicable 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 or the Trustee, and the assumption by any such successor of the covenants of the State or the Trustee under the applicable State Undertaking; (iv) to add to the covenants of the State for the benefit of the Holders of the Series 2013 Bonds of the applicable Series, or to surrender any right or power therein conferred upon the State or the Corporation; (v) for any purposes for which, and subject to the conditions pursuant to which, amendments may be made under the Rule, 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 applicable 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 applicable State Undertaking, as amended, would have complied with the requirements of the Rule at the time of the primary offering of the Series 2013 Bonds of the applicable Series, after taking into account any amendments, or formal authoritative interpretations by the Securities and Exchange Commission of the Rule 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 Series 2013 Bonds of the applicable Series will have been paid in full or such Bonds shall have been defeased pursuant to the Series A Indenture and the Series B Indenture, as applicable; provided, however, that if the Rule (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 the Rule (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 applicable Series of Series 2013 Bonds, then the information required to be provided thereunder, insofar as it was required to be provided by a provision of the Rule so declared, will no longer be required to be provided thereunder.

LITIGATION

There is no litigation pending or, to the best knowledge of the Corporation, threatened in any court (either in State or federal court) to restrain or enjoin the issuance or delivery of the Series 2013 Bonds or questioning the creation, organization or existence of the Corporation, the validity or enforceability of the Act, the Series A Sale Agreement, the Series B Sale Agreement, the Series A Indenture, the Series B Indenture, the Series A Contract, the Series B Contract, the sale of each of the Series A Pledged Settlement Payments and the Series B Pledged Settlement Payments by the State to the Corporation, the proceedings for the authorization, execution, authentication and delivery of the Series 2013 Bonds or the validity of the Series 2013 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 G- CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY."

TAX MATTERS

Opinion of Bond Counsel and Co-Bond. In the opinion of Hawkins Delafield & Wood LLP, Bond Counsel to the Corporation, and D. Seaton and Associates, Co-Bond Counsel to the Corporation, under existing statutes and court decisions and assuming continuing compliance with certain tax covenants described herein (i) interest on the Series 2013 Bonds is excluded from gross income for Federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2013 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 their opinions, Bond Counsel and Co-Bond Counsel have relied on certain representations, certifications of fact, and statements of reasonable expectations made by the Corporation and the State in connection with the Series 2013 Bonds, and Bond Counsel and Co-Bond Counsel have 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 2013 Bonds from gross income under Section 103 of the Code.

In addition, in the opinion of Bond Counsel and Co-Bond Counsel, under existing statutes, interest on the Series 2013 Bonds is exempt from personal income taxes imposed by the State of New York or any political subdivisions thereof, including The City of New York.

Bond Counsel and Co-Bond Counsel express no opinion regarding any other Federal or state tax consequences with respect to the Series 2013 Bonds. Bond Counsel and Co-Bond Counsel render their opinions under existing statutes and court decisions as of the issue date, and assume no obligation to update, revise or supplement its opinions to reflect any action hereafter taken or not taken, or any facts or circumstances that may hereafter come to their attention, or changes in law or in interpretations thereof that may hereafter occur, or for any other reason. Bond Counsel and Co-Bond Counsel express 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 2013 Bonds, or under state and 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 2013 Bonds in order that interest on the Series 2013 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 2013 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 2013 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 Series A Indenture and the Series B Indenture, and the State has covenanted in the Series A Sales Agreement and the Series B Sales Agreement to comply with certain applicable requirements of the Code to assure the exclusion of interest on the Series 2013 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 2013 Bonds. It does not purport to address all aspects of Federal taxation that may be relevant to a particular owner of a Series 2013 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 2013 Bonds.

Prospective owners of the Series 2013 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 and Railroad Retirement benefits, individuals otherwise eligible for the earned income tax credit, and 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 2013 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 2013 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 2013 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 2013 Bonds is expected to be the initial public offering price set forth on the inside front cover page of this Official Statement. Bond Counsel and Co-Bond Counsel further are of the opinion that, for any Series 2013 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 2013 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 2013 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 2013 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 2013 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 (in certain cases involving a Premium Bond callable prior to its stated maturity date, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). 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.

Information Reporting and Backup Withholding. Information reporting requirements apply to interest paid on tax-exempt obligations, including the Series 2013 Bonds. In general, such requirements are satisfied if the interest recipient completes, and provides the payor with, a Form W-9, "Request for Taxpayer Identification Number and Certification," or if the recipient is one of a limited class of exempt recipients. A recipient not otherwise exempt from information reporting who fails to satisfy the information reporting requirements will be subject to "backup withholding," which means that the payor is required to deduct and withhold a tax from the interest payment, calculated in the manner set forth in the Code. For the foregoing purpose, a "payor" generally refers to the person or entity from whom a recipient receives its payments of interest or who collects such payments on behalf of the recipient.

If an owner purchasing a Series 2013 Bond through a brokerage account has executed a Form W-9 in connection with the establishment of such account, as generally can be expected, no backup withholding should occur. In any event, backup withholding does not affect the excludability of the interest on the Series 2013 Bonds from gross income for Federal income tax purposes. Any amounts withheld pursuant to backup withholding would be allowed as a refund or a credit against the owner's Federal income tax once the required information is furnished to the Internal Revenue Service.

Miscellaneous Tax Matters. Tax legislation, administrative action taken by tax authorities, or court decisions, whether at the Federal or state level, may adversely affect the tax-exempt status of interest on the Series 2013 Bonds under Federal or state law and could affect the market price or marketability of the Series 2013 Bonds.

Prospective purchasers of the Series 2013 Bonds should consult their own tax advisors regarding the foregoing matters.

STATE NOT LIABLE ON THE SERIES 2013A BONDS

PURSUANT TO THE ACT, THE SERIES A BONDS, INCLUDING THE SERIES 2013A 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 A BONDS, INCLUDING ANY SERIES 2013A BONDS, BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES A PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER.

STATE NOT LIABLE ON THE SERIES 2013B BONDS

PURSUANT TO THE ACT, THE SERIES B BONDS, INCLUDING THE SERIES 2013B 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 B BONDS, INCLUDING ANY SERIES 2013B BONDS, BE PAYABLE OUT OF ANY FUNDS OR ASSETS OTHER THAN THE SERIES B PLEDGED REVENUES. THE CORPORATION HAS NO TAXING POWER.

RATINGS

S&P has assigned a rating of "AA-" to the Series 2013 Bonds. Fitch has assigned a rating of "AA-" to the Series 2013 Bonds.

According to the S&P report on the Series 2013 Bonds, the ratings reflect the appropriation obligation of the State. Accordingly, although the Series 2013 Bonds are structured to be self-supporting from Pledged Settlement Payments, there is no reflection of the security of the Pledged Settlement Payments or its risks in the ratings. Similarly, according to the Fitch rating report on the Series 2013 Bonds, while Pledged Settlement Payments are the expected source of payment, ultimate security and the assigned ratings rest on the Series A Contract and the Series B Contract. Ratings 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 2013 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 2013 Bonds. A securities rating is not a recommendation to buy, sell or hold securities and may be subject to revision or withdrawal at any time.

VERIFICATION OF MATHEMATICAL COMPUTATIONS

Upon delivery of the Series 2013A Bonds, the arithmetical accuracy of certain computations included in the schedules provided by the Underwriters on behalf of the Corporation relating to the: (i) adequacy of forecasted receipts of principal and interest on the Series A Defeasance Collateral and cash to be held pursuant to the Series 2003A-1C Refunding Escrow Agreement; (ii) forecasted payments of principal and interest with respect to the Series 2003A-1C Refunded Bonds on and prior to their maturities and/or redemption dates; and (iii) yields with respect to the Series 2013A Bonds and on the obligations and other securities to be deposited pursuant to the Series 2003A-1C Refunding Escrow Agreement upon delivery of the Series 2013A Bonds, will be verified by Causey Demgen & Moore P.C., independent certified public accountants (the "**Verification Agent**"). Such verification shall be based solely upon information and assumptions supplied to the Verification Agent by the Underwriters. The Verification Agent has not made a study or evaluation of the information and assumptions on which such computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions or the achievability of the forecasted outcome.

Upon delivery of the Series 2013B Bonds, the arithmetical accuracy of certain computations included in the schedules provided by the Underwriters on behalf of the Corporation relating to the: (i) adequacy of forecasted receipts of principal and interest on the Series B Defeasance Collateral and cash to be held pursuant to the Series 2003B-1C Refunding Escrow Agreement; (ii) forecasted payments of principal and interest with respect to the Series 2003B-1C Refunded Bonds on and prior to their maturities and/or redemption dates; and (iii) yields with respect to the Series 2013B Bonds and on the obligations and other securities to be deposited pursuant to the Series 2003B-1C Refunding Escrow Agreement upon delivery of the Series 2013B Bonds, will be verified by the Verification Agent. Such verification shall be based solely upon information and assumptions supplied to the Verification Agent by the Underwriters. The Verification Agent has not made a study or evaluation of the information and assumptions on which such computations are based and, accordingly, has not expressed an opinion on the data used, the reasonableness of the assumptions or the achievability of the forecasted outcome.

LEGAL INVESTMENTS

The Act provides that the Series 2013 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 2013 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 Underwriters listed on the cover page of this Official Statement (the "**Underwriters**") have agreed, subject to certain conditions, to purchase the Series 2013A Bonds from the Corporation for a purchase price of $702,951,647.50 (representing the principal amount of the Series 2013A Bonds, plus original issue premium of $45,692,197.25 and less an underwriting discount of $2,830,549.75) and the Series 2013B Bonds from the Corporation for a purchase price of $605,703,799.27 (representing the principal amount of the Series 2013B Bonds, plus original issue premium of $42,347,729.60 and less an underwriting discount of $2,298,930.33). The Underwriters will be obligated to purchase all Series 2013 Bonds if any such Series 2013 Bonds are purchased.

The Series 2013 Bonds may be offered and sold to certain dealers (including dealers depositing the Series 2013 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.

In addition, certain of the Underwriters may have entered into distribution agreements with other broker-dealers (that have not been designated by the Corporation as Underwriters) for the distribution of the Series 2013 Bonds at the original issue prices. Such agreements generally provide that the relevant Underwriter will share a portion of its underwriting compensation or selling concession with such broker-dealers.

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 Underwriters and their respective affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. Certain of the Underwriters and their respective affiliates have, from time to time, performed, and may in the future, perform various investment banking services for the Corporation, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the Underwriters and their respective affiliates may make or hold a broad array of investments and activity trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may be at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve the Series 2013 Bonds.

LEGAL MATTERS

Hawkins Delafield & Wood LLP, New York, New York, as Bond Counsel to the Corporation, and D. Seaton and Associates, New York, New York, as Co-Bond Counsel to the Corporation, will render the opinions with respect to the validity of the Series 2013A Bonds and the Series 2013B Bonds in substantially the forms set forth in

APPENDIX I hereto. Bond Counsel and Co-Bond Counsel to the Corporation will also pass upon certain legal matters for the Corporation.

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) each of the Series A Contract and the Series B Contract has been duly authorized, executed and delivered by the State, and assuming the due execution and delivery by the Corporation, each of the Series A Contract and the Series B 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 and Orrick, Herrington & Sutcliffe LLP, Disclosure Counsel to the Corporation.

Certain legal matters will be passed upon for the Underwriters by Hiscock & Barclay, LLP, Albany, New York, as Underwriters' Counsel.

OTHER PARTIES

Financial Advisor

Public Resources Advisory Group (the "**Financial Advisor**"), has been retained to act as financial advisor for the Corporation in connection with the issuance of the Series 2013 Bonds.

The following sentence has been provided by the Financial Advisor. Although the Financial Advisor has assisted in the preparation of this Official Statement, the Financial Advisor is 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.

IHS Global

IHS Global has been retained by the Corporation as an independent econometric expert. The IHS Global Report attached as APPENDIX F hereto is included herein in reliance on IHS Global as experts in such matters. IHS Global's fees for acting as the Corporation's independent econometric consultant are not contingent upon the issuance of the Series 2013 Bonds. The IHS Global Report should be read in its entirety.

TOBACCO SETTLEMENT FINANCING CORPORATION

By: /s/ Marian Zucker
Authorized Representative

December 5, 2013

APPENDIX A

THE SERIES A CONTRACT AND THE SERIES B CONTRACT

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TOBACCO SETTLEMENT FINANCING CORPORATION CONTINGENCY CONTRACT, dated as of June 1, 2003 (the "Contract"), 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 Assembly. 2106-B, a Chapter 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 June 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 2003 Supplement dated as of June 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 2003A 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 2003A Bonds (which provides for payment to bondholders in the event that Series 2003A 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 2003A 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 2003A 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 4.3 or 4.4.

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.

[Signature Page for Contingency Contract]

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 June, 2003.

Approved as to form:
Attorney General

APPROVED AS TO FORM
NYS ATTORNEY GENERAL
JUN 17 2003
STEPHEN J. HENSEL
ASSOCIATE ATTORNEY

By:______________________________
Date:

STATE OF NEW YORK

Carole E. Stone
Director of the Budget

By:______________________________
John Cape
First Deputy Director

Approved as to form:
Counsel

By:______________________________
Date:

TOBACCO SETTLEMENT
FINANCING CORPORATION

____
Authorized Officer

Approved:
State Comptroller

By:______________________________

Date: 6/17/03

[Signature Page for Contingency Contract]

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 June, 2003.

Approved as to form:
Attorney General

By:______________________________
Date:

STATE OF NEW YORK

Carole E. Stone
Director of the Budget

By: ______________________________
John Cape
First Deputy Director

Approved as to form:
Counsel

By:______________________________
Date: 6/18/03

TOBACCO SETTLEMENT
FINANCING CORPORATION

____
Authorized Officer

Approved:
State Comptroller

By:______________________________

Date:______________________________

TOBACCO SETTLEMENT FINANCING CORPORATION CONTINGENCY CONTRACT

between the

STATE OF NEW YORK

and the

TOBACCO SETTLEMENT FINANCING CORPORATION

Dated as of December 1, 2003

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.

[Signature Page for Contingency Contract]

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~~

APPROVED AS TO FORM
NYS ATTORNEY GENERAL
NOV 25 2003
STEPHEN J. HENSEL
ASSOCIATE ATTORNEY

By:
Date:

STATE OF NEW YORK

Carole E. Stone

Carole E. Stone
Director of the Budget

Approved as to form:
Counsel

By:
Robert M. Drillings
Senior Vice President and Counsel

Date: 12/2/2003

TOBACCO SETTLEMENT
FINANCING CORPORATION

Stephen J. Hunt
Executive Director

Approved:
State Comptroller

By: Richard C. Hill

Date: 11/26/2003

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 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 June 19, 2013. It was updated on November 25, 2013. The AIS was filed with the Municipal Securities Rulemaking Board (MSRB) through its Electronic Municipal Market Access (EMMA) system. An electronic copy of this AIS can be accessed through the EMMA system at www.emma.msrb.org. An official copy of the AIS may be obtained by contacting 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.ny.gov.

The Basic Financial Statements and Other Supplementary Information for the State fiscal year ended March 31, 2013 were prepared by the State Comptroller in accordance with accounting principles generally accepted in the United States of America and independently audited in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The Basic Financial Statements and Other Supplementary Information were issued on July 29, 2013 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 Basic Financial Statements and Other Supplementary Information, which are included in the Comprehensive Annual Financial Report, 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

November 25, 2013

This is the second quarterly update (the "AIS Update") to the Annual Information Statement of the State of New York (the "AIS"), dated June 19, 2013. This AIS Update contains information only through November 25, 2013 and should be read in its entirety, together with the AIS. The State expects to issue the next AIS Update in February 2014, following the release of the Governor's Executive Budget Financial Plan for FY 2015.

In this AIS Update, readers will find:

1. Extracts from the Mid-Year Update to the Financial Plan for FY 2014 (the "Updated Financial Plan"), issued by the Division of the Budget ("DOB"). The Updated Financial Plan (which is available on the DOB website, www.budget.ny.gov), includes a summary of operating results for the first six months of fiscal year 2014, and updates to the State's official Financial Plan projections for FY 2014 through FY 2017[1].

2. A discussion of issues and risks that may affect the Financial Plan during the State's current fiscal year or in future years (under the heading "Risks and Uncertainties Related to the State Financial Plan").

3. A summary of the Generally Accepted Accounting Principles ("GAAP")-basis results for the prior three fiscal years (reprinted as a convenience from the First Quarterly Update to the AIS released in August 2013).

4. Updated information regarding the State Retirement Systems.

5. Updated information on certain public authorities and localities of the State.

6. The status of significant litigation and arbitration that has the potential to adversely affect the State's finances.

7. Financial plan tables that summarize actual General Fund receipts and disbursements for fiscal year 2013 and projected receipts and disbursements for fiscal years 2014 through 2017 on a General Fund, State Operating Funds and All Governmental Funds basis.

DOB is responsible for preparing the State's Financial Plan and presenting the information that appears in this AIS Update on behalf of the State. In preparing this AIS Update, DOB has also relied on information drawn from other sources, including the Office of the State Comptroller ("OSC"). In particular, information contained in the section entitled "State Retirement Systems" has been furnished by OSC, while information relating to matters described in the section entitled "Litigation and Arbitration" has been furnished by the State Office of the Attorney General. DOB has not undertaken any independent verification of the information contained in these sections of the AIS Update.

[1] The fiscal year is identified by the calendar year in which it ends. For example, fiscal year 2014 ("FY 2014") is the fiscal year that began on April 1, 2013 and will end on March 31, 2014.

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 position, including potential operating results for the current fiscal year and projected budget gaps for future fiscal years that may vary materially from the information provided in this AIS Update. Investors and other market participants should, however, refer to the AIS, as updated, or supplemented from time to time, for the most current official information regarding the financial position of the State.

The factors affecting the State's financial condition are complex. This AIS Update contains forecasts, projections and estimates that are based on expectations and assumptions which existed at the time such forecasts were prepared. Since many factors may materially affect fiscal and economic conditions in the State, the inclusion in this AIS Update of forecasts, projections, and estimates should not be regarded as a representation that such forecasts, projections, and estimates will occur. Forecasts, projections and estimates are not intended as representations of fact or guarantees of results. The words "expects," "forecasts," "projects," "intends," "anticipates," "estimates," and analogous expressions are intended to identify forward-looking statements in this AIS Update. Any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially and adversely from those projected. Such risks and uncertainties include, among others, general economic and business conditions; changes in political, social, economic and environmental conditions, including climate change and extreme weather events; impediments to the implementation of gap-closing actions; regulatory initiatives and compliance with governmental regulations; litigation; actions by the Federal government to reduce or disallow expected aid including Federal aid authorized or appropriated by Congress, but subject to sequestration, administrative actions, or other actions that would reduce aid to the State; and various other events, conditions and circumstances, many of which are beyond the control of the State. These forward-looking statements speak only as of the date of this AIS Update.

In addition to regularly scheduled quarterly updates to the AIS, the State may issue AIS supplements or other disclosure notices to the AIS 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 Update in Official Statements or related disclosure documents for State or State-supported debt issuance. The State has filed this AIS Update with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access ("EMMA") system. An electronic copy of this AIS Update can be accessed through EMMA at www.emma.msrb.org. An official copy of this AIS Update may be obtained by contacting the New York State Division of the Budget, State Capitol, Albany, NY 12224, Tel: (518) 474-2302.

In July 2013, OSC issued the Basic Financial Statements for FY 2013 (ended March 31, 2013). Copies may be obtained by contacting the Office of the State Comptroller, 110 State Street, Albany, NY 12236 and on its website at www.osc.state.ny.us. The Basic Financial Statements for FY 2013 can also be accessed through EMMA at www.emma.msrb.org.

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BUDGETARY AND ACCOUNTING PRACTICES

The State’s **General Fund** receives the majority of State taxes and all income not earmarked for a particular program or activity. State law requires the Governor to submit, and the Legislature to enact, a General Fund budget that is balanced on a cash basis of accounting. The State Constitution and State Finance Law do not provide a precise definition of budget balance. In practice, the General Fund is considered balanced if sufficient resources are, or are expected to be, available during the fiscal year for the State to: (a) make all planned payments, including Personal Income Tax (“PIT”) refunds, without the issuance of deficit notes or bonds or extraordinary cash management actions, (b) restore the balances in the Tax Stabilization Reserve and Rainy Day Reserve to levels at or above the levels on deposit when the fiscal year began, and (c) maintain other reserves, as required by law. For purposes of calculating budget balance, the General Fund includes transfers to and from other funds.

The General Fund is the sole financing source for the School Tax Relief ("STAR") Fund. In addition, it is typically the financing source of last resort for the State’s other major funds, which include the Health Care Reform Act (“HCRA”) funds, the Dedicated Highway and Bridge Trust Fund (“DHBTF”), and the Lottery Fund. Therefore, the General Fund projections account for any estimated funding shortfalls in these funds. Since the General Fund is the fund that is required to be balanced, the focus of the State’s budgetary and gap-closing discussion is generally weighted toward the General Fund.

From time to time, DOB will informally designate unrestricted balances in the General Fund for specific policy goals (e.g., the payment of costs related to potential labor contracts covering prior contract periods). These amounts are typically identified with the phrase "reserved for" and are not held in distinct accounts within the General Fund and may be used for other purposes.

State Operating Funds is a broader measure of spending for operations (as distinct from capital purposes) that is funded with State resources. It includes financial activity not only in the General Fund, but also State-funded special revenue funds and debt service funds (both the General Fund and State Operating Funds exclude spending from capital projects funds and Federal funds). DOB views State Operating Funds to be a more comprehensive measure of State-funded activities for operating purposes that are funded with State resources (i.e., taxes, assessments, fees, tuition) than the General Fund. The State Operating Funds perspective has the advantage of eliminating certain distortions in operating activities that may be caused by, among other things, the State's complex fund structure, the transfer of money among funds, and the accounting of disbursements against appropriations in different funds. For example, the State funds its share of the Medicaid program from both the General Fund and from State Special Revenue Funds, including Health Care Reform Act funds. The State Operating Funds perspective captures Medicaid disbursements from both of these fund types, giving a more complete accounting of State-funded Medicaid disbursements. For such reasons, the discussion of disbursement projections often emphasizes the State Operating Funds perspective.

The State also reports disbursements and receipts activity for **All Governmental Funds** (“All Funds”), which includes spending from Capital Projects Funds and State and Federal operating funds, providing the most comprehensive view of the cash-basis financial operations of the State. The State accounts for receipts and disbursements by the fund in which the activity takes place (such as the General Fund), and the broad category or purpose of that activity (such as State Operations). The Financial Plan tables sort State projections and results by fund and category.

Fund types of the State include: the General Fund; State special revenue funds, which receive certain dedicated taxes, fees and other revenues that are used for a specified purpose; Federal Special Revenue Funds, which receive certain Federal grants; State and Federal Capital Projects Funds, which account for costs incurred in the construction and rehabilitation of roads, bridges, prisons, university facilities, and other infrastructure projects; and Debt Service Funds, which account for the payment of principal, interest and related expenses for debt issued by the State and its public authorities.

State Finance Law also requires DOB to prepare a *pro forma* financial plan using, to the extent practicable, generally accepted accounting principles ("GAAP"), although this requirement is for informational purposes. The GAAP-basis financial plan is not used by DOB as a benchmark for managing State finances during the fiscal year and is not updated on a quarterly basis. The GAAP-basis financial plan follows, to the extent practicable, the accrual methodologies and fund accounting rules applied by OSC in preparation of the audited Basic Financial Statements. However, GAAP is a financial reporting regime, not a budgeting system.

OVERVIEW OF THE UPDATED FINANCIAL PLAN

SUMMARY

Financial results through September 2013 remain in line with DOB's expectations. DOB estimates that the General Fund will remain in balance in FY 2014 on a budgetary (cash) basis of accounting, based on its review of operating results through September 2013 and other information.

General Fund receipts, including transfers from other funds, are now expected to total $61.6 billion in FY 2014, a decrease of $47 million from the First Quarterly Update. The downward revision reflects lower than expected collections of section 18-a assessments on utility companies through September 2013 attributable to declines in utility prices and energy consumption.

General Fund disbursements, including transfers to other funds, are expected to total $61.5 billion in FY 2014, a decrease of $47 million from the First Quarterly Update. The Updated Financial Plan reflects savings from the recalculation of the State's pension payments based on updated information ($31 million). In addition, DOB expects that, based on claims to date, the cost of reimbursing local governments for general public health programs will be lower than projected in the First Quarterly Update ($29 million). Lastly, the Updated Financial Plan includes an additional $13 million in funding to assist areas affected by flooding in the Mohawk Valley region, bringing the total FY 2014 funding to $29 million.[2]

DOB expects the State to end FY 2014 with a General Fund closing balance of $1.8 billion, unchanged from the First Quarterly Update. For planning purposes, the Updated Financial Plan continues to assume a $318 million prepayment of FY 2015 debt service, but DOB will determine the specific prepayments that will be made later in the current fiscal year. The level of prepayments may change, depending on the State's fiscal position.

The projections for General Fund budget gaps in future years remain unchanged from the First Quarterly Update, with gaps of $1.7 billion in FY 2015, $2.9 billion in FY 2016, and $2.9 billion in FY 2017. By law, the Governor must propose, and the Legislature must enact, a General Fund budget that is balanced on a cash basis of accounting.

[2] Recovery aid of $16 million was included in the First Quarterly Update.

MID-YEAR OPERATING RESULTS (APRIL - SEPTEMBER 2013)

GENERAL FUND RESULTS VERSUS ENACTED BUDGET

Operating results through September 30, 2013 were positive in comparison to the estimate in the FY 2014 Enacted Budget Financial Plan as reflected in the AIS.

The State ended the month of September 2013 with a closing balance of $6.3 billion in the General Fund, $1.6 billion higher than projected in the Enacted Budget Financial Plan (and $710 million higher than the revised projections of the First Quarterly Update). The higher balance is mainly due to lower than planned spending ($1.2 billion).

GENERAL FUND OPERATING RESULTS THROUGH SEPTEMBER 2013
(millions of dollars)

	Enacted	Revised		Variance Above/(Below)	
	Plan	Plan	Results	Enacted	Revised
Opening Balance	**1,610**	**1,610**	**1,610**	**0**	**0**
Total Receipts	**31,577**	**32,058**	**31,933**	**356**	**(125)**
Taxes:	29,976	30,075	30,063	87	(12)
Personal Income Tax[1]	20,253	20,306	20,347	94	41
User Taxes and Fees[1]	6,086	6,179	6,226	140	47
Business Taxes	2,789	2,716	2,568	(221)	(148)
Other Taxes[1]	848	874	922	74	48
Receipts and Grants	1,461	1,671	1,556	95	(115)
Transfers From Other Funds	140	312	314	174	2
Total Spending	**28,503**	**28,104**	**27,269**	**(1,234)**	**(835)**
Education	7,727	7,422	7,077	(650)	(345)
Health Care	6,450	6,191	6,091	(359)	(100)
Social Services	1,479	1,400	1,418	(61)	18
Higher Education	1,308	1,359	1,261	(47)	(98)
All Other Local Assistance	1,376	1,394	1,338	(38)	(56)
Personal Service	2,814	2,851	2,862	48	11
Non-Personal Service	922	808	794	(128)	(14)
General State Charges	2,448	2,505	2,398	(50)	(107)
Debt Service Transfer	633	610	462	(171)	(148)
Capital Projects Transfer	529	601	580	51	(21)
State Share Medicaid Transfer	831	993	1,159	328	166
SUNY Operations Transfer	812	812	810	(2)	(2)
All Other Transfers	1,174	1,158	1,019	(155)	(139)
Change in Operations	**3,074**	**3,954**	**4,664**	**1,590**	**710**
Closing Balance	**4,684**	**5,564**	**6,274**	**1,590**	**710**

[1] Includes transfers from other funds after debt service.

Through September 2013, General Fund receipts, including transfers from other funds, were $356 million above initial projections, reflecting higher tax collections ($87 million), miscellaneous receipts ($95 million) and transfers from other funds ($174 million).

The variance in tax collections is comprised of higher PIT collections due to stronger than anticipated current year estimated and 2012 final tax return payments ($94 million); higher user taxes and fees ($140 million) reflecting stronger than expected collections for sales associated with autos, dining and entertainment, and expenditures by utilities for post-Sandy repairs; higher other taxes receipts ($74 million) due to stronger real estate prices and transaction volume, as well as estate tax receipts; and lower business tax collections ($221 million) driven mainly by lower gross collections for insurance and bank taxes due to a weakness in 2013 liability payments.

Higher than anticipated miscellaneous receipts include the unanticipated settlement payments of $250 million from Bank of Tokyo-Mitsubishi UFJ ("BTMU") for its violation of banking laws concerning interactions with countries and entities subject to international sanctions, and $10 million from Deloitte Financial Advisory Services for its violation of banking laws during its consulting work at Standard Chartered Bank; offset by lower abandoned property collections ($100 million) and lower collections from the section 18-a temporary assessment imposed on public utility companies ($38 million).

Transfers from other funds were higher than initially estimated due to the additional revenue generated by the recently settled gaming agreements ($203 million) between New York State and the Oneida Nation of Indians, the Saint Regis Mohawk Tribe, and the Seneca Nation of Indians.

Through September 2013, General Fund disbursements, including transfers to other funds, were $1.2 billion lower than the FY 2014 Enacted Budget Financial Plan projection, due mainly to lower local assistance spending.

Local assistance spending was lower than estimated ($1.2 billion), mainly in the areas of education ($650 million) and health care spending ($359 million). The education variance includes less-than-anticipated School Aid disbursements through September (which do not impact annual disbursement estimates), and $238 million in pre-school special education payments that were processed in October instead of September. The health variance includes the earlier than expected receipt of Medicaid audit recoveries that offset State spending ($200 million); lower utilization across multiple service categories which, along with routine timing of the receipt and application of credits, resulted in lower Medicaid cycle activity; reduced Medicaid administrative costs; and declines in public health program spending, including the General Public Health Work ("GPHW") program. The annual GPHW estimate has been revised downward in this AIS Update.

Non-personal service costs ($128 million) were lower than planned mainly in DOH, including Medicaid contract spending ($40 million); Office of Temporary and Disability Assistance ("OTDA") ($21 million); Judiciary ($19 million); OGS ($17 million); DTF ($9 million); and State Police ($6 million). The variances in mental hygiene transfers to support operational facility costs are a function of timing associated with the submission of claims for payment. The debt service transfer was lower as a result of an administrative delay in the disbursement of the State University of New York ("SUNY") Construction Fund payments ($171 million).

STATE OPERATING FUNDS RESULTS VERSUS ENACTED BUDGET

The State ended September 2013 with a closing balance of $9.1 billion in State Operating Funds, $1.9 billion above the Enacted Budget Financial Plan estimate ($923 million higher than the revised estimate included with the First Quarterly Update to the AIS). The higher balance is mainly due to lower than planned spending ($1.5 billion) and is comprised mainly of lower education and health care spending consistent with the General Fund variance.

STATE OPERATING FUNDS RESULTS THROUGH SEPTEMBER 2013
(millions of dollars)

	Enacted	Revised		Variance Above/(Below)	
	Plan	Plan	Results	Enacted	Revised
Opening Balance	**4,360**	**4,360**	**4,360**	**0**	**0**
Total Receipts	**43,778**	**44,244**	**44,048**	**270**	**(196)**
Taxes:	33,691	33,781	33,728	37	(53)
Personal Income Tax	21,486	21,538	21,575	89	37
User Taxes and Fees	7,234	7,342	7,386	152	44
Business Taxes	3,516	3,432	3,247	(269)	(185)
Other Taxes	1,455	1,469	1,520	65	51
Miscellaneous/Federal Receipts	10,087	10,463	10,320	233	(143)
Total Spending	**42,160**	**41,825**	**40,643**	**(1,517)**	**(1,182)**
Education	10,061	9,750	9,409	(652)	(341)
Health Care	9,608	9,245	9,000	(608)	(245)
Social Services	1,480	1,401	1,420	(60)	19
Transportation	2,376	2,344	2,320	(56)	(24)
Higher Education	1,308	1,359	1,261	(47)	(98)
All Other Local Assistance	2,834	3,131	3,021	187	(110)
Personal Service	6,242	6,324	6,243	1	(81)
Non-Personal Service	2,652	2,575	2,589	(63)	14
General State Charges	3,345	3,441	3,289	(56)	(152)
Debt Service	2,253	2,247	2,086	(167)	(161)
Capital Projects	1	8	5	4	(3)
Other Financing Sources	**1,219**	**1,368**	**1,305**	**86**	**(63)**
Change in Operations	**2,837**	**3,787**	**4,710**	**1,873**	**923**
Closing Balance	**7,197**	**8,147**	**9,070**	**1,873**	**923**

Through September 2013, total receipts in State Operating Funds were $270 million higher than Enacted Budget Financial Plan projections, reflecting the combined impacts of higher collections for both taxes ($37 million) and miscellaneous receipts ($233 million).

As noted in the General Fund operating results, the variance in tax collections is a function of higher PIT collections and user taxes, offset by lower business tax receipts.

Higher non-tax receipts reflects the financial settlement payments described in the General Fund section, partly offset by lower abandoned property collections; lower HCRA assessment revenue attributable to the impact of MRT initiatives on reducing costs throughout the State's health care industry; and lower SUNY miscellaneous receipts.

State Operating Funds spending was $1.5 billion below planned levels, due to lower spending in local assistance ($1.2 billion), agency operations ($118 million), and debt service ($167 million).

These variances include the General Fund variances described above, as well as lower health care spending in other State funds, including the Federal-State Health Reform Partnership ("F-SHRP") ($97 million) attributable to administrative delays associated with the processing of payments, and lower

HCRA and provider assessment revenues used to finance a portion of health care spending. Other variances include lower transit operating aid ($56 million), due to the delay of a scheduled transit aid payment pursuant to a revised cash flow schedule agreement between the State and the MTA; and unanticipated payments made to municipalities pursuant to the recent tribal-state compact agreements ($116 million).

ALL GOVERNMENTAL FUNDS RESULTS

All Governmental Funds ended September 2013 with a closing balance of $7.8 billion, $1.3 billion above the Enacted Budget ($739 million higher than the revised estimate included with the First Quarterly Update to the AIS). The higher balance is comprised of lower than projected spending ($1.9 billion) including a lower level of Federal operating funds, partly offset by lower available resources ($593 million).

All GOVERNMENTAL FUNDS RESULTS THROUGH SEPTEMBER 2013
(millions of dollars)

	Enacted	Revised		Variance Above/(Below)	
	Plan	Plan	Results	Enacted	Revised
Opening Balance	**3,876**	**3,876**	**3,876**	**0**	**0**
Total Receipts	**68,650**	**68,173**	**68,057**	**(593)**	**(116)**
Taxes:	34,391	34,474	34,419	29	(55)
Personal Income Tax	21,486	21,538	21,575	89	37
User Taxes and Fees	7,548	7,647	7,692	144	45
Business Taxes	3,854	3,772	3,586	(268)	(186)
Other Taxes	1,503	1,517	1,566	63	49
Miscellaneous Receipts	11,987	11,993	11,795	(192)	(198)
Federal Grants	22,272	21,706	21,843	(429)	137
Total Spending	**66,033**	**64,946**	**64,087**	**(1,946)**	**(859)**
State Operating Funds:	42,160	41,825	40,643	(1,517)	(1,182)
Education	10,061	9,750	9,409	(652)	(341)
Health Care	9,608	9,245	9,000	(608)	(245)
Social Services	1,480	1,401	1,420	(60)	19
Transportation	2,376	2,344	2,320	(56)	(24)
Higher Education	1,308	1,359	1,261	(47)	(98)
All Other Local Assistance	2,834	3,131	3,021	187	(110)
Personal Service	6,242	6,324	6,243	1	(81)
Non-Personal Service	2,652	2,575	2,589	(63)	14
General State Charges	3,345	3,441	3,289	(56)	(152)
Debt Service	2,253	2,247	2,086	(167)	(161)
Capital Projects	1	8	5	4	(3)
Capital Projects Funds	3,836	3,723	3,882	46	159
Federal Operating Funds	20,037	19,398	19,562	(475)	164
Other Financing Sources	**(20)**	**(29)**	**(33)**	**(13)**	**(4)**
Change in Operations	**2,597**	**3,198**	**3,937**	**1,340**	**739**
Closing Balance	**6,473**	**7,074**	**7,813**	**1,340**	**739**

Through September 2013, total receipts in All Funds were $593 million lower than initial projections, reflecting the combined impact of lower Federal Aid ($429 million) and miscellaneous receipts ($192 million), partly offset by higher tax collections ($29 million).

In addition to the tax collection and miscellaneous receipt variances noted earlier, other significant variances include lower than planned receipts due to a timing delay of bond sales associated with certain economic development programs ($412 million) and Federal Grant aid variances commensurate to the spending variances described below.

In addition to the General Fund and State Operating Fund spending variances described earlier, the most notable variances are attributable to lower Federal spending ($475 million) in the areas of Medicaid ($920 million) related to the ACA, and the timing of disaster assistance reimbursements, that are partly offset by earlier than planned spending for public assistance programs ($535 million) and education ($455 million).

ALL GOVERNMENTAL FUNDS ANNUAL CHANGE

The All Governmental Funds balance through September 2013 was $7.8 billion, or $1.8 billion higher than the prior year. The growth in the fund balance in the current year is attributable to a higher opening balance ($516 million), greater available resources from All Governmental Funds receipts ($5.4 billion), partly offset by higher year-to-date spending ($4.1 billion).

All GOVERNMENTAL FUNDS RESULTS YEAR-OVER-YEAR
APRIL THROUGH SEPTEMBER
(millions of dollars)

	FY 2013	FY 2014	Increase/(Decrease)	
	Results	Results	$	%
Opening Balance	**3,360**	**3,876**	**516**	
Total Receipts	**62,623**	**68,057**	**5,434**	**8.7%**
Taxes:	31,635	34,419	2,784	8.8%
Personal Income Tax	19,368	21,575	2,207	11.4%
User Taxes and Fees	7,341	7,692	351	4.8%
Business Taxes	3,458	3,586	128	3.7%
Other Taxes	1,468	1,566	98	6.7%
Miscellaneous Receipts	11,723	11,795	72	0.6%
Federal Grants	19,265	21,843	2,578	13.4%
Total Spending	**59,940**	**64,087**	**4,147**	**6.9%**
State Operating Funds:	39,627	40,643	1,016	2.6%
Education	9,799	9,409	(390)	-4.0%
Health Care	8,444	9,000	556	6.6%
Social Services	1,644	1,420	(224)	-13.6%
Transportation	2,102	2,320	218	10.4%
Higher Education	1,124	1,261	137	12.2%
All Other Local Assistance	3,255	3,021	(234)	-7.2%
Personal Service	6,095	6,243	148	2.4%
Non-Personal Service	2,195	2,589	394	17.9%
General State Charges	2,646	3,289	643	24.3%
Debt Service	2,320	2,086	(234)	-10.1%
Capital Projects	3	5	2	66.7%
Capital Projects Funds	3,260	3,882	622	19.1%
Federal Operating Funds	17,053	19,562	2,509	14.7%
Other Financing Sources	**(34)**	**(33)**	**1**	
Change in Operations	**2,649**	**3,937**	**1,288**	
Closing Balance	**6,010**	**7,813**	**1,803**	

All Governmental Funds tax receipts through September 2013 are $2.8 billion higher than the prior year, with 80 percent of the growth attributable to higher PIT collections ($2.2 billion). This was due in part to taxpayer accelerations of income into the 2012 tax year to avoid increased 2013 Federal tax rates. Other growth in tax receipts includes higher user tax collections ($351 million) associated with recurring and non-recurring taxable purchases such as auto sales, entertainment activities, and utility expenses for post-Sandy repair work; and higher business taxes ($128 million) driven by higher audit receipts for corporate franchise taxes in April and May of 2013. The remaining growth in receipts is in Federal Grants ($2.6 billion) and is generally a result of increased Federal program spending, as described in greater detail below.

Nearly two-thirds of the $4.1 billion annual increase in All Governmental Funds spending through September 2013 is attributable to higher Federal spending ($2.5 billion), mainly in the areas of health care, disaster assistance associated with Sandy-related storm recovery activities, and public assistance.

State Operating Funds spending has increased by $1.0 billion through September 2013 compared to the prior year. Growth in local assistance spending includes higher Medicaid spending due to lower spending during the first six months of the prior year as a result of delayed Federal approval of certain rate increases; transit aid spending from available resources; and increased higher education spending.

Agency operations spending growth includes higher personal service costs, which is mainly comprised of increased compensation, overtime and other payments; and non-personal service costs, which includes increased spending by SUNY from additional revenue being generated at their campuses. Spending for GSCs has increased from the prior year, as the State’s pension payments are now being paid on a monthly basis, rather than during the final month of the fiscal year, to generate interest savings.

Capital projects spending has increased by $622 million from the prior year, which is a result of both budgeted growth, particularly for DOT-related costs in the DHBTF, and from certain system related transaction delays during FY 2012 related to fringe benefit billing processes.

MULTI-YEAR FINANCIAL PLAN REVISIONS

The following table summarizes the revisions to the financial plan that affect General Fund operating projections since the First Quarterly Update issued in August 2013. Descriptions of the changes follow the table.

SUMMARY OF REVISIONS TO FIRST QUARTERLY UPDATE FINANCIAL PLAN
GENERAL FUND BUDGETARY BASIS OF ACCOUNTING
SAVINGS/(COSTS)
(millions of dollars)

	FY 2014	FY 2015	FY 2016	FY 2017
FIRST QUARTERLY UPDATE SURPLUS/(GAPS)	**0**	**(1,742)**	**(2,889)**	**(2,948)**
RECEIPTS REVISIONS	**(47)**	**0**	**0**	**0**
18-a Temporary Utility Assessments	(47)	0	0	0
DISBURSEMENTS REVISIONS	**47**	**0**	**0**	**0**
State Pension Bill	31	0	0	0
General Public Health Work Program	29	0	0	0
NYS Flood Recovery	(13)	0	0	0
MID-YEAR UPDATE BUDGET SURPLUS/(GAPS)	**0**	**(1,742)**	**(2,889)**	**(2,948)**

The projections for General Fund budget gaps in future years remain unchanged from the First Quarterly Update, with gaps of $1.7 billion in FY 2015, $2.9 billion in FY 2016, and $2.9 billion in FY 2017. By law, the Governor must propose, and the Legislature must enact, a General Fund budget that is balanced on a cash basis of accounting.

REVISIONS

- **Section 18-a Temporary Utility Assessments:** Collections of assessments on utility companies through September 2013 were lower than planned. The lower collections were attributable to declines in utility prices and energy consumption.

- **State Pension Payment:** The State's 2014 pension bill has been recalculated to reflect updated information. Monthly prepayments applied to the State's FY 2014 pension bill have resulted in net interest savings.

- **General Public Health Work Program:** The State's estimated annual reimbursement to local health departments for a share of costs associated with providing certain public health services has been lowered as a result of lower than anticipated municipal claims on various services.

- **NYS Flood Recovery:** The Financial Plan has been updated to include an additional $13 million in recovery assistance aid to homeowners, business operators and farmers in five counties impacted by severe flooding that occurred between June 26 and July 3, 2013. State aid for flooding costs since budget enactment totals $29 million. Homeowners and renters may apply for up to $31,900 in assistance, and small business owners and farmers may apply for up to $50,000 in assistance.

PROJECTED CLOSING BALANCES

DOB expects the State to end FY 2014 with a General Fund closing balance of $1.8 billion, an increase of $94 million from the Enacted Budget Financial Plan and unchanged from the First Quarterly Update. The change for the Enacted Budget reflects a $100 million increase in the undesignated fund balance, offset by the use of $6 million to fund retroactive labor settlements with lifeguards, as noted in the First Quarterly Update (retroactive payments are scheduled for November 2013).

FY 2014 ESTIMATED GENERAL FUND CLOSING BALANCES
(millions of dollars)

	Enacted Budget	Change	First Quarterly Update	Change	Mid-Year Update
GENERAL FUND BALANCE	**1,709**	**94**	**1,803**	**0**	**1,803**
STATUTORY RESERVES					
Tax Stabilization Reserve Fund	1,131	0	1,131	0	1,131
Rainy Day Reserve Fund	175	0	175	0	175
Community Projects Fund	68	0	68	0	68
Contingency Reserve Fund	21	0	21	0	21
RESERVED FOR		0		0	
Prior-Year Labor Agreements (2007-2011)	51	(6)	45	0	45
Debt Management	263	0	263	0	263
Undesignated Fund Balance	0	100	100	0	100

The combined balances in the State's principal "rainy day" reserve funds, the Tax Stabilization Reserve Fund and the Rainy Day Reserve Fund, are equal to approximately 2.1 percent of estimated General Fund disbursements in FY 2014. The Community Projects Fund reflects projected year-end balances available to finance discretionary grants from existing reappropriations. The Contingency Reserve Fund balance is available only to pay lawsuits against the State in excess of $25 million or for other legally specified purposes.

The Updated Financial Plan continues to reserve money in the General Fund balance to cover potential retroactive labor settlements with unions that have not agreed to terms for prior contract periods. The reserve is calculated based on the pattern settlement for the FY 2008 through FY 2011 period that was agreed to by the State's largest unions.

The Updated Financial Plan continues to reserve $263 million for debt management purposes in FY 2014, which is consistent with the First Quarterly Update.

ANNUAL SPENDING GROWTH

DOB estimates that State Operating Funds spending will total $90.7 billion in FY 2014, an increase of $1.8 billion (2.1 percent) from FY 2013 results. Excluding the impact of planned prepayments, State Operating Funds spending growth is estimated at 1.7 percent.

All Governmental Funds spending excluding extraordinary Federal aid for Superstorm Sandy disaster assistance and the ACA, which includes capital projects and Federal Operating Funds, totals $135.3 billion, an increase of $2.8 billion (2.1 percent) from FY 2013 results. Excluding the impact of planned prepayments, All Funds spending growth (again excluding Superstorm Sandy and ACA), is estimated at 1.8 percent. Please see the Financial Plan tables for unadjusted All Funds disbursements.

The following table summarizes the major sources of annual change in State spending by major program, purpose, and fund perspective.

ANNUAL STATE SPENDING
(millions of dollars)

	FY 2013	FY 2014	Annual Change	
	Results	Estimated	$	%
LOCAL ASSISTANCE	**58,578**	**59,696**	**1,118**	**1.9%**
School Aid	20,163	20,471	308	1.5%
DOH Medicaid (Incl Operational Costs) [1]	15,900	16,421	521	3.3%
Transportation	4,303	4,739	436	10.1%
Mental Hygiene	3,602	2,833	(769)	-21.3%
STAR	3,286	3,419	133	4.0%
Social Services	3,031	2,996	(35)	-1.2%
Higher Education	2,629	2,825	196	7.5%
Public Health/Aging	2,040	2,193	153	7.5%
Special/Other Education	1,927	2,032	105	5.4%
Local Government Assistance	754	764	10	1.3%
All Other[2]	943	1,003	60	6.4%
STATE OPERATIONS/FRINGE BENEFITS	**24,120**	**24,902**	**782**	**3.2%**
State Operations	**17,683**	**17,844**	**161**	**0.9%**
Personal Service:	12,403	12,366	(37)	-0.3%
Executive Agencies	7,112	7,010	(102)	-1.4%
University System	3,468	3,500	32	0.9%
Elected Officials	1,823	1,856	33	1.8%
Non-Personal Service:	5,280	5,478	198	3.8%
Executive Agencies	2,707	2,764	57	2.1%
University System	2,083	2,169	86	4.1%
Elected Officials	490	545	55	11.2%
Fringe Benefits/Fixed Costs	**6,437**	**7,058**	**621**	**9.6%**
Pension Contribution	1,601	1,982	381	23.8%
Employee Health Insurance	3,129	3,315	186	5.9%
Other Fringe Benefits/Fixed Costs	1,707	1,761	54	3.2%
DEBT SERVICE	**6,138**	**6,060**	**(78)**	**-1.3%**
CAPITAL PROJECTS	**8**	**11**	**3**	**37.5%**
TOTAL STATE OPERATING FUNDS	**88,844**	**90,669**	**1,825**	**2.1%**
SOF EXCL. PLANNED FY 2014 PREPAYMENTS	***88,844***	***90,351***	***1,507***	***1.7%***
Capital Projects (State Funds)	**5,679**	**6,146**	**467**	**8.2%**
TOTAL STATE FUNDS	**94,523**	**96,815**	**2,292**	**2.4%**
Federal Aid (Including Capital Grants) [3]	**37,997**	**38,459**	**462**	**1.2%**
TOTAL ALL GOVERNMENTAL FUNDS [4]	**132,520**	**135,274**	**2,754**	**2.1%**
ALL FUNDS EXCL. FY 2014 PREPAYMENTS [4]	***132,520***	***134,956***	***2,436***	**1.8%**

[1] Department of Health Medicaid spending only (excludes other State agency spending and transfers). For display purposes, includes Medicaid operational spending that supports contracts related to the management of Medicaid and the costs of administrative takeover.

[2] "All Other" includes an adjustment for Medicaid operational costs to avoid distorting Financial Plan category totals, as well as local aid spending in a number of other programs, including education, parks and the environment, economic development, public safety, and disaster assistance.

[3, 4] Excludes Federal disaster aid for Superstorm Sandy, at $577 million in FY 2013 and estimated at $5.1 billion in FY 2014, and additional Federal aid under the Affordable Care Act, estimated at approximately $600 million in FY 2014. Including disbursements for these purposes, All Funds disbursements are expected to total $141 billion in FY 2014, an increase of 5.9 percent.

Local assistance spending in FY 2014 is expected to increase by $1.1 billion, or 1.9 percent, over FY 2013 results. On a school year basis, School Aid is expected to increase by 4.9 percent in 2014, which is above the growth rate in personal income. School Aid in the future years of the Financial Plan is assumed to increase at levels based on the growth in State personal income. State-funded DOH Medicaid spending is projected to increase by 3.9 percent (not shown on table), excluding the impact of the State's takeover of Medicaid administration, and is consistent with the statutory growth cap. In addition, ACA continues to provide additional Federal resources to finance Medicaid spending. Transportation spending growth is the result of increased dedicated tax receipts and State subsidy payments to the MTA. Growth in other local assistance includes increases across several programs and activities. In addition, results in FY 2013 fell below planned levels in many areas, which, absent other changes, has the effect of increasing the annual growth rate in FY 2014 in those areas.

Agency spending on personal and non-personal service is expected to remain nearly flat on an annual basis. This reflects ongoing efforts to redesign State agency operations initiated in FY 2013. Spending on fringe benefits is projected to increase by $622 million. This includes an increase of $381 million in the State's annual pension contribution, including repayment of amounts amortized in prior years. The Financial Plan assumes the State will continue to amortize a percentage of its annual pension costs, consistent with legislation approved in 2010.

Consistent with past years, the aggregate spending projections (i.e., the sum of all projected spending by individual agencies) in special revenue funds have been adjusted downward based on typical spending patterns and the observed variance over time between estimated and actual results.

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RISKS AND UNCERTAINTIES RELATED TO THE STATE FINANCIAL PLAN

GENERAL

The Updated Financial Plan is subject to many complex economic, social, financial, political, and environmental risks and uncertainties, many of which are outside the ability of the State to control. DOB believes that the projections of receipts and disbursements in the Updated Financial Plan are based on reasonable assumptions, but there can be no assurance that actual results will not differ materially and adversely from these projections. In certain fiscal years, actual receipts collections have fallen substantially below the levels forecast in the Updated Financial Plan.

The Updated Financial Plan is based on numerous assumptions, including the condition of the State and national economies and the concomitant receipt of economically sensitive tax receipts in the amounts projected. Other uncertainties and risks concerning the economic and receipts forecasts include the impact of the following: national and international events, such as Federal budget and debt ceiling negotiations; ongoing financial instability in the Euro-zone; changes in consumer confidence, oil supplies and oil prices; continuing or worsening strife in the Middle East; climate change and extreme weather events; Federal statutory and regulatory changes concerning financial sector activities; changes concerning financial sector bonus payouts, as well as any future legislation governing the structure of compensation; shifts in monetary policy affecting interest rates and the financial markets; financial and real estate market developments, which may adversely affect bonus income and capital gains realizations; possible changes in Federal tax law relating to the taxation of interest on municipal bonds; and the levels of household debt, which may adversely affect consumer spending and State tax collections.

The Updated Financial Plan is subject to various other uncertainties and contingencies relating to the extent, if any, to which wage increases for State employees exceed projected annual wage costs; changes in the size of the State's workforce; the actualization of the projected rate of return for pension fund assets and current assumptions with respect to wages for State employees affecting the State's required pension fund contributions; the extent to which litigation-related judgments against the State results in new or higher than projected costs; the willingness and ability of the Federal government to provide the aid contemplated by the Updated Financial Plan; the ability of the State to implement cost reduction initiatives, including reductions in State agency operations, and the success with which the State controls expenditures; and the ability of the State and its public authorities to market securities successfully in the public credit markets. Some of these specific issues are described in more detail herein. The projections and assumptions contained in the Updated Financial Plan are subject to revisions which may reflect substantial adverse changes resulting from the occurrence of one or more uncertainties. No assurance can be given that these estimates and projections, which depend in part upon actions the State expects to be taken but that are not within the State's control, will be realized.

BUDGET RISKS AND UNCERTAINTIES

There can be no assurance that the State's General Fund budget gaps will not increase materially from current projections. If this were to occur, the State would be required to take additional gap-closing actions. Such actions may include, but are not limited to, additional reductions in State agency operations; delays or reductions in payments to local governments or other recipients of State aid; delays in or suspension of capital maintenance and construction; extraordinary financing of operating expenses;

or other measures. In some cases, the ability of the State to implement such actions requires the approval of the Legislature and cannot be implemented solely by the action of the Governor.

The Updated Financial Plan projections generally assume that School Aid and Medicaid disbursements will be limited to the growth in State personal income and the ten-year average growth in the Medicaid component of the Consumer Price Index (CPI), respectively. However, the Enacted Budget authorized spending for School Aid to increase in excess of the growth in personal income for SY 2014.

State law grants the Governor certain powers to achieve the Medicaid savings assumed in the Updated Financial Plan. However, there can be no assurance that these powers will be sufficient to limit the rate of annual growth in DOH State Funds Medicaid spending to the levels estimated in the Updated Financial Plan. In addition, savings are dependent upon timely Federal approvals, revenue performance in the State's HCRA fund (which finances approximately one-third of the DOH State-share costs of Medicaid), and the participation of health care industry stakeholders.

The forecast contains specific transaction risks and other uncertainties including, but not limited to, the receipt of certain payments from public authorities; the receipt of miscellaneous revenues at the levels expected in the Updated Financial Plan, including payments pursuant to the Tribal-State Compact that have failed to materialize in prior years, but which were received in the current year as part of an agreement between the State and certain tribal nations; and the achievement of cost-saving measures including, but not limited to, the transfer of available fund balances to the General Fund at the levels currently projected. Such risks and uncertainties, if they were to materialize, could have an adverse impact on the Updated Financial Plan in the current year or future years.

FEDERAL ISSUES

The State receives a substantial amount of Federal aid for health care, education, transportation, and other governmental purposes, as well as Federal funding to address response and recovery to severe weather events. Any reduction in Federal funding levels could have a materially adverse impact on the Updated Financial Plan. In addition, the Updated Financial Plan may be adversely affected by other actions taken by the Federal government, including audits, disallowances, and changes to Federal participation rates or other Medicaid rules. Issues of particular concern are described below.

FEDERAL REIMBURSEMENT FOR STATE MENTAL HYGIENE SERVICES

The Federal government lowered Medicaid developmental disability center payment rates, effective April 1, 2013, which will reduce Federal funding to the State by approximately $1.1 billion annually, beginning in FY 2014. The Updated Financial Plan includes a plan to address the loss in Federal aid, including $90 million in the Office for People with Developmental Disabilities (OPWDD) savings associated with reduced administrative costs, enhanced audit recoveries and improved program efficiencies. The plan is subject to implementation risks and is dependent, in part, on the approval of the Federal government. As described below, the Federal Centers for Medicare and Medicaid Services (CMS) may seek to retroactively recover Federal funds paid to the State regarding this matter.

AUDIT DISALLOWANCE

In addition to the reductions in rates that commenced on April 1, 2013, on February 8, 2013, the U.S. Department of Health & Human Services Office of the Inspector General, at the direction of the Federal CMS, began a review to determine the allowability of Medicaid costs for services provided in prior years to the Medicaid population in New York State-Operated Intermediate Care Facilities for the Developmentally Disabled (ICF/DD). The initial review period includes claims for services provided during the period April l, 2010 through March 31, 2011. As a result of this review, CMS may seek to recover Federal funds for any payments that it determines to have been in excess of Federal requirements. The State has resolved CMS concerns regarding its prospective payments to ICF/DDs with a State plan change effective April 1, 2013, and continues to have discussions with CMS to resolve the concerns related to the April 1, 2010 through March 31, 2011 period. As noted above, adverse action by the Federal government relative to the allowability of Medicaid costs or services in years prior to FY 2014 is expected to result in a reduction in Federal aid of an estimated $1.1 billion annually beginning in FY 2014. A comparable amount of Federal aid is at risk for any prior period that may be pursued by CMS. Matters of this type are sometimes resolved with a prospective solution (as already commenced by the State), and the State is not aware of any similar attempts by the Federal government to retroactively recover Federal aid of this magnitude that was paid pursuant to an approved State plan. The State continues to seek CMS approval to proceed with the development of a sustainable system of service funding and delivery for individuals with developmental disabilities. However, there can be no assurance that Federal action in this matter will not result in materially adverse changes to the Updated Financial Plan.

BUDGET CONTROL ACT

The Federal Budget Control Act ("BCA") of 2011 imposed annual caps on Federal discretionary spending over a ten-year period and mandated an additional $1.2 trillion in deficit reduction, which, if not enacted, would be achieved through the sequestration of funds in Federal Fiscal Year ("FFY") 2013 and lowered discretionary spending caps in the following years. As the required deficit reduction was not achieved by the March 1, 2013 deadline, an across-the-board 5 percent reduction in FFY 2013 funding for Federal nondefense discretionary programs was implemented. If Congress does not act to otherwise achieve the BCA deficit reduction requirements, DOB estimates that New York State and local governments could lose approximately $5 billion in Federal funding over nine years, including reductions in Federal funding that passes through the State budget for school districts, as well as environmental, criminal justice and social services programs.

DEBT CEILING

A Federal government default on payments, particularly if it persisted for a prolonged period, can be expected to have a materially adverse effect on the national and state economies, financial markets, and intergovernmental aid payments.

The specific effects on the Updated Financial Plan of a Federal government payment default are unknown and impossible to predict. However, data from past economic downturns suggest that the State's revenue loss could be substantial if the economy goes into a recession due to a Federal default, according to DOB. For context, during the last recession, New York lost 324,000 jobs, State wages fell 7.2 percent in 2009, and taxable capital gains realizations fell 52 percent in 2008 and 41 percent in 2009.

A payment default by the United States may adversely affect the municipal bond market, as well. Municipal issuers, as well as the State, could face higher borrowing costs and impaired market access. This would jeopardize planned capital investments in roads and bridges, higher education facilities, hazardous waste remediation, environmental projects, and economic development projects. Additionally, the market for and market value of outstanding municipal obligations, including municipal obligations of the State, could be adversely affected.

HEALTH INSURANCE COMPANY CONVERSIONS

State law permits a health insurance company to convert its organizational status from a not-for-profit to a for-profit corporation (a "health care conversion"), subject to a number of terms, conditions, and approvals. Under State law, the State is entitled to proceeds from the monetization of a health service corporation, from a not-for-profit to a for-profit corporation, and such proceeds must be used by the State for health care related expenses. The Updated Financial Plan counts on conversion proceeds of $175 million in FY 2014, and $300 million annually in FY 2015, FY 2016, and FY 2017. In recent years, the Updated Financial Plan has counted on similar amounts from conversions, which have not been realized. It is expected that any proceeds received will be deposited into the HCRA account. If estimated proceeds from health care conversions are not realized on the timetable or at the levels assumed in the FY 2014 Enacted Budget, the State may be required to take other actions, such as reducing planned spending in HCRA, or financing additional health care expenses in the General Fund, or both.

STATUS OF CURRENT LABOR NEGOTIATIONS (CURRENT CONTRACT PERIOD)

The State has labor contracts in force for the current contract period with approximately 90 percent of unionized State employees, including its three largest employee unions, Civil Service Employees Association (CSEA), Public Employees Federation (PEF), and the United University Professions (UUP), as well as the New York State Police Benevolent Association (NYSPBA) (representing the Agency Police Services Unit (APSU) bargaining unit, formerly Agency Law Enforcement Services (ALES), NYSCOPBA, and Council 82). Generally, the contracts provide for no across-the-board salary increases for FY 2012 through FY 2014, increases to employee health insurance contributions, and a temporary reduction in employee compensation through a Deficit Reduction Program ("DRP"). Employees will receive a 2 percent salary increase in both FY 2015 and FY 2016, and, at the end of their contract term, the value of FY 2013 deficit reduction adjustments. The PEF and NYSPBA contracts generally mirror the provisions for the other unions, but cover a four-year period, whereas the others cover a five-year period. PEF and NYSPBA-represented employees will receive a 2 percent salary increase in FY 2015. PEF-represented employees will be repaid all DRP adjustments at the end of their contract in lieu of the $1,000 lump sum payment per employee. Employees represented by the UUP ratified their agreement with the State on June 4, 2013. The agreement contains no general salary increases until FY 2014 and FY 2015 when there will be 2 percent general salary increases awarded in each year, payments to be awarded by the Chancellor, and performance incentive lump sum payments awarded by campus presidents. UUP-represented employees will also have a DRP. Employees in the unions that have reached settlements with the State received contingent layoff protection through FY 2013 and continued protection for the remaining term of the agreements. Reductions in force due to management decisions to close or restructure facilities authorized by legislation, Spending and Government Efficiency Commission (SAGE) determinations, or material or unanticipated changes in the State's fiscal circumstances are not covered by this protection.

LABOR SETTLEMENTS FOR PRIOR CONTRACT PERIODS

The Updated Financial Plan continues to identify a portion of the General Fund balance to cover the costs of a pattern settlement with unions that have not agreed to contracts for prior contract periods. The amount expected to be needed is calculated based on the general salary increases agreed to by the State's largest unions for the same period. There can be no assurance that actual settlements related to prior periods will not exceed the amounts informally designated for this purpose. In addition, the State's ability to fund the amounts so designated in FY 2014 and beyond depends on the achievement of balanced budgets in those years. The Updated Financial Plan does not include reserves for settlements covering the current contract period (i.e., starting in FY 2012).

CURRENT CASH-FLOW PROJECTIONS

The State authorizes the General Fund to borrow resources temporarily from available funds in the Short Term Investment Pool (STIP) for up to four months, or to the end of the fiscal year, whichever period is shorter. The amount of resources that can be borrowed by the General Fund is limited to the available balances in STIP, as determined by the State Comptroller. Available balances include money in the State's governmental funds and a relatively small amount of other moneys belonging to the State. Several accounts in Debt Service Funds and Capital Projects Funds that are part of All Governmental Funds are excluded from the balances deemed available in STIP. These excluded funds consist of bond proceeds and money obligated for debt service payments.

DOB expects that the State will have sufficient liquidity to make payments as they become due throughout FY 2014, but that the General Fund may, from time to time on a daily basis, need to borrow resources temporarily from other funds in STIP. The State continues to reserve money on a quarterly basis for debt service payments that are financed with General Fund resources. Money to pay debt service on bonds secured by dedicated receipts, including PIT bonds, continues to be set aside as required by law and bond covenants. The following table provides an estimate of month-end balances for FY 2014.

ALL FUNDS MONTH-END CASH BALANCES
FY 2014
(millions of dollars)

	General Fund	Other Funds	All Funds
April (Results)	6,379	3,175	9,554
May (Results)	3,744	3,765	7,509
June (Results)	4,805	2,684	7,489
July (Results)	4,407	2,671	7,078
August (Results)	3,642	3,312	6,954
September (Results)	6,273	1,539	7,812
October (Projected)	5,478	2,753	8,231
November (Projected)	4,076	3,036	7,112
December (Projected)	5,747	1,081	6,828
January (Projected)	7,190	2,816	10,006
February (Projected)	6,481	3,096	9,577
March (Projected)	1,803	2,306	4,109

PENSION AMORTIZATION

Under legislation enacted in August 2010, the State and local governments may amortize (defer paying) a portion of their annual pension costs beginning in FY 2011. Amortization temporarily reduces the pension costs that must be paid by public employers in a given fiscal year, but results in higher costs overall when repaid with interest. The legislation enacted a formula to set amortization thresholds for each year. The amortization thresholds may increase or decrease by up to one percentage point annually. Pension contribution costs in excess of the amortization thresholds, which, in FY 2014 will be 12.5

percent of payroll for the Employees' Retirement System (ERS) and 20.5 percent for the Police and Fire Retirement System (PFRS), may be amortized.

The Updated Financial Plan forecast assumes that the State will continue to amortize a portion of its pension costs, pursuant to the FY 2011 legislation. The State's minimum ERS pension contribution rate, as a percentage of payroll, was 9.5 percent in FY 2011, 10.5 percent in FY 2012, 11.5 percent in FY 2013, and is 12.5 percent in FY 2014. DOB projects the rate to be 13.5 percent in FY 2015, 14.5 percent in FY 2016, and 15.5 percent in FY 2017. The FY 2018 amortization threshold is projected by DOB to equal the normal contribution rate of 15.6 percent of payroll. Therefore, no amortization of ERS costs is expected to be applicable for FY 2018 and beyond.

The State's minimum PFRS pension contribution rate was 17.5 percent in FY 2011, 18.5 percent in FY 2012 and 19.5 percent in FY 2013. The rate is 20.5 percent in FY 2014 and DOB projects the rate to be 21.5 percent in FY 2015, 22.5 percent in FY 2016, and 23.5 percent in FY 2017. The PFRS amortization threshold is also projected to equal the normal contribution rate of 23.7 percent by FY 2018. Therefore, no amortization of PFRS costs are expected to be applicable for FY 2018 and beyond. These projected contribution rates, however, are based on projected market returns and numerous actuarial assumptions. The next quinquennial study is scheduled to take place in 2015 and may result in material changes to the projections set forth herein.

The authorizing legislation also permits amortization in all future years if the actuarial contribution rate is greater than the amortization thresholds. In addition, the State is required to begin repayment of the amounts amortized beginning in the fiscal year immediately following the amortizations. Repayment of the amortized amounts is required to be made over a period of not more than ten years at an interest rate to be determined by the State Comptroller annually for amounts amortized in that year and with the rate fixed for the entire term of that amortization.

In FY 2013, the State made pension payments to the New York State Local Retirement System (NYSLRS) of $1.217 billion. The amount amortized is $674.1 million. In addition, the State's Office of Court Administration (OCA) made its pension payment of $189.4 million. The amount amortized is $104.4 million. The $778.5 million in total deferred payments will be repaid with interest over the next ten years, beginning in FY 2014.

For amounts amortized in FY 2011, FY 2012, FY 2013, and FY 2014, the State Comptroller set interest rates of 5 percent, 3.75 percent, 3 percent, and 3.67 percent, respectively. The Updated Financial Plan forecast assumes that both the State and OCA will elect to amortize pension costs in future years, consistent with the provisions of the authorizing legislation, and repay such amounts at an interest cost assumed by DOB to be 3.67 percent (per annum) over ten years from the date of each deferred payment, consistent with the interest rate charged on the FY 2014 amortized amounts.

The following table, which summarizes pension contributions and projections for future fiscal years, reflects the "Normal Costs" of pension contributions as the amount the State would contribute to fund pensions before amortization, along with actual "New Amortized Amounts" in prior years and assumed "New Amortized Amounts" in upcoming years. The repayment costs (principal and interest) associated with these amortizations are reflected as the "Amortization Payment." Consistent with these amortization assumptions, Part TT of Chapter 57 of the Laws of 2010 requires that: (a) the State make additional contributions in upcoming fiscal years, above the actuarially required contribution, and (b) once all outstanding amortizations are paid off, additional contributions be set aside as reserves for rate increases, to be invested by the State Comptroller and used to offset future rate increases.

As noted above, DOB's most recent pension contribution rate forecast assumes that the normal contribution rate will equal the amortization threshold in FY 2018. Therefore, the State would not have the option to amortize any of its pension costs in 2018, or in the immediately succeeding fiscal years. Projections in the following table are based on certain DOB assumptions about actuarial factors on investment earnings and benefits to be paid, and while DOB believes such assumptions to be reasonable, actual results may vary from the projections provided in the following table, and such variances could be substantial.

EMPLOYEE RETIREMENT SYSTEM AND POLICE AND FIRE RETIREMENT SYSTEM[1]
PENSION CONTRIBUTIONS AND OUTYEAR PROJECTIONS

(millions of dollars)

Fiscal Year	Normal Costs[2]	New Amortized Amounts	Amortization Payment	Total
2011 Results	1,552.8	(249.6)	0.0	1,303.2
2012 Results	2,041.7	(562.9)	32.3	1,511.1
2013 Results	2,085.3	(778.5)	100.9	1,407.7
2014 Projected	2,543.5	(950.6)	192.1	1,785.0
2015 Projected	2,509.9	(744.0)	292.7	2,058.6
2016 Projected	2,103.4	(262.7)	379.9	2,220.6
2017 Projected	1,883.4	(44.6)	410.7	2,249.5
2018 Projected	1,886.4	0.0	415.4	2,301.8
2019 Projected	1,904.1	0.0	416.0	2,320.1
2020 Projected	1,941.1	0.0	416.0	2,357.1
2021 Projected	1,967.0	0.0	416.0	2,383.0
2022 Projected	1,980.7	0.0	383.6	2,364.3
2023 Projected	1,968.1	0.0	315.1	2,283.2
2024 Projected	1,942.0	0.0	223.8	2,165.8
2025 Projected	1,913.3	0.0	123.2	2,036.5
2026 Projected	1,870.1	0.0	36.0	1,906.1
2027 Projected	1,838.0	0.0	5.2	1,843.2
2028 Projected	1,831.2	0.0	0.0	1,831.2

Source: NYS DOB.

[1] Pension contribution values do not include pension costs related to the Optional Retirement Program and Teachers' Retirement System for SUNY and SED, whereas the projected pension disbursements in the Financial Plan tables presented in this Updated Financial Plan include such pension disbursements.

[2] Include payments from amortization prior to FY 2011. Such prior amortization payments will end in FY 2017.

OTHER POST-EMPLOYMENT BENEFITS (OPEB)

State employees become eligible for post-employment benefits (i.e., health insurance) if they reach retirement while working for the State, are enrolled in the New York State Health Insurance Program (NYSHIP) (or are enrolled in the State's opt-out program) at the time they have reached retirement, and have at least ten years of NYSHIP-benefits-eligible service. The cost of providing post-retirement health insurance is shared between the State and the retired employee. Contributions are established by law and may be amended by the Legislature. The State pays its share of costs on a Pay-As-You-Go (PAYGO) basis as required by law.

In accordance with the Governmental Accounting Standards Board (GASB) Statement 45, the State must perform an actuarial valuation every two years for purposes of calculating OPEB liabilities. As disclosed in Note 13 of the State's Basic Financial Statements for FY 2013, the Annual Required Contribution (ARC) represents the annual level of funding that, if set aside on an ongoing basis, is projected to cover normal costs each year and to amortize any unfunded liabilities of the plan over a period not to exceed 30 years. Amounts required but not actually set aside to pay for these benefits are accumulated, with interest, as part of the net OPEB obligation, after adjusting for amounts previously required.

As reported in the State's Basic Financial Statements for FY 2013, the unfunded actuarial accrued liability for FY 2013 is $66.5 billion ($54.3 billion for the State and $12.2 billion for SUNY), a decline of $5.5 billion from FY 2012 ($5.4 billion for the State and $0.1 billion for SUNY). The unfunded actuarial accrued liability for FY 2013 used an actuarial valuation of OPEB liabilities as of April 1, 2012 for the State and as of April 1, 2010 for SUNY. These valuations were determined using the Frozen Entry Age actuarial cost method, and are amortized over an open period of 30 years using the level percentage of projected payroll amortization method.

The actuarially determined annual OPEB cost for FY 2013 totaled $3.4 billion ($2.6 billion for the State and $0.8 billion for SUNY), a decline of $520 million from FY 2012 ($490 million for the State and $30 million for SUNY). The actuarially determined cost is calculated using the Frozen Entry Age actuarial cost method, allocating costs on a level basis over earnings. The actuarially determined cost was $2.0 billion ($1.4 billion for the State and $0.6 billion for SUNY) greater than the cash payments for retiree costs made by the State in FY 2013. This difference between the State's PAYGO costs, and the actuarially determined required annual contribution under GASB Statement 45, reduced the State's net asset condition at the end of FY 2013 by $2.0 billion.

GASB does not require the additional costs to be funded on the State's budgetary (cash) basis, and no funding is assumed for this purpose in the Updated Financial Plan. The State continues to finance these costs, along with all other employee health care expenses, on a PAYGO basis.

There is no provision in the Updated Financial Plan to fund the actuarial required contribution for OPEB. If the State began making the actuarial required contribution, the additional cost above the PAYGO amounts would be lowered. The State's Health Insurance Council, which consists of GOER, Civil Service and DOB, will continue to review this matter and seek input from the State Comptroller, the legislative fiscal committees and other outside parties. However, it is not expected that the State will alter its planned funding practices in light of existing fiscal conditions.

LITIGATION

Litigation against the State may include potential challenges to the constitutionality of various actions. The State may also be affected by adverse decisions that are the result of various lawsuits. Such adverse decisions may not meet the materiality threshold to warrant individual description but, in the aggregate, could still adversely affect the Updated Financial Plan.

UPDATE ON STORM RECOVERY

In August 2011, Hurricane Irene disrupted power and caused extensive flooding to various New York State counties. In September 2011, Tropical Storm Lee caused flooding in additional New York State counties and, in some cases, exacerbated the damage caused by Hurricane Irene two weeks earlier. Little more than one year later, on October 29, 2012, Superstorm Sandy struck the East Coast, causing widespread infrastructure damage and economic losses to the greater New York region. The frequency and intensity of these storms presents economic and financial risks to the State. Major disaster response and recovery activities have been ongoing. In January 2013, the Federal government approved approximately $60 billion in Federal disaster aid for general recovery, rebuilding and mitigation activity nationwide, of which New York anticipates receiving approximately one-half. The State expects to receive $5.1 billion in extraordinary Federal assistance during FY 2014 specifically for Superstorm Sandy expenses. There can be no assurance that all anticipated Federal disaster aid described above will be provided to the State and its affected entities, or that such Federal disaster aid will be provided on the expected schedule.

CLIMATE CHANGE ADAPTATION

Climate change is expected to cause long-term threats to physical and biological systems. Potential hazards and risks related to climate change for the State include, among other things, rising sea levels, more severe coastal flooding and erosion hazards, and more intense storms. Storms in recent years, including Superstorm Sandy, Hurricane Irene, and Tropical Storm Lee, have demonstrated vulnerabilities in the State’s infrastructure, including mass transit systems, power transmission and distribution systems, and other critical lifelines, to extreme weather events, including coastal flooding caused by storm surges. Significant long-term planning and investment by the Federal government, State, and municipalities is expected to be needed to adapt existing infrastructure to the risks posed by climate change.

FINANCIAL CONDITION OF NEW YORK STATE LOCALITIES

The fiscal demands on the State may be affected by the fiscal conditions of New York City and potentially other localities, which rely in part on State aid to balance their budgets and meet their cash requirements. Certain localities outside New York City, including cities, and counties, have experienced financial problems and have requested and received additional State assistance during the last several State fiscal years.

BOND MARKET

Implementation of the Updated Financial Plan is dependent on the State's ability to market its bonds successfully. The State finances much of its capital spending in the first instance from the General Fund or STIP, which it then reimburses with proceeds from the sale of bonds. If the State cannot sell bonds at the levels (or on the timetable) expected in the capital plan, it can adversely affect the State’s overall cash position and capital funding plan. The success of projected public sales will, among other things, be subject to prevailing market conditions. Future developments in the financial markets, including possible changes in Federal tax law relating to the taxation of interest on municipal bonds, as well as future developments concerning the State and public discussion of such developments, generally may affect the market for outstanding State-supported and State-related debt.

CAPITAL COMMITMENT PLAN

The New York Works Task Force was formed in FY 2013 to assist in the coordination of long-term capital planning among State agencies and public authorities. Consistent with the long-term planning goals of New York Works, the DOB formulated 10-year capital commitment and disbursement projections for State agencies as part of the FY 2013 capital plan. The total commitment and disbursement levels permissible over the 10-year capital planning horizon reflect, among other things, projected capacity under the State's debt limit, anticipated levels of Federal aid, and the timing of capital activity based on known needs and historical patterns.

DEBT REFORM ACT LIMIT

The Debt Reform Act of 2000 restricts the issuance of State-supported debt to capital purposes only and limits such debt to a maximum term of 30 years. The Act limits the amount of new State-supported debt to 4 percent of State personal income and new State-supported debt service costs to 5 percent of All Funds receipts. The restrictions apply to all new State-supported debt issued since April 1, 2000. The cap on new State-supported debt outstanding began at 0.75 percent of personal income in FY 2001 and was fully phased-in at 4 percent of personal income during FY 2011, while the cap on new State-supported debt service costs began at 0.75 percent of All Funds receipts in FY 2001 and is fully phased in at 5 percent during FY 2014.

The statute requires that the limitations on the amount of State-supported debt and debt service costs be calculated by October 31 of each year and reported in the Mid-Year Financial Plan. If the actual amount of new State-supported debt outstanding and debt service costs for the prior fiscal year are below the caps at this time, State-supported debt may continue to be issued. However, if either the debt outstanding or the debt service caps are met or exceeded, the State would be precluded from issuing new State-supported debt until the next annual cap calculation is made and debt is found to be within the applicable limitations.

For FY 2013, the cumulative debt outstanding and debt service caps are 4.00 and 4.98 percent, respectively. As shown in the tables below, the actual levels of debt outstanding and debt service costs continue to remain below the statutory caps. From April 1, 2000 through March 31, 2013 the State has issued new debt resulting in $37.5 billion of debt outstanding applicable to the debt reform cap. This is about $4.2 billion below the statutory debt outstanding limitation. In addition, the debt service costs on this new debt totaled $3.7 billion in FY 2013, or roughly $3.0 billion below the statutory debt service limitation.

DEBT OUTSTANDING CAP
(millions of dollars)

	Dollar	Percent
Personal Income (CY 2012)[1]	1,041,931	
Max. Allowable Debt Outstanding[2]	41,677	4.00%
Debt Outstanding Subject to Cap	37,523	3.60%
Remaining Capacity	4,155	0.40%

[1] U.S. Bureau of Economic Analysis.

[2] Equal to 4 percent of CY Personal Income.

DEBT SERVICE CAP
(millions of dollars)

	Dollar	Percent
All Funds Receipts (FY 2013)	133,174	
Max. Allowable Debt Service	6,637	4.98%
Debt Service Subject to Cap	3,670	2.76%
Remaining Capacity	2,967	2.23%

Current projections estimate that debt outstanding and debt service will continue to remain below the limits imposed by the Act. Based on the most recent personal income and debt outstanding forecasts, the available room under the debt outstanding cap is expected to decline from $2.4 billion in FY 2014 to $720 million in FY 2017. This includes the estimated impact of the bond-financed portion of capital commitment levels included in DOB's 10-year capital planning projections. Debt outstanding and debt service caps continue to include the existing SUNY Dormitory Facilities lease revenue bonds, which are backed by a general obligation pledge of SUNY. Bonds issued under the newly created SUNY Dormitory Facilities Revenue credit are not included in the State's calculation of debt caps. Capital spending priorities and debt financing practices may be adjusted from time to time to preserve available debt capacity and stay within the statutory limits, as events warrant.

DEBT OUTSTANDING SUBJECT TO CAP
(millions of dollars)

Year	Personal Income	Cap %	Cap $	Debt Outstanding Since April 1, 2000	$ Remaining Capacity	Debt as a % of PI	% Remaining Capacity
FY 2013	1,041,931	4.00%	41,677	37,523	4,155	3.60%	0.40%
FY 2014	1,070,620	4.00%	42,825	40,432	2,393	3.78%	0.22%
FY 2015	1,127,009	4.00%	45,080	43,639	1,442	3.87%	0.13%
FY 2016	1,181,754	4.00%	47,270	46,517	753	3.94%	0.06%
FY 2017	1,240,533	4.00%	49,621	48,902	720	3.94%	0.06%
FY 2018	1,303,500	4.00%	52,140	50,657	1,483	3.89%	0.11%

TOTAL STATE-SUPPORTED DEBT
(millions of dollars)

Debt Outstanding Prior to April 1, 2000	Total State-Supported Debt Outstanding
15,011	52,534
13,661	54,093
11,940	55,579
10,560	57,077
9,019	57,921
7,503	58,161

DEBT SERVICE SUBJECT TO CAP
(millions of dollars)

Year	All Funds Receipts	Cap %	Cap $	Debt Service Since April 1, 2000	$ Remaining Capacity	DS as a % of Revenue	% Remaining Capacity
FY 2013	133,174	4.98%	6,637	3,670	2,967	2.76%	2.23%
FY 2014	140,932	5.00%	7,047	3,925	3,121	2.79%	2.21%
FY 2015	143,366	5.00%	7,168	4,211	2,958	2.94%	2.06%
FY 2016	148,119	5.00%	7,406	4,594	2,812	3.10%	1.90%
FY 2017	154,010	5.00%	7,701	4,988	2,712	3.24%	1.76%
FY 2018	155,908	5.00%	7,795	5,328	2,468	3.42%	1.58%

TOTAL STATE-SUPPORTED DEBT SERVICE
(millions of dollars)

Debt Service Prior to April 1, 2000	Total State-Supported Debt Service
2,468	6,138
2,122	6,047
1,563	5,774
1,859	6,453
1,766	6,754
1,711	7,039

DEBT FINANCING CHANGES

SALES TAX REVENUE BOND PROGRAM

Legislation adopted with the FY 2014 Enacted Budget creates a new Sales Tax Revenue Bond Program which constitutes State-supported debt subject to the Debt Reform Act debt caps described above. The legislation creates the Sales Tax Revenue Bond Tax Fund, a sub-fund within the General Debt Service Fund that will provide for the payment of these bonds. The new Sales Tax Revenue Bonds are secured by the dedication of payments from this fund, which receives one percent of the State's four percent sales and use tax receipts. With a limited exception, upon the satisfaction of all of the obligations and liabilities of the Local Government Assistance Corporation (LGAC), the amount of sales tax receipts directed to this fund will increase to two percent. Tax receipts in excess of debt service requirements will be transferred to the State's General Fund.

The Sales Tax Revenue Bonds will be used interchangeably with PIT bonds to finance most of the State's capital needs. Based on current projections and anticipated coverage requirements, the State expects to issue about $1 billion of Sales Tax Revenue Bonds annually. The first bonds for the Sales Tax Revenue Bond Program were issued in October 2013.

SUNY DORMITORY FACILITIES REVENUE BOND PROGRAM

Legislation adopted with the FY 2014 Enacted Budget created a new bonding program for SUNY Dormitory Facilities. The new bonding program is supported solely by third party revenues generated by student rents. All rental revenues flow to the newly created Dormitory Facilities Revenue Fund held by the Commissioner of Taxation and Finance as assigned to the Dormitory Authority of the State of New York (DASNY) for the payment of debt service without an appropriation. Unlike the existing program, the new program will not include a SUNY general obligation pledge, thereby eliminating any recourse to the State. Accordingly, such bonds are not classified as State-supported debt for purposes of the Debt Reform Act. Future SUNY Dormitory Facilities capital needs will be funded through the new credit. Under this legislation, the existing SUNY Dormitory Facilities lease revenue bonds and associated debt service will continue to be counted as State-supported debt until they are refunded into the new program or are paid off at maturity. The first bonds on the new SUNY Dormitory Facilities credit were issued in August 2013.

SECURED HOSPITAL PROGRAM

Under the Secured Hospital Program, the State entered into service contracts to enable certain financially distressed not-for-profit hospitals to have tax-exempt debt issued on their behalf to pay for the cost of upgrading their primary health care facilities. In the event of shortfalls in revenues to pay debt service on the Secured Hospital bonds (which include hospital payments made under loan agreements between DASNY and the hospitals and certain reserve funds held by the applicable trustees for the bonds) the service contracts obligate the State to pay debt service, subject to annual appropriations by the Legislature, on bonds issued by the New York State Medical Care Facilities Financing Agency and by DASNY through the Secured Hospital Program. As of March 31, 2013, there were approximately $421 million of bonds outstanding for this program.

The financial condition of hospitals in the State's Secured Hospital Program continues to deteriorate. Of the six remaining hospitals in the program, two are experiencing significant operating losses that have impaired their ability to remain current on their loan agreements with DASNY. In relation to the Secured Hospital Program, the State expects to pay debt service costs of $13 million in FY 2014, approximately $30 million annually for FY 2015 through FY 2017, and $17 million in FY 2018. These amounts are based on the actual experience to date of the participants in the program, and would cover the debt service costs for two hospitals that currently are not meeting the terms of their legal agreements with DASNY, as well as the debt service costs of a third hospital that is now closed. The State has estimated additional exposure of up to $44 million annually, if all hospitals in the program failed to meet the terms of their agreement with DASNY and if available reserve funds were depleted.

SUNY DOWNSTATE HOSPITAL AND LONG ISLAND COLLEGE HOSPITAL

In May 2011, the New York State Supreme Court issued an order (the "May 2011 Order") that approved the transfer of real property and other assets of Long Island College Hospital ("LICH") to a New York State not-for-profit corporation ("Holdings"), the sole member of which is SUNY. Subsequent to such transfer, Holdings leased the LICH hospital facility to SUNY Downstate Hospital ("Downstate Hospital"). In 2012, DASNY issued a portion of its tax exempt State Personal Income Tax Revenue Bonds ("PIT Bonds"), Series 2012D to refund approximately $100 million in outstanding debt originally incurred by LICH.

To address the deteriorating financial condition of Downstate Hospital, which has been caused in part by the deteriorating financial position of LICH, legislation adopted with the FY 2014 Enacted Budget required the Chancellor of SUNY to submit to the Governor and the Legislature a multi-year sustainability plan for the Downstate Hospital. Specifically, the legislation required the sustainability plan to: a) set forth recommendations necessary to achieve financial stability for Downstate Hospital, and b) preserve the academic mission of Downstate Hospital's medical school. In accordance with this legislation, the Chancellor of SUNY submitted the sustainability plan for Downstate Hospital on May 31, 2013, and supplemented the plan with changes in a letter dated June 13, 2013. The supplemented plan was approved by both the Commissioner of Health and the Director of the Budget on June 13, 2013. Generally, the approved sustainability plan anticipates: a) a significant restructuring of health care service lines at University Hospital Brooklyn in order to achieve financial milestones assumed in the sustainability plan, and supported by State financial assistance from the State Department of Health; and, b) leveraging the LICH asset value to support the costs associated with Downstate Hospital exiting LICH operations, while accommodating continued health care services consistent with the needs of the community.

In 2013, the Judge Demarest (who issued the May 2011 Order) issued, *sua sponte*, certain additional orders that could affect the validity of the May 2011 Order. Such orders issued in 2013 are under appeal and all proceedings before Judge Demarest are stayed pending such appeal. Further, SUNY, together with Holdings, has issued a request for proposals to provide healthcare services in or around the LICH facilities and to purchase the LICH real estate. The outcomes of such processes may require the expenditure of State funds or the defeasance of such PIT Bonds, in whole or in part. There can be no assurance that the resolution of the legal and financial issues surrounding LICH, including payment of outstanding liabilities, will not have a materially adverse impact on SUNY.

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FINANCIAL PLAN PROJECTIONS FISCAL YEARS 2014 THROUGH 2017

INTRODUCTION

This section presents the State's updated multi-year Financial Plan and the projections for receipts and disbursements, reflecting the impact of the revisions to the First Quarterly Update Financial Plan described in this AIS Update. This section includes FY 2013 results and projections for 2014 through 2017, with an emphasis on the FY 2014 projections.

The State's cash-basis budgeting system, complex fund structure, and practice of earmarking certain tax receipts for specific purposes, complicate the discussion of the State's receipts and disbursements projections. Therefore, to minimize the distortions caused by these factors and, equally important, to highlight relevant aspects of the projections, DOB has adopted the following approaches in summarizing the projections:

- **Receipts:** The detailed discussion of tax receipts covers projections for both the General Fund and State Funds (including capital projects). The latter perspective reflects overall estimated tax receipts before their diversion among various funds and accounts, including tax receipts dedicated to capital projects funds (which fall outside of the General Fund and State Operating Funds accounting perspectives). DOB believes this presentation provides a clearer picture of projected receipts, trends and forecast assumptions, by factoring out the distorting effects of earmarking certain tax receipts.

- **Disbursements:** Over 40 percent of projected State-financed spending for operating purposes is accounted for outside of the General Fund and is primarily concentrated in the areas of health care, School Aid, higher education, transportation and mental hygiene. To provide a clearer picture of spending commitments, the multi-year projections and growth rates are presented, where appropriate, on both a General Fund and State Operating Funds basis.

In evaluating the State's multi-year operating forecast, it should be noted that the reliability of the estimates and projections as a predictor of the State's future financial position is likely to diminish the further removed such estimates and projections are from the date of the Updated Financial Plan. Accordingly, in terms of out-year projections (FY 2015 through FY 2017), FY 2015 is the most relevant from a planning perspective.

SUMMARY

DOB estimates that the Updated Financial Plan is balanced on a General Fund cash basis in FY 2014, and leaves projected General Fund deficits that total approximately $1.74 billion in FY 2015 and $2.9 billion in both FY 2016 and FY 2017. The net operating shortfall in State Operating Funds is projected at $1.7 billion in FY 2015, $2.7 billion in FY 2016 and $2.6 billion in FY 2017.[3]

The following tables present the Financial Plan multi-year projections, as well as reconciliation between the State Operating Funds projections and the General Fund budget gaps. The tables are followed by a summary of the multi-year receipts and disbursements forecasts.

GENERAL FUND PROJECTIONS
(millions of dollars)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
	Results	Updated	Projected	Projected	Projected
RECEIPTS					
Taxes (After Debt Service)	54,568	57,264	58,476	62,050	65,153
Miscellaneous Receipts/Federal Grants	3,566	3,308	3,595	2,776	2,797
Other Transfers	649	1,071	768	723	726
Total Receipts	**58,783**	**61,643**	**62,839**	**65,549**	**68,676**
DISBURSEMENTS					
Local Assistance Grants	39,760	40,258	42,598	45,056	47,276
School Aid	17,110	17,290	18,573	19,390	20,519
Medicaid	11,109	11,232	11,391	12,136	12,631
All Other	11,541	11,736	12,634	13,530	14,126
State Operations	7,856	7,568	7,819	8,117	8,214
Personal Service	6,130	5,686	5,852	6,113	6,129
Non-Personal Service	1,726	1,882	1,967	2,004	2,085
General State Charges	4,550	4,922	5,328	5,604	5,873
Transfers to Other Funds	6,794	8,702	8,861	9,682	10,248
Debt Service	1,647	1,646	1,165	1,452	1,345
Capital Projects	916	1,227	1,384	1,400	1,799
Mental Hygiene State Share Medicaid	2,846	1,813	1,338	1,311	1,279
SUNY Operations	340	971	971	971	971
All Other	1,045	3,045	4,003	4,548	4,854
Total Disbursements	**58,960**	**61,450**	**64,606**	**68,459**	**71,611**
RESERVES/RESERVED FOR:	**(177)**	**193**	**(25)**	**(21)**	**13**
Prior-Year Labor Agreements (2007-11)	(206)	(32)	10	12	13
Community Projects Fund	(9)	(25)	(35)	(33)	0
Debt Management	0	250	0	0	0
Undesignated Fund Balance	38	0	0	0	0
BUDGET SURPLUS/(GAP) PROJECTIONS	**0**	**0**	**(1,742)**	**(2,889)**	**(2,948)**

[3] The annual imbalances projected for the General Fund and State Operating Funds in future years are similar because the General Fund is the financing source of last resort for many State programs. Imbalances in other funds are typically financed by the General Fund.

FY 2014 MID-YEAR UPDATE - STATE OPERATING FUNDS PROJECTIONS
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
RECEIPTS					
Taxes	64,932	67,924	69,672	73,883	77,547
Miscellaneous Receipts/Federal Grants	20,141	19,853	20,383	19,542	19,731
Total Receipts	**85,073**	**87,777**	**90,055**	**93,425**	**97,278**
DISBURSEMENTS					
Local Assistance Grants	58,578	59,696	62,219	64,872	67,289
School Aid	20,163	20,471	21,692	22,514	23,641
STAR	3,286	3,419	3,602	3,704	3,805
Other Education Aid	1,927	2,032	2,091	2,197	2,328
Higher Education	2,629	2,825	2,911	2,994	3,066
Medicaid	15,879	16,230	16,780	17,591	18,248
Public Health/Aging	2,040	2,193	1,997	1,989	1,960
Mental Hygiene	3,602	2,833	3,450	3,967	4,173
Social Services	3,032	2,996	3,050	3,146	3,242
Transportation	4,303	4,739	4,831	4,910	4,995
Local Government Assistance	754	764	769	782	794
All Other	963	1,194	1,046	1,078	1,037
State Operations	17,683	17,844	18,275	18,877	19,185
Personal Service	12,403	12,366	12,642	13,078	13,210
Non-Personal Service	5,280	5,478	5,633	5,799	5,975
General State Charges	6,437	7,058	7,533	7,954	8,287
Pension Contribution	1,601	1,982	2,256	2,418	2,446
Health Insurance (Active Employees)	1,720	1,824	1,945	2,060	2,232
Health Insurance (Retired Employees)	1,409	1,491	1,531	1,651	1,788
All Other	1,707	1,761	1,801	1,825	1,821
Debt Service	6,138	6,060	5,805	6,482	6,783
Capital Projects	8	11	5	5	5
Total Disbursements	**88,844**	**90,669**	**93,837**	**98,190**	**101,549**
Net Other Financing Sources/(Uses)	4,283	2,848	2,105	2,052	1,625
NET OPERATING SURPLUS/ (DEFICIT)	**512**	**(44)**	**(1,677)**	**(2,713)**	**(2,646)**
RECONCILIATION TO GENERAL FUND GAP					
Designated Fund Balances:	(512)	44	(65)	(176)	(302)
General Fund	177	(193)	25	21	(13)
Special Revenue Funds	(736)	297	(95)	(204)	(268)
Debt Service Funds	47	(60)	5	7	(21)
GENERAL FUND BUDGET GAP	**0**	**0**	**(1,742)**	**(2,889)**	**(2,948)**

ECONOMIC BACKDROP

THE NATIONAL ECONOMY

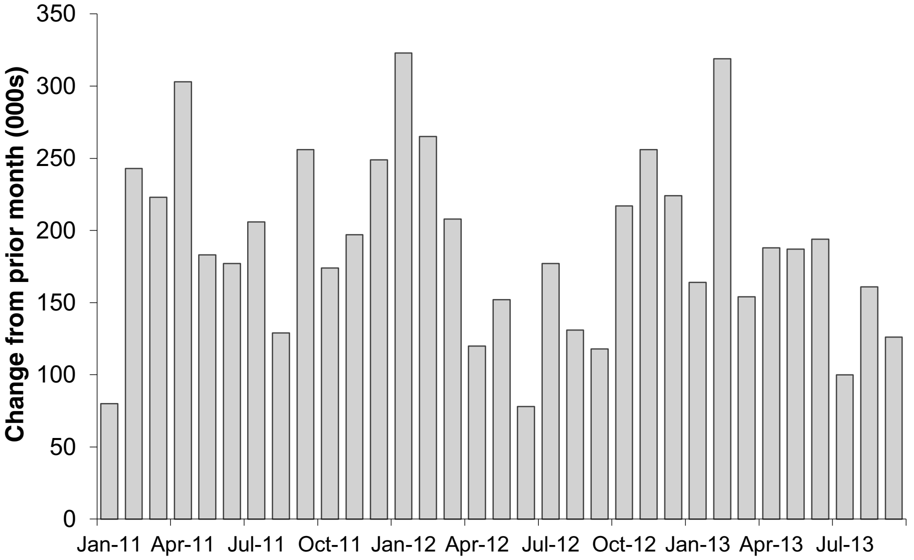
The persistent weakness that has plagued much of the current recovery has continued into the third quarter of calendar year 2013. A measure of unexpected interest rate volatility may have been inadvertently introduced by the Federal Reserve in the wake of its June 19, 2013 meeting. Anticipation of when the Federal Reserve would start to "taper" its long-term asset purchases resulted in an approximately 40 basis-point increase in the 10-year Treasury yield within a period of less than three weeks. By early September 2013, the 10-year yield was nearing its highest levels in over two years. Higher long-term rates had a substantial impact on the highly interest rate-sensitive housing market recovery, with mortgage applications falling 86 percent in the third quarter of 2013 after a 21 percent decline in the second quarter of 2013. As a result, both residential housing construction and real household spending appear to have weakened more in the third quarter than anticipated in the First Quarterly Update forecast.

The 16-day Federal government shutdown and the uncertainty engendered by political wrangling in the nation's capital are expected to reduce growth during the fourth quarter of 2013. In contrast, real U.S. export growth has recently been stronger than anticipated, supporting the possibility that the global economy bottomed out earlier this year, while the drag from Federal fiscal policy and the Congressional sequestration should diminish by early 2014. Equity markets are at record highs and gasoline prices are at near-term lows. Due in part to these factors, DOB's outlook for stronger growth in the coming calendar year remains unchanged. Real U.S. GDP growth of 1.5 percent is now projected for 2013, followed by growth of 2.4 percent for 2014.

Consistent with weaker domestic final sales growth, recent employment gains have also been lower than anticipated in the First Quarterly Update to the Financial Plan. Private sector job growth has been on a downward trend since the end of 2012, but that trend accelerated in the third quarter of 2013. Average monthly private sector job gains fell from 212,000 in the first quarter of this year to 190,000 jobs in the second quarter and 129,000 in the third. The largest contributors to the deceleration have been professional and business services and leisure and hospitality. As a result, downward revisions have been made to employment growth for both 2013 and 2014. Employment growth of 1.6 percent is now projected for both 2013 and 2014.

Consistent with weaker job growth, estimated growth in wages and total personal income for the current year and next year have also been revised down, although weaker growth in wages is expected to be partially offset by stronger growth in some of the non-wage components of income, such as proprietor's and dividend income. Growth of 2.8 percent is estimated for both wages and personal income for 2013, with growth accelerating to 4.5 percent for both measures in 2014. The relatively large swing in income growth between 2013 and 2014 reflects the shifting of income from 2013 into 2012 in advance of increases in the two top Federal marginal tax rates at the beginning of this year.

Recent U.S. Private Sector Employment Gains



Source: Moody's Analytics.

The euro-zone economies appear to be stabilizing, leading to an upward revision in real U.S. export growth to 2.7 percent for the current year. However, uncertainty surrounding domestic demand is expected to restrain private business spending by even more than anticipated in the July update forecast. Real growth in private nonresidential fixed investment has been revised down to 2.4 percent for 2013. With growth expected to remain weak over the near-term, the Federal Reserve is likely to delay the tapering of its long-term asset purchases into the first half of 2014 and will not start to raise its federal funds rate target until early 2015. With gasoline prices at their lowest levels since the beginning of this year and the overall outlook for inflation remaining moderate, the central bank has room to maintain its accommodative stance well into the near future. The growth in consumer prices for 2013 remains at 1.5 percent for 2013, but it has been revised down to 1.8 percent from 2.1 percent for 2014 in anticipation of continuing low energy prices.

The response of financial markets to the timing of Federal Reserve "tapering" presents a significant headwind to national economic growth in 2014, particularly given the lack of experience on which to draw. Energy prices continue to be volatile and present both upside and downside risk to the household consumption forecast, as do home and equity price growth. Finally, the cost to the economy of the government shutdown remains uncertain, but the preliminary evidence is not encouraging. With the battle over the Federal budget and the debt ceiling pushed back to January and February 2014, displays of political gridlock represent substantial risk to economic activity in early 2014.

DOB's economic outlook calls for weaker growth for the current calendar year than was projected in July, followed by substantial improvement in 2014. However, there are significant risks to this forecast. The budget sequester is estimated to have had a substantial negative impact on the labor market and could result in a larger decline in government spending than anticipated in the coming months, resulting in a greater loss of government jobs or private jobs related to government procurement. The global economy is expected to improve, but emerging market growth remains slower than in the earlier phase in the recovery. Slower export growth than expected could negatively affect growth in U.S. corporate profits, investment, and jobs. In contrast, faster global growth than expected could result in a faster upturn in the demand for U.S. exports.

U.S. ECONOMIC INDICATORS (Percent change from prior calendar year)	2012 (Estimated)	2013 (Forecast)	2014 (Forecast)
Real U.S. Gross Domestic Product	2.8	1.5	2.4
Consumer Price Index (CPI)	2.1	1.5	1.8
Personal Income	4.2	2.8	4.5
Nonagricultural Employment	1.7	1.6	1.6

Source: Moody's Analytics; DOB staff estimates.

THE NEW YORK STATE ECONOMY

The State economy has performed well in the context of a challenging national and global economic environment. New York's private sector labor market remains strong, continuing to exhibit robust growth in professional and business services, private educational services, and tourism-related leisure and hospitality services. However, New York has not been entirely immune to the national slowdown. Private sector employment growth of 1.4 percent is projected for the 2013 calendar year, followed by growth of a similar pace for 2014. These growth rates represent marginal downward revisions from July, but remain above historical averages.

In contrast with recent private labor market trends, public sector employment is expected to continue to decline well into 2014. The ongoing downsizing of both the finance and government sectors has been contributing to unusually weak income growth over the past two years. In advance of Federal tax increases at the start of this year, a sizable magnitude of wages, dividends, and capital gains were accelerated into the fourth quarter of 2012. Consequently, it is more instructive to view State income growth on a fiscal year basis rather than on a calendar year basis. Weaker growth of 3.8 percent is now estimated for the State fiscal year in progress, but offsetting that revision is stronger growth in the non-wage components of personal income. On balance, personal income growth of 3.7 percent is now projected for FY 2014, followed by growth of 4.9 percent for FY 2015. These projections represent only marginal revisions from the First Quarterly Update Financial Plan forecast.

NEW YORK STATE ECONOMIC INDICATORS (Percent change from prior State fiscal year)	2012-13 (Actual)	2013-14 (Forecast)	2014-15 (Forecast)
Personal Income	2.9	3.7	4.9
Wages	3.0	3.8	4.5
Nonagricultural Employment	1.2	1.1	1.2

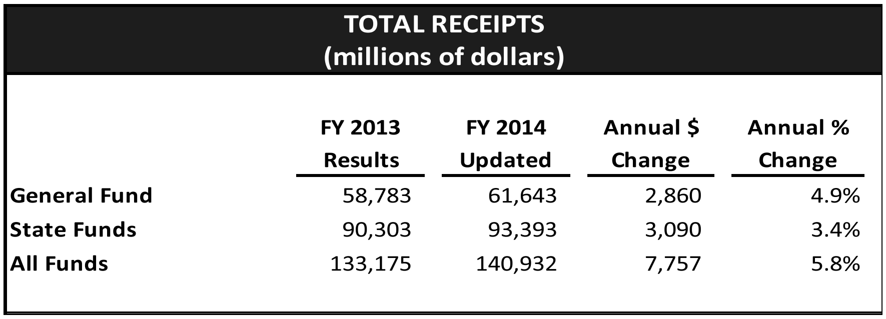
Source: Moody's Analytics; New York State Department of Labor; DOB staff estimates.

All of the risks to the U.S. forecast apply to the State forecast as well, although as the nation's financial capital, the volume of financial market activity and equity market volatility pose a particularly large degree of uncertainty for New York. Recent events have demonstrated how sensitive markets can be to shifting expectations surrounding Federal Reserve policy. The resulting market gyrations are likely to have a larger impact on the State economy than on the nation as a whole. Thus, the recent volatility in long-term interest rates adds an additional degree of risk to the finance and insurance sector bonus forecast. In addition, with Wall Street still adjusting its compensation practices in the wake of the passage of financial reform, both the bonus and non-bonus components of employee pay are becoming more difficult to estimate. Securities industry revenues have in the past been a useful predictor of bonus payouts, but that relationship has become much more erratic in recent years.

The estimation of taxpayer response to changes in Federal tax law creates an additional layer of uncertainty and risk to the forecast. To the extent that 2013 base wages were shifted into the end of 2012 to avoid rising Federal tax rates, 2014 wage growth could be stronger than expected. In contrast, a weaker labor market than projected could result in lower wages. Similarly, should financial and real estate markets be weaker than anticipated, taxable capital gains realizations could be negatively affected. These effects could ripple through the State economy, depressing employment, wage, and household spending growth. In contrast, stronger national and world economic growth, or a stronger upturn in stock prices, along with even stronger activity in mergers and acquisitions and other Wall Street activities, could result in higher wage and bonuses growth than projected.

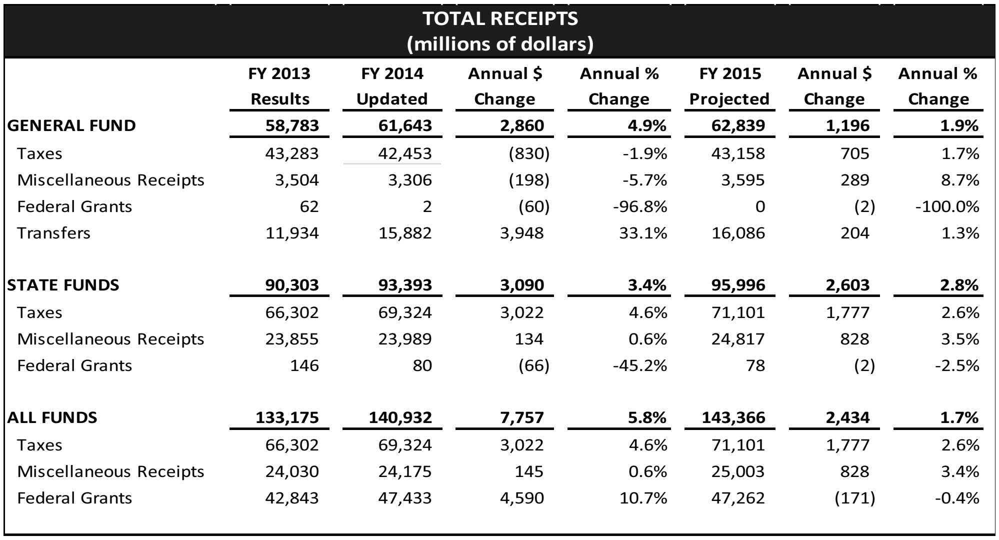
ALL FUNDS RECEIPTS PROJECTIONS

The receipts forecast describes estimates for the State's principal taxes, miscellaneous receipts, and transfers from other funds. Financial Plan receipts comprise a variety of taxes, fees, and charges for State-provided services, Federal grants, and other miscellaneous receipts. The receipts estimates and projections have been prepared by DOB with the assistance of the Department of Taxation and Finance and other agencies responsible for the collection of State receipts. The following tables summarize the current receipts forecast.



TOTAL RECEIPTS
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Annual $ Change	Annual % Change
General Fund	58,783	61,643	2,860	4.9%
State Funds	90,303	93,393	3,090	3.4%
All Funds	133,175	140,932	7,757	5.8%



TOTAL RECEIPTS
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Annual $ Change	Annual % Change	FY 2015 Projected	Annual $ Change	Annual % Change
GENERAL FUND	**58,783**	**61,643**	**2,860**	**4.9%**	**62,839**	**1,196**	**1.9%**
Taxes	43,283	42,453	(830)	-1.9%	43,158	705	1.7%
Miscellaneous Receipts	3,504	3,306	(198)	-5.7%	3,595	289	8.7%
Federal Grants	62	2	(60)	-96.8%	0	(2)	-100.0%
Transfers	11,934	15,882	3,948	33.1%	16,086	204	1.3%
STATE FUNDS	**90,303**	**93,393**	**3,090**	**3.4%**	**95,996**	**2,603**	**2.8%**
Taxes	66,302	69,324	3,022	4.6%	71,101	1,777	2.6%
Miscellaneous Receipts	23,855	23,989	134	0.6%	24,817	828	3.5%
Federal Grants	146	80	(66)	-45.2%	78	(2)	-2.5%
ALL FUNDS	**133,175**	**140,932**	**7,757**	**5.8%**	**143,366**	**2,434**	**1.7%**
Taxes	66,302	69,324	3,022	4.6%	71,101	1,777	2.6%
Miscellaneous Receipts	24,030	24,175	145	0.6%	25,003	828	3.4%
Federal Grants	42,843	47,433	4,590	10.7%	47,262	(171)	-0.4%

After controlling for the impact of tax law changes, base tax revenue is estimated to increase by 4.6 percent for FY 2014 and 4.8 percent for FY 2015.

CHANGE FROM ENACTED BUDGET FINANCIAL PLAN FORECAST

Current year All Funds tax receipt estimates are unchanged from the First Quarterly Update to the Financial Plan. Miscellaneous receipts have been revised down by $47 million, due to the estimated impact of lower utility bills on section 18-a receipts.

CHANGE FROM FIRST QUARTERLY UPDATE FORECAST
(millions of dollars)

	FY 2014				FY 2015			
	First Quarter	Mid-Year Update	$ Change	% Change	First Quarter	Mid-Year Update	$ Change	% Change
GENERAL FUND[1]	**45,808**	**45,761**	**(47)**	**-0.1%**	**46,753**	**46,753**	**0**	**0.0%**
Taxes	42,453	42,453	0	0.0%	43,158	43,158	0	0.0%
Miscellaneous Receipts	3,353	3,306	(47)	-1.4%	3,595	3,595	0	0.0%
Federal Grants	2	2	0	0.0%	0	0	0	0.0%
STATE FUNDS	**93,440**	**93,393**	**(47)**	**-0.1%**	**95,996**	**95,996**	**0**	**0.0%**
Taxes	69,324	69,324	0	0.0%	71,101	71,101	0	0.0%
Miscellaneous Receipts	24,036	23,989	(47)	-0.2%	24,817	24,817	0	0.0%
Federal Grants	80	80	0	0.0%	78	78	0	0.0%
ALL FUNDS	**140,979**	**140,932**	**(47)**	**0.0%**	**143,366**	**143,366**	**0**	**0.0%**
Taxes	69,324	69,324	0	0.0%	71,101	71,101	0	0.0%
Miscellaneous Receipts	24,222	24,175	(47)	-0.2%	25,003	25,003	0	0.0%
Federal Grants	47,433	47,433	0	0.0%	47,262	47,262	0	0.0%

[1] Excludes Transfers.

MULTI-YEAR RECEIPTS

TOTAL RECEIPTS
(millions of dollars)

	FY 2014 Updated	FY 2015 Projected	Annual $ Change	FY 2016 Projected	Annual $ Change	FY 2017 Projected	Annual $ Change
General Fund	**61,643**	**62,839**	**1,196**	**65,549**	**2,710**	**68,676**	**3,127**
Taxes	42,453	43,158	705	46,037	2,879	48,502	2,465
State Funds	**93,393**	**95,996**	**2,603**	**99,769**	**3,773**	**102,937**	**3,168**
Taxes	69,324	71,101	1,777	75,332	4,231	79,002	3,670
All Funds	**140,932**	**143,366**	**2,434**	**148,119**	**4,753**	**154,010**	**5,891**
Taxes	69,324	71,101	1,777	75,332	4,231	79,002	3,670

The Updated Financial Plan economic forecast calls for a continuation of the ongoing recovery in employment and wages. This increases the economic base on which the outyear revenue forecast is built. Overall, receipts in the two fiscal years following FY 2015 are expected to grow consistently with the projected moderate growth in both the U.S. and New York economies.

REVENUE RISKS

- Financial market volatility caused by interest rate uncertainty could result in higher or lower financial sector bonus payments than those embodied in the forecast.

- If gasoline prices exceed those embodied in the forecast, more disposable consumer income would be diverted to fuel, decreasing consumption of taxable goods and services.
- If European economic growth is more sluggish than expected, exports could fall, causing corporate profits and tax receipts to grow more slowly than expected.
- Consumer purchases and the housing market could be negatively impacted if long-term interest rates rise faster than anticipated.
- Bank and corporate franchise tax revenue streams are contingent on the timing and size of anticipated audit proceeds. Negotiations between the State and taxpayers are subject to unexpected delays, which may force audit proceeds into a subsequent fiscal year.

PERSONAL INCOME TAX

PERSONAL INCOME TAX
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
GENERAL FUND[1]	**26,884**	**28,488**	**6.0%**	**29,397**	**3.2%**	**31,492**	**7.1%**	**33,545**	**6.5%**
Gross Collections	47,443	50,496	6.4%	52,678	4.3%	56,218	6.7%	59,529	5.9%
Refunds (Includes State/City Offset)	(7,216)	(7,953)	10.2%	(8,679)	9.1%	(9,290)	7.0%	(9,729)	4.7%
STAR	(3,286)	(3,419)	4.0%	(3,602)	5.4%	(3,704)	2.8%	(3,805)	2.7%
RBTF	(10,057)	(10,636)	5.8%	(11,000)	3.4%	(11,732)	6.7%	(12,450)	6.1%
STATE/ALL FUNDS	**40,227**	**42,543**	**5.8%**	**43,999**	**3.4%**	**46,928**	**6.7%**	**49,800**	**6.1%**
Gross Collections	47,443	50,496	6.4%	52,678	4.3%	56,218	6.7%	59,529	5.9%
Refunds (Includes State/City Offset)	(7,216)	(7,953)	10.2%	(8,679)	9.1%	(9,290)	7.0%	(9,729)	4.7%

[1] Excludes Transfers.

General Fund income tax receipts are net of deposits to the STAR Fund, which provides property tax relief, and the Revenue Bond Tax Fund (RBTF), which supports debt service payments on State personal income tax revenue bonds. General Fund income tax receipts for FY 2014 of $28.5 billion are expected to increase by $1.6 billion (6 percent) from the prior year, mainly reflecting the increase in All Funds receipts noted above. RBTF deposits are projected to be $10.6 billion and the STAR transfer is projected to be $3.4 billion. General Fund income tax receipts for FY 2015 of $29.4 billion are projected to increase by $909 million (3.2 percent). The RBTF and STAR deposits are projected to be $11 billion and $3.6 billion, respectively. General Fund income tax receipts for FY 2016 of $31.5 billion are projected to increase by $2.1 billion (7.1 percent). RBTF deposits are projected to be $11.7 billion and STAR deposits are projected to be $3.7 billion.

All Funds PIT receipts for FY 2014 are projected to be $42.5 billion, an increase of $2.3 billion (5.8 percent) from FY 2013. This primarily reflects robust growth in extension (i.e., prior year estimated) payments for tax year 2012 along with moderate growth in withholding, final returns, and delinquent collections, partially offset by a decrease in current estimated payments for tax year 2013 and growth in total refunds.

All Funds income tax receipts for FY 2015 of $44 billion are projected to increase $1.5 billion (3.4 percent) from the prior year. This increase primarily reflects increases of $2.3 billion (7.1 percent) in withholding and $1.4 billion (16.2 percent) in estimated payments related to tax year 2014 (i.e. current year estimated) partially offset by a $1.6 billion (30.2 percent) decline in extension payments related to tax year 2013 (i.e., prior year estimated) and growth in total refunds of $726 million (9.1 percent). The projection for tax year 2014 estimated payments reflects strong projected capital gains and dividend income growth following a deflated tax year 2013 base. The significant decline in tax year 2013 extension payments stems from the aforementioned acceleration of capital gains that occurred into tax year 2012.

All Funds income tax receipts for FY 2016 of $46.9 billion are projected to increase $2.9 billion (6.7 percent) from the prior year. This change primarily reflects increases of $2.3 billion (6.5 percent) in withholding, $812 million (8 percent) in estimated payments related to tax year 2015 (i.e., current year estimated), $278 million in extension payments for tax year 2014 (i.e., prior year estimated), and $100 million in final returns payments for tax year 2014 (i.e., current year), partially offset by a $611 million (7 percent) increase in total refunds. Delinquencies are projected to increase $40 million (3.2 percent) from the prior year.

All Funds income tax receipts are projected to increase by $2.9 billion (6.1 percent) in FY 2017 to reach $49.8 billion, while General Fund receipts are projected to be $33.5 billion.

USER TAXES AND FEES

USER TAXES AND FEES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
GENERAL FUND[1]	**9,112**	**6,548**	**-28.1%**	**6,806**	**3.9%**	**7,085**	**4.1%**	**7,265**	**2.5%**
Sales Tax	8,423	5,866	-30.4%	6,125	4.4%	6,406	4.6%	6,589	2.9%
Cigarette and Tobacco Taxes	443	431	-2.7%	425	-1.4%	418	-1.6%	410	-1.9%
Alcoholic Beverage Taxes	246	251	2.0%	256	2.0%	261	2.0%	266	1.9%
STATE/ALL FUNDS	**14,615**	**15,116**	**3.4%**	**15,674**	**3.7%**	**16,257**	**3.7%**	**16,620**	**2.2%**
Sales Tax	11,989	12,530	4.5%	13,086	4.4%	13,677	4.5%	14,065	2.8%
Cigarette and Tobacco Taxes	1,551	1,491	-3.9%	1,466	-1.7%	1,436	-2.0%	1,405	-2.2%
Motor Fuel Tax	492	500	1.6%	504	0.8%	507	0.6%	510	0.6%
Highway Use Tax	145	140	-3.4%	143	2.1%	151	5.6%	149	-1.3%
Alcoholic Beverage Taxes	246	251	2.0%	256	2.0%	261	2.0%	266	1.9%
Taxicab Surcharge	83	90	8.4%	100	11.1%	101	1.0%	101	0.0%
Auto Rental Tax	109	114	4.6%	119	4.4%	124	4.2%	124	0.0%

[1] Excludes Transfers.

General Fund user taxes and fees receipts are expected to total $6.5 billion in FY 2014, a decrease of $2.6 billion (28.1 percent) from FY 2013. This decrease reflects an Enacted Budget accounting change that will first deposit 25 percent of sales tax receipts that were formerly directed to the General Fund into the new Sales Tax Bond Fund. The balance will be transferred to the General Fund after the payment of debt service. General Fund user taxes and fees receipts are projected to total $6.8 billion in FY 2015, an increase of $258 million (3.9 percent) from FY 2014 and reflect the All Funds changes discussed above.

All Funds user taxes and fees receipts for FY 2014 are estimated to be $15.1 billion, an increase of $501 million (3.4 percent) from FY 2013. All Funds sales tax receipts are estimated to be $12.5 billion, an increase of $541 million (4.5 percent) from FY 2013. The underlying sales tax base measured before the impact of law changes is estimated to increase by 3.2 percent. Non-sales tax user taxes and fees are estimated to decrease by $40 million from FY 2013, mainly due to a decline in cigarette tax receipts ($60 million).

All Funds user taxes and fees receipts for FY 2015 are projected to be $15.7 billion, an increase of $558 million (3.7 percent) from FY 2014. This mainly reflects an expected increase in the sales tax base due to higher consumption partially offset by continued declines in taxable cigarette consumption.

All Funds user taxes and fees are projected to be $16.3 billion in FY 2016 and $16.6 billion in FY 2017. This predominantly reflects continued projected growth in the sales tax base partially offset by continued projected declines in taxable cigarette consumption. General Fund user taxes and fees are projected to be $7.1 billion in FY 2016 and $7.3 billion in FY 2017.

BUSINESS TAXES

BUSINESS TAXES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
GENERAL FUND	**6,253**	**6,348**	**1.5%**	**5,811**	**-8.5%**	**6,301**	**8.4%**	**6,523**	**3.5%**
Corporate Franchise Tax	2,624	2,914	11.1%	2,220	-23.8%	2,573	15.9%	2,691	4.6%
Corporation and Utilities Tax	686	596	-13.1%	620	4.0%	636	2.6%	652	2.5%
Insurance Tax	1,346	1,418	5.3%	1,468	3.5%	1,523	3.7%	1,540	1.1%
Bank Tax	1,597	1,420	-11.1%	1,503	5.8%	1,569	4.4%	1,640	4.5%
Petroleum Business Tax	0	0	0.0%	0	0.0%	0	0.0%	0	0.0%
STATE/ALL FUNDS	**8,465**	**8,611**	**1.7%**	**8,152**	**-5.3%**	**8,702**	**6.7%**	**8,990**	**3.3%**
Corporate Franchise Tax	3,009	3,359	11.6%	2,687	-20.0%	3,063	14.0%	3,204	4.6%
Corporation and Utilities Tax	895	781	-12.7%	807	3.3%	828	2.6%	855	3.3%
Insurance Tax	1,509	1,587	5.2%	1,644	3.6%	1,706	3.8%	1,730	1.4%
Bank Tax	1,912	1,694	-11.4%	1,789	5.6%	1,870	4.5%	1,956	4.6%
Petroleum Business Tax	1,140	1,190	4.4%	1,225	2.9%	1,235	0.8%	1,245	0.8%

General Fund business tax receipts for FY 2014 of $6.3 billion are estimated to increase by $95 million (1.5 percent) from FY 2013 results. Business tax receipts deposited to the General Fund reflect the All Funds trends discussed above. General Fund business tax receipts for FY 2015 of $5.8 billion are projected to decrease $537 million (8.5 percent) from the prior year. Business tax receipts deposited to the General Fund reflect the All Funds trends discussed below.

All Funds business tax receipts for FY 2014 are estimated to be $8.6 billion, an increase of $146 million (1.7 percent) from the prior year. The estimates reflect growth across all taxes except the corporate and utilities tax and the bank tax.

All Funds corporate franchise tax receipts are estimated to increase $350 million (11.6 percent) from FY 2013. This increase is mainly attributable to higher estimated audit receipts and slightly stronger estimated gross receipts. Audit receipts are expected to increase $273 million from the previous year.

The corporation and utilities tax is expected to decline $114 million (12.7 percent) from FY 2013. Adjusted for the timing of a prior year telecommunications refund ($30 million), the decline in FY 2014 would be 9.3 percent. Two large telecommunications sector audits were received in FY 2013. This is the primary reason for the year-over-year decline in receipts. Gross receipts are expected to show a slight decline from the previous year due to the end-of-session LIPA restructuring legislation.

All Funds insurance tax receipts are estimated to increase $78 million (5.2 percent) from FY 2013. This reflects a return to growth from the improving economy.

The bank tax receipts are estimated to decline $218 million (11.4 percent) in FY 2014. FY 2013 was a record year for bank tax receipts. Gross receipts and audits are estimated to be lower in FY 2014 than FY 2013. The several large audit cases that were settled in FY 2013 and the strong growth in gross receipts (18.1 percent) are not expected to be repeated in FY 2014.

Petroleum business tax receipts are expected to increase $50 million (4.4 percent) in FY 2014 primarily due to the 5 percent increase in the Petroleum Business Tax (PBT) tax rates effective January 2013 and an anticipated 3 percent increase in PBT tax rates effective January 2014.

All Funds business tax receipts for FY 2015 of $8.2 billion are projected to decrease $459 million (5.3 percent) from the prior year. This decrease primarily reflects the first year of repayment of deferred tax credits to taxpayers. Excluding this payback, FY 2015 receipts would be virtually unchanged from FY 2014.

All Funds business tax receipts for FY 2016 and FY 2017 reflect projected trends in corporate profits, taxable insurance premiums, electric utility consumption and prices, the consumption of telecommunications services, and automobile fuel consumption and fuel prices. Business tax receipts are projected to increase to $8.7 billion (6.7 percent) in FY 2016 and to $9 billion (3.3 percent) in FY 2017. General Fund business tax receipts over this period are expected to increase to $6.3 billion (8.4 percent) in FY 2016 and $6.5 billion (3.5 percent) in FY 2017.

OTHER TAXES

OTHER TAXES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
GENERAL FUND[1]	**1,034**	**1,069**	**3.4%**	**1,144**	**7.0%**	**1,159**	**1.3%**	**1,169**	**0.9%**
Estate Tax	1,014	1,050	3.6%	1,125	7.1%	1,140	1.3%	1,150	0.9%
Gift Tax	1	0	-100.0%	0	0.0%	0	0.0%	0	0.0%
Real Property Gains Tax	0	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Pari-Mutuel Taxes	18	18	0.0%	18	0.0%	18	0.0%	18	0.0%
All Other Taxes	1	1	0.0%	1	0.0%	1	0.0%	1	0.0%
STATE/ALL FUNDS	**1,790**	**1,809**	**1.1%**	**1,954**	**8.0%**	**2,044**	**4.6%**	**2,109**	**3.2%**
Estate Tax	1,014	1,050	3.6%	1,125	7.1%	1,140	1.3%	1,150	0.9%
Gift Tax	1	0	-100.0%	0	0.0%	0	0.0%	0	0.0%
Real Property Gains Tax	0	0	0.0%	0	0.0%	0	0.0%	0	0.0%
Real Estate Transfer Tax	756	740	-2.1%	810	9.5%	885	9.3%	940	6.2%
Pari-Mutuel Taxes	18	18	0.0%	18	0.0%	18	0.0%	18	0.0%
All Other Taxes	1	1	0.0%	1	0.0%	1	0.0%	1	0.0%

[1] Excludes Transfers.

General Fund other tax receipts are expected to be nearly $1.1 billion in FY 2014, an increase of $35 million (3.4 percent) from FY 2013. This reflects a change in estate tax receipts. General Fund other tax receipts are expected to total more than $1.1 billion in FY 2015. This reflects an increase of $75 million (7.1 percent) in estate tax receipts due to a projected increase in household net worth. General Fund other tax receipts for FY 2016 are projected to grow by $15 million (1.3 percent) entirely due to the modest growth in the estate tax. General Fund other tax receipts for FY 2017 are projected to increase by $10 million (0.9 percent), also due to estate tax growth.

All Funds other tax receipts for FY 2014 are estimated to be $1.8 billion, an increase of $19 million (1.1 percent) from FY 2013. This mainly reflects an increase of $36 million (3.6 percent) in estate tax receipts, partially offset by a decline of $16 million (2.1 percent) in real estate transfer tax receipts. The estate tax increase is the result of an expected return in FY 2014 to a number of super-large estate payments (payments of over $25 million) consistent with long-term trends. The FY 2014 real estate transfer tax estimate reflects the shift of transfers from FY 2014 into FY 2013 caused by uncertainty surrounding potential Federal tax law changes, which more than offsets estimated improvements in FY 2014 market pricing.

All Funds other tax receipts for FY 2015 are projected to be just under $2 billion, an increase of $145 million (8 percent) from FY 2014. This reflects strong projected growth in both the real estate transfer and estate taxes.

The FY 2016 All Funds receipts projection for other taxes is over $2 billion, an increase of $90 million (4.6 percent) from FY 2015. Growth in the estate tax is projected to follow forecast increases in household net worth. Receipts from the real estate transfer tax are also projected to increase, reflecting continuing growth in the residential and commercial real estate markets.

The FY 2017 All Funds receipts projection for other taxes is $2.1 billion, an increase of $65 million (3.2 percent) from FY 2016. Moderate growth is projected in estate tax collections, following forecast increases in household net worth. Real estate transfer tax collections are projected to grow as a result of increases in the value of real property transfers.

MISCELLANEOUS RECEIPTS AND FEDERAL GRANTS

MISCELLANEOUS RECEIPTS AND FEDERAL GRANTS
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
GENERAL FUND	**3,566**	**3,308**	**-7.2%**	**3,595**	**8.7%**	**2,776**	**-22.8%**	**2,797**	**0.8%**
Miscellaneous Receipts	3,504	3,306	-5.7%	3,595	8.7%	2,776	-22.8%	2,797	0.8%
Federal Grants	62	2	-96.8%	0	-100.0%	0	0.0%	0	0.0%
STATE FUNDS	**24,001**	**24,069**	**0.3%**	**24,895**	**3.4%**	**24,437**	**-1.8%**	**23,935**	**-2.1%**
Miscellaneous Receipts	23,855	23,989	0.6%	24,817	3.5%	24,359	-1.8%	23,857	-2.1%
Federal Grants	146	80	-45.2%	78	-2.5%	78	0.0%	78	0.0%
ALL FUNDS	**66,873**	**71,608**	**7.1%**	**72,265**	**0.9%**	**72,787**	**0.7%**	**75,008**	**3.1%**
Miscellaneous Receipts	24,030	24,175	0.6%	25,003	3.4%	24,545	-1.8%	24,043	-2.0%
Federal Grants	42,843	47,433	10.7%	47,262	-0.4%	48,242	2.1%	50,965	5.6%

All Funds miscellaneous receipts include moneys received from HCRA financing sources, SUNY tuition and patient income, lottery receipts for education, assessments on regulated industries, and a variety of fees and licenses. All Funds miscellaneous receipts are projected to total $24.2 billion in FY 2014, an annual increase of $145 million from FY 2013 results, or less than one percent annually.

Federal grants help pay for State spending on Medicaid, temporary and disability assistance, mental hygiene, school aid, public health, and other activities. Annual changes to Federal grants generally correspond to changes in Federally-reimbursed spending and Federal allocations. Accordingly, DOB typically plans Federal reimbursement to be received in the State fiscal year that spending occurs, but timing sometimes varies. All Funds Federal grants are projected to total $47.4 billion in FY 2014, an increase of $4.6 billion from FY 2013, driven primarily by additional Federal funding for disaster assistance costs, as well as the annual impact of increased Federal spending associated with the ACA.

All Funds miscellaneous receipts are projected to increase by $828 million in FY 2015, which includes bond proceeds for capital projects. All Funds Federal grants are projected to decrease by $171 million in FY 2015, driven primarily by the timing of Federal disaster assistance costs, the majority of which is expected to be disbursed during FY 2014.

All Funds miscellaneous receipts are projected to decline by $458 million in FY 2016, driven by the decline in General Fund resources transferred from SIF, partially offset by a projected increase in miscellaneous receipts from bond proceeds available to fund capital improvement projects. All Funds miscellaneous receipts decrease by $502 million in FY 2017, driven by a projected decrease in miscellaneous receipts for capital projects, partially offset by increases in SUNY income and HCRA revenue collections.

Annual Federal grants growth of $980 million in FY 2016 and $2.7 billion in FY 2017 is primarily due to growth in Medicaid spending, reflecting the continued impact of spending associated with the ACA.

MISCELLANEOUS RECEIPTS AND FEDERAL GRANTS: CHANGE FROM FIRST QUARTERLY UDPATE FORECAST (millions of dollars)

	FY 2014				FY 2015			
	First Quarter	Mid-Year Update	$ Change	% Change	First Quarter	Mid-Year Update	$ Change	% Change
GENERAL FUND	**3,355**	**3,308**	**(47)**	**-1.4%**	**3,595**	**3,595**	**0**	**0.0%**
Miscellaneous Receipts	3,353	3,306	(47)	-1.4%	3,595	3,595	0	0.0%
Federal Grants	2	2	0	0.0%	0	0	0	0.0%
STATE FUNDS	**24,116**	**24,069**	**(47)**	**-0.2%**	**24,895**	**24,895**	**0**	**0.0%**
Miscellaneous Receipts	24,036	23,989	(47)	-0.2%	24,817	24,817	0	0.0%
Federal Grants	80	80	0	0.0%	78	78	0	0.0%
ALL FUNDS	**71,655**	**71,608**	**(47)**	**-0.1%**	**72,265**	**72,265**	**0**	**0.0%**
Miscellaneous Receipts	24,222	24,175	(47)	-0.2%	25,003	25,003	0	0.0%
Federal Grants	47,433	47,433	0	0.0%	47,262	47,262	0	0.0%

All Funds miscellaneous receipts have been revised downward by $47 million in FY 2014 due to the estimated impact of lower utility bills on 18-a receipts to the General Fund.

Federal grants projections for FY 2014 and FY 2015 remain unchanged from the FY 2014 Enacted Budget Financial Plan and First Quarterly Update to the Financial Plan.

DISBURSEMENTS

Total disbursements in FY 2014 are estimated at $61.5 billion in the General Fund and $90.7 billion in State Operating Funds. Over the multi-year Financial Plan, State Operating Funds spending projections assume Medicaid and School Aid will grow at their statutorily-indexed rates. The FY 2014 Enacted Budget authorized a School Aid increase in excess of the personal income cap for SY 2014. The projections do not reflect any potential impact of automatic Federal spending reductions that were triggered on March 1, 2013.

The multi-year disbursements projections take into account agency staffing levels, program caseloads, funding formulas contained in State and Federal law, inflation and other factors. Factors that affect spending estimates vary by program. For example, public assistance spending is based primarily on anticipated caseloads that are estimated by analyzing historical trends and projected economic conditions. Projections account for the timing of payments, since not all of the amounts appropriated in the Budget are disbursed in the same fiscal year. Consistent with past years, the aggregate spending projections (i.e., the sum of all projected spending by individual agencies) in Special Revenue Funds have been adjusted downward in all fiscal years based on typical spending patterns and the observed variance between estimated and actual results over time.

Medicaid, education, pension costs, employee and retiree health benefits, and debt service are significant drivers of annual spending growth.

LOCAL ASSISTANCE GRANTS

Local Assistance spending includes payments to local governments, school districts, health care providers, and other entities, as well as financial assistance to, or on behalf of, individuals, families and not-for-profit organizations. State-funded local assistance spending is estimated at $59.7 billion in FY 2014 and accounts for 66 percent of total State Operating Funds spending. Education and health care spending account for approximately two-thirds of local assistance spending.

Selected assumptions used in preparing the spending projections for the State's major local aid programs and activities are summarized in the following table.

FORECAST FOR SELECTED PROGRAM MEASURES AFFECTING OPERATING ACTIVITIES

		Forecast			
	FY 2013 Results	**FY 2014 Updated**	**FY 2015 Projected**	**FY 2016 Projected**	**FY 2017 Projected**
MEDICAID					
Medicaid Coverage	4,812,715	5,176,084	6,110,639	6,169,418	6,198,080
- Family Health Plus Caseload	446,259	467,246	0	0	0
- Child Health Plus Caseload	344,000	356,000	368,000	380,000	392,000
State Takeover of County/NYC Costs	$1,613	$1,690	$1,665	$1,800	$2,168
- Family Health Plus	$477	$528	$219	$0	$0
- Medicaid	$1,136	$1,162	$1,446	$1,800	$2,168
EDUCATION					
School Aid (School Year)	$20,236	$21,228	$21,950	$22,784	$24,037
Education Personal Income Growth Index			3.4%	3.8%	5.5%
HIGHER EDUCATION					
Public Higher Education Enrollment (FTEs)	567,473	566,707	565,941	565,078	564,880
Tuition Assistance Program Recipients	309,921	310,065	310,065	310,065	310,065
PUBLIC ASSISTANCE					
Family Assistance Program	259,739	249,528	243,345	238,262	233,706
Safety Net Program - Families	122,805	118,706	115,450	112,747	110,279
Safety Net Program - Singles	191,764	185,777	184,815	184,361	184,385
MENTAL HYGIENE					
Total Mental Hygiene Community Beds	90,209	93,162	96,144	99,036	101,000
- OMH Community Beds	38,564	40,888	43,290	45,576	46,954
- OPWDD Community Beds	39,565	40,120	40,650	41,150	41,650
- OASAS Community Beds	12,080	12,154	12,204	12,310	12,396
PRISON POPULATION (CORRECTIONS)	54,617	54,300	54,000	53,800	53,700

Note: Dollar amounts in table are in millions.

EDUCATION

SCHOOL AID

School Aid helps support elementary and secondary education for New York pupils enrolled in 676 major school districts throughout the State. State funding is provided to districts based on statutory aid formulas and through reimbursement of categorical expenses. State funding for schools assists districts in meeting locally defined needs, supports the construction of school facilities, and finances school transportation for nearly three million students statewide.

SCHOOL YEAR (JULY 1 — JUNE 30)

School Aid will increase by $992 million in School Year (SY) 2014, a 4.9 percent increase from SY 2013. In addition, $75 million of competitive grant funding is provided for several key initiatives recommended by the *New* NY Education Reform Commission in its Preliminary Report to the Governor, including pre-kindergarten and extended learning, bringing the total annual education aid increase to $1.067 billion. The Enacted Budget also included a new two-year appropriation that continues Education Law provisions to tie future School Aid increases to the rate of growth in New York State personal income.

Projected School Aid funding is a function of both a personal income growth index used to determine allowable growth, and future legislation to allocate the allowable increases. Current law prescribes allowable growth to include spending for new competitive grant programs to reward school districts that demonstrate significant student performance improvements or undertake long-term structural changes to reduce costs and improve efficiency. Allowable growth also includes increases in expense-based aid programs (i.e., Building Aid, Transportation Aid) under existing statutory provisions. Any remaining allowable growth is allocated pursuant to a chapter of law for purposes including, but not limited to, additional spending for competitive grants, increases in Foundation Aid, or restoration of the Gap Elimination Adjustment.

Based on updated estimates of personal income growth, School Aid is projected to increase by an additional $722 million in SY 2015 and $834 million in SY 2016. School Aid is projected to reach an annual total of $24.0 billion in SY 2017.

STATE FISCAL YEAR

SCHOOL AID AND *NEW* NY EDUCATION REFORM INITIATIVES - SCHOOL YEAR BASIS (JULY 1 - JUNE 30)
(millions of dollars)

	SY 2013	SY 2014	Change	SY 2015	Change	SY 2016	Change	SY 2017	Change
School Aid	$20,236	$21,228	$992	$21,950	$722	$22,784	$834	$24,037	$1,253
			4.9%		3.4%		3.8%		5.5%
New NY Education Reform Initiatives	$0	$75	$75	$75	$0	$75	$0	$75	$0
Total	**$20,236**	**$21,303**	**$1,067**	**$22,025**	**$722**	**$22,859**	**$834**	**$24,112**	**$1,253**
			5.3%		**3.4%**		**3.8%**		**5.5%**

The State finances School Aid and *New* NY Education Reform Initiatives from General Fund receipts and from Lottery Fund receipts, including video lottery terminals (VLTs), which are accounted for and disbursed from a dedicated account. Because the State fiscal year begins on April 1, the State typically pays approximately 70 percent of the annual school year commitment during the State fiscal year in which it is enacted, and pays the remaining 30 percent in the first three months of the following State fiscal year.

The table below summarizes the multi-year projected funding levels on a State fiscal year basis.

SCHOOL AID AND EDUCATION REFORM AID - STATE FISCAL YEAR BASIS
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**20,163**	**20,471**	**1.5%**	**21,692**	**6.0%**	**22,514**	**3.8%**	**23,641**	**5.0%**
General Fund Local Assistance	17,110	17,289	1.0%	18,573	7.4%	19,390	4.4%	20,519	5.8%
General Fund Lottery Aid Guarantee	0	10	N/A	0	N/A	0	0.0%	0	0.0%
Core Lottery Aid	2,217	2,230	0.6%	2,225	-0.2%	2,227	0.1%	2,225	-0.1%
VLT Lottery Aid	857	881	2.8%	894	1.5%	897	0.3%	897	0.0%
VLT Aid Balance Roll	(21)	21	N/A	0	N/A	0	0.0%	0	0.0%
Other Lottery Fund Resources	0	40	N/A	0	N/A	0	0.0%	0	0.0%

State spending for School Aid and *New* NY Education Reform Initiatives is projected to total $20.5 billion in FY 2014. In future years, receipts available to finance this category of aid from core lottery sales are projected to remain stable, while VLT receipts are anticipated to increase through FY 2015 as a result of the recent implementation of the VLT facility at the Aqueduct Racetrack. In addition to State aid, school districts receive approximately $3 billion annually in Federal categorical aid.

OTHER EDUCATION AID

In addition to School Aid, the State provides funding and support for various other education-related initiatives. These include: special education services; pre-kindergarten through grade 12 education programs; cultural education; higher and professional education programs; and adult career and continuing education services.

Major programs under the Office of Prekindergarten through Grade 12 address specialized student needs or reimburse school districts for education-related services, including the school breakfast and lunch programs, non-public school aid, and various special education programs. In special education, New York provides a full spectrum of services to over 400,000 students from ages 3 to 21. Higher and professional education programs monitor the quality and availability of postsecondary education programs and regulate the licensing and oversight of 50 professions.

OTHER EDUCATION
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**1,927**	**2,032**	**5.4%**	**2,091**	**2.9%**	**2,197**	**5.1%**	**2,328**	**6.0%**
Special Education	1,352	1,418	4.9%	1,522	7.3%	1,626	6.8%	1,751	7.7%
All Other Education	575	614	6.8%	569	-7.3%	571	0.4%	577	1.1%

Special education growth is primarily driven by an increase in program costs and enrollment for preschool special education and the summer school special education programs. The increase in other education spending for FY 2014 over FY 2013 is driven primarily by one-time costs associated with targeted aid and grants, which are not projected to continue beyond FY 2014.

In order to enhance oversight of the preschool special education program, the FY 2014 Enacted Budget also supports the expansion of State and county audit capabilities and the development of data systems to enhance analysis of available program data.

SCHOOL TAX RELIEF PROGRAM

The STAR program provides school tax relief to taxpayers. The three components of STAR and their approximate shares in FY 2014 are: the basic school property tax exemption for homeowners with income under $500,000 (55 percent), the enhanced school property tax exemption for senior citizen homeowners with income under $79,050 (27 percent), and a flat refundable credit and rate reduction for income-eligible New York City resident personal income taxpayers (18 percent).

SCHOOL TAX RELIEF (STAR)
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
TOTAL STATE OPERATING FUNDS	**3,286**	**3,419**	**4.0%**	**3,602**	**5.4%**	**3,704**	**2.8%**	**3,805**	**2.7%**
Basic Exemption	1,857	1,896	2.1%	1,997	5.3%	2,052	2.8%	2,106	2.6%
Enhanced (Seniors)	841	912	8.4%	986	8.1%	1,014	2.8%	1,040	2.6%
New York City PIT	588	611	3.9%	619	1.3%	638	3.1%	659	3.3%

The STAR program exempts the first $30,000 of every eligible homeowner’s property value from the local school tax levy. Lower-income senior citizens will receive a $63,300 exemption in FY 2014. Spending for the STAR property tax exemption reflects reimbursements made to school districts to offset the reduction in property tax revenues.

The annual increase in a qualifying homeowner’s STAR exemption benefit is limited to 2 percent. Homeowners who earn more than $500,000 a year are not eligible for the STAR property tax exemption. New York City personal income taxpayers with annual income over $500,000 have a reduced benefit.

The FY 2014 Enacted Budget Financial Plan established a STAR re-registration and anti-fraud program. This program is expected to eliminate waste, fraud and abuse in the STAR exemption by (1) authorizing the Department of Taxation and Finance to require all recipients of a Basic STAR exemption to be registered with the Department, and (2) strengthening the penalties for fraud while tightening the standards and procedures for determining eligibility.

HIGHER EDUCATION

Local assistance for higher education spending includes funding for the City University of New York (CUNY), SUNY and the Higher Education Services Corporation (HESC). The State provides assistance for CUNY's senior college operations, and works in conjunction with the City of New York to support CUNY's community colleges. The CUNY system is the largest urban public university system in the nation. Funding for SUNY supports 30 community colleges across multiple campuses.

The State also provides a sizeable benefit to SUNY and CUNY through the debt service it pays on bond-financed capital projects at the universities. This is not reflected in the annual spending totals for the universities. State debt service payments for capital projects at SUNY and CUNY are expected to total about $1.4 billion in FY 2014.

HESC administers the TAP program that provides awards to income-eligible students. It also provides centralized processing for other student financial aid programs, and offers prospective students information and guidance on how to finance a college education. The financial aid programs that the Corporation administers are funded by the State and the Federal government.

Annual growth by CUNY in FY 2014 reflects the net impact of enrollment changes at community colleges, additional fringe benefit costs, and the timing of aid payments across State fiscal years. Growth in HESC reflects the rising cost of higher education tuition and the consequent demand for increased tuition assistance. SUNY local assistance reflects an increase in community college aid, which fully annualizes in the outyears.

HIGHER EDUCATION
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**2,629**	**2,825**	**7.5%**	**2,911**	**3.0%**	**2,994**	**2.9%**	**3,066**	**2.4%**
City University	**1,220**	**1,345**	**10.2%**	**1,401**	**4.2%**	**1,470**	**4.9%**	**1,548**	**5.3%**
City University	1,026	1,130	10.1%	1,185	4.9%	1,254	5.8%	1,332	6.2%
Community College	194	215	10.8%	216	0.5%	216	0.0%	216	0.0%
Higher Education Services	**947**	**1,004**	**6.0%**	**1,018**	**1.4%**	**1,032**	**1.4%**	**1,026**	**-0.6%**
Tuition Assistance Program	893	948	6.2%	959	1.2%	972	1.4%	966	-0.6%
Aid for Part Time Study	14	12	-14.3%	12	0.0%	12	0.0%	12	0.0%
Scholarships/Awards	40	44	10.0%	47	6.8%	48	2.1%	48	0.0%
State University	**462**	**476**	**3.0%**	**492**	**3.4%**	**492**	**0.0%**	**492**	**0.0%**
State University	457	472	3.3%	485	2.8%	485	0.0%	485	0.0%
Other/Cornell	5	4	-20.0%	7	75.0%	7	0.0%	7	0.0%

Note: State support for SUNY four-year institutions is funded through State operations rather than local assistance.

HEALTH CARE

Local assistance for health care-related spending includes Medicaid, statewide public health programs and a variety of mental hygiene programs. The DOH works with the local health departments and social services departments, including New York City, to coordinate and administer statewide health insurance programs and activities. The majority of government-financed health care programs are included under DOH, but many programs are supported through multi-agency efforts. The Medicaid program finances inpatient hospital care, outpatient hospital services, clinics, nursing homes, managed care, prescription drugs, home care, family health plus (FHP) (a State-administered program to provide comprehensive health insurance for low-income families which do not meet certain Medicaid-eligibility thresholds), and services provided in a variety of community-based settings (including mental health, substance abuse treatment, developmental disabilities services, school-based services and foster care services). The State share of Medicaid spending is budgeted and expended principally through DOH, but State share Medicaid spending also appears in the Financial Plan estimates for mental hygiene agencies, child welfare programs and the Department of Corrections and Community Supervision.

MEDICAID

Medicaid is a means-tested program that finances health care services for low-income individuals and long-term care services for the elderly and disabled, primarily through payments to health care providers. The Medicaid program is financed jointly by the State, the Federal government, and local governments (including New York City). New York State's Medicaid spending is projected to total approximately $55.7 billion in FY 2014, including the local contribution.

The FY 2014 Enacted Budget includes the continuation of the Medicaid spending cap enacted in FY 2012, and recommends funding consistent with its provisions. The cap is based on the ten-year rolling average of the medical component of the CPI. Statutory changes approved with the FY 2012 Enacted Budget to grant the Executive certain administrative powers to help hold Medicaid spending to the capped level were amended through legislation included in the FY 2014 Enacted Budget to provide flexibility to adjust Medicaid projections to meet unanticipated costs resulting from the event of a natural or other type of disaster. The statutory provisions of the Medicaid spending cap have been extended through FY 2015, pursuant to authorization included in the FY 2014 Enacted Budget. The cap itself remains in place, and the Financial Plan assumes that statutory authority will be extended in subsequent years.

Based on updated data, the allowable growth under the cap is 3.9 percent. The FY 2014 Enacted Budget also eliminated the FHP program effective January 1, 2015. The majority of the population receiving health care benefits through FHP will begin receiving more robust health care benefits through the Medicaid program, pursuant to new Medicaid eligibility thresholds and increased Federal payments pursuant to the ACA. The remaining FHP population, those above Medicaid levels, will be eligible for Federal tax credits in the New York State Health Benefit Exchange and the State will pay remaining out-of-pocket costs for these individuals up to previous FHP levels. The proposed transition to the Exchange is expected to provide savings to the State of $59.0 million in FY 2015.

TOTAL STATE-SHARE MEDICAID DISBURSEMENTS[1]
(millions of dollars)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
	Results	Updated	Projected	Projected	Projected
Department of Health					
DOH State Share	15,900	16,421	16,977	17,805	18,474
Local Assistance	15,879	16,230	16,780	17,591	18,248
State Operations[2]	21	191	197	214	226
Annual $ Change - DOH Only		521	556	828	669
Annual % Change - DOH Only		3.3%	3.4%	4.9%	3.8%
Other State Agencies					
Mental Hygiene	4,758	4,902	5,429	6,020	6,140
Foster Care	89	87	90	94	98
Education	17	0	0	0	0
Corrections	0	12	12	12	12
Total State Share (All Agencies)	**20,764**	**21,422**	**22,508**	**23,931**	**24,724**
Annual $ Change - Total State Share		658	1,086	1,423	793
Annual % Change - Total State Share		3.2%	5.1%	6.3%	3.3%

[1] Medicaid services growth is indexed to the 10-year average of CPI Medical, currently 3.9 percent. Financial Plan spending is adjusted for the inclusion of Medicaid State Operations spending (formerly outside the Medicaid Cap), which is supporting expanded functions pursuant to the phased-in takeover of local administrative responsibilities, and the decision of Monroe County to participate in the Medicaid local cap program, rather than continuing the sales tax intercept option. Finally, the State Share of Medicaid is adjusted for increased Federal Financial Participation beginning in January 2014.

[2] Increased State Operations costs in FY 2014 reflects the transfer of the Office of Health Insurance Programs to Medicaid from Public Health without new spending.

Factors affecting the level of Medicaid spending growth that must be managed within the cap include Medicaid enrollment, costs of provider health care services (particularly in managed care) and levels of utilization. The number of Medicaid recipients, including FHP, is expected to exceed 5.6 million at the end of FY 2014, an increase of 7.3 percent from the FY 2013 caseload of 5.3 million, a result mainly attributable to expanded eligibility pursuant to the ACA. Under the provisions of the ACA, the Federal government is expected to finance a greater share of Medicaid costs, the impact of which is expected to lower future growth in the State share of Medicaid costs beginning in FY 2014.

Total “state share” Medicaid, which includes Medicaid costs of State agencies in addition to DOH, reflects downward spending adjustments of $820 million in FY 2014, $535 million in FY 2015, and $357 million thereafter. This is attributable to the impact of reduced Federal revenue associated with the reimbursement of Medicaid costs at State-operated facilities providing developmental disability services. To compensate for the reduced Federal reimbursement for services provided, the State is undertaking various actions to reduce overall costs while minimizing any impact on service delivery. These actions include shifting a portion of OPWDD Medicaid costs to DOH, the impact of which is expected to be managed on a neutral Financial Plan basis through the implementation of several actions, including comprehensive program reforms consistent with other states to generate Federal reimbursement for services already being provided, and the management of certain MRT investment initiatives. These savings are valued at $730 million in FY 2014, $445 million in FY 2015, and $267 million in each of

FYs 2016 and 2017, and are part of the Mental Hygiene Stabilization Fund within the DOH global spending cap.

The FY 2013 Enacted Budget included authorization for the State to take over administration of the Medicaid program, and to cap spending on local Medicaid administration at FY 2012 appropriation levels. The FY 2013 Enacted Budget also provided Medicaid spending relief for all counties and New York City by reducing growth in local Medicaid payments. These changes are expected to provide fiscal and administrative relief to local governments.

As allowed under the FY 2013 Enacted Budget legislation, Monroe County, which had previously authorized a State intercept of sales tax in lieu of payment for its portion of the local share of Medicaid, chose to enter the Medicaid local cap program effective February 1, 2013.

The State share of DOH Medicaid spending is comprised of the General Fund, HCRA, provider assessment revenue, and indigent care payments. The following table provides information on the financing sources for State Medicaid spending (more information on HCRA can be found in the section entitled "HCRA Financial Plan").

DEPARTMENT OF HEALTH MEDICAID[1]

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
STATE OPERATING FUNDS	**15,900**	**16,421**	**3.3%**	**16,977**	**3.4%**	**17,805**	**4.9%**	**18,474**	**3.8%**
Total General Fund - Local	11,109	11,232	1.1%	11,391	1.4%	12,136	6.5%	12,631	4.1%
Total General Fund - State Operations	21	191	809.5%	197	3.1%	214	8.6%	226	5.6%
Other State Funds Support	4,770	4,998	4.8%	5,389	7.8%	5,455	1.2%	5,617	3.0%
HCRA Financing	3,214	3,437	6.9%	3,812	10.9%	3,878	1.7%	4,040	4.2%
Indigent Care Support	767	776	1.2%	792	2.1%	792	0.0%	792	0.0%
Provider Assessment Revenue	783	785	0.3%	785	0.0%	785	0.0%	785	0.0%
Other	6	0	-100.0%	0	0.0%	0	0.0%	0	0.0%

[1] Does not include Medicaid spending in other State agencies, transfers, or the local government share of total Medicaid program spending.

The FY 2014 Enacted Budget transferred all administrative costs, including those State resources associated with the local Medicaid takeover program, from the Public Health budget to the Medicaid budget. This change will align operational resources with programmatic responsibilities, and provide the necessary flexibility for meeting emerging needs during the course of the year. Using additional efficiencies gained from the local Medicaid takeover, this change is expected to avoid State General Fund costs of approximately $32 million in FY 2014, $50 million in FY 2015, and $67 million annually thereafter, without placing additional fiscal pressure on the Medicaid Global Cap.

Ongoing MRT efforts have identified a variety of other programmatic efficiencies and re-investments which are expected to improve overall service delivery within the health care industry, but which are not expected to have a significant net financial impact on the State's Medicaid program.

PUBLIC HEALTH/AGING PROGRAMS

Public Health includes the Elderly Pharmaceutical Insurance Coverage (EPIC) program that provides prescription drug insurance to low-income seniors, the Child Health Plus (CHP) program that finances health insurance coverage for children of low-income families up to the age of 19, the General Public Health Work (GPHW) program that reimburses local health departments for the cost of providing certain public health services, the Early Intervention (EI) program that pays for services to infants and toddlers under the age of three with disabilities or developmental delays, and other HCRA and State-supported programs.

The State Office for the Aging promotes and administers programs and services for New Yorkers 60 years of age and older. The Office primarily oversees community-based services, including but not limited to in-home services and nutrition assistance, provided through a network of county Area Agencies on Aging and local providers.

Many public health programs, such as the EI and GPHW programs, are run by county health departments and reimbursed by the State for a share of program costs. The State spending projections do not include the county share of public health funding. In addition, a significant portion of HCRA spending is included under the public health budget.

PUBLIC HEALTH AND AGING
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**2,040**	**2,193**	**7.5%**	**1,997**	**-8.9%**	**1,989**	**-0.4%**	**1,960**	**-1.5%**
Public Health	**1,927**	**2,079**	**7.9%**	**1,877**	**-9.7%**	**1,862**	**-0.8%**	**1,828**	**-1.8%**
Child Health Plus	364	380	4.4%	446	17.4%	378	-15.2%	304	-19.6%
General Public Health Work	247	186	-24.7%	237	27.4%	233	-1.7%	238	2.1%
EPIC	98	170	73.5%	207	21.8%	237	14.5%	258	8.9%
Early Intervention	144	151	4.9%	167	10.6%	171	2.4%	171	0.0%
HCRA Program Account	442	431	-2.5%	429	-0.5%	441	2.8%	441	0.0%
F-SHRP	249	384	54.2%	0	-100.0%	0	0.0%	0	0.0%
All Other	383	377	-1.6%	391	3.7%	402	2.8%	416	3.5%
Aging	**113**	**114**	**0.9%**	**120**	**5.3%**	**127**	**5.8%**	**132**	**3.9%**

Spending growth in the CHP program through FY 2015 largely reflects costs associated with the expectation of additional caseload growth under the ACA. As CHP enrollment increases, initial costs to the State are expected; however, these costs are expected to decrease beginning in FY 2016 when enhanced Federal participation rates become effective.

Increased State support for the EPIC program, which was authorized in the FY 2013 Enacted Budget to provide coverage of Medicare Part D co-payments and co-insurance for enrollees outside of the existing coverage gap, is also driving a substantial portion of spending growth, as this change took effect on January 1, 2013. Increased spending for expanded EPIC coverage, as well as growth due to the rising costs of prescription drug medication, is expected to be partly financed by additional revenue generated from rebates received from drug manufacturers.

The F-SHRP program, which is Federal funding provided to the State on a time-limited basis through a Federal waiver under terms and conditions aimed at improving the delivery of health care services, is expected to terminate at the end of FY 2014. Spending growth in FY 2014 reflects the anticipation of peak utilization prior to the expiration of funding.

The year-over-year decrease for GPHW in FY 2014 reflects revised spending assumptions associated with reduced municipal claiming on various services.

HCRA FINANCIAL PLAN

HCRA was established in 1996 to help finance a portion of State health care activities. Extensions and modifications to HCRA have financed new health care programs, including FHP, and provided additional funding for the expansion of existing programs such as CHP. HCRA has also provided additional financing for the health care industry, including investments in worker recruitment and retention, and the Health Care Efficiency and Affordability Law for New Yorkers (HEAL NY) program for capital improvements to health care facilities.

HCRA receipts include surcharges and assessments on hospital revenues, a "covered lives" assessment paid by insurance carriers, a portion of cigarette tax revenues, and other revenues dedicated by statute, as well as potential future proceeds from insurance company conversions. Total HCRA revenues are estimated to grow by approximately 3.3 percent on an annual basis during the Financial Plan period.

In addition to FHP, CHP, and HEAL NY, HCRA helps fund Medicaid, EPIC, physician excess medical malpractice insurance, and Indigent Care payments, which provide funding to hospitals serving a disproportionate share of individuals without health insurance.

The FY 2014 Enacted Budget included reductions to various public health programs and the shift of funding for certain programs between HCRA and the General Fund. The shifts are expected to lower spending in HCRA by approximately $145 million in FY 2014 and $175 million thereafter and increase the General Fund spending by the same amount.

HCRA is expected to remain in balance over the multi-year projection period. Under the current HCRA appropriation structure, spending reductions will occur if resources are insufficient to meet spending levels. These spending reductions could potentially affect core HCRA programs. The reauthorizations of HCRA in prior years maintained HCRA's balance without the need for automatic spending reductions.

Given the inter-relationship between the General Fund and HCRA, any balances in HCRA are typically eliminated by adjusting the level of Medicaid disbursements that HCRA finances. This reduces costs that otherwise would have been paid for by the General Fund. Conversely, any shortfall in HCRA is expected to be financed by the General Fund.

HCRA FINANCIAL PLAN FY 2013 THROUGH FY 2017
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
OPENING BALANCE	**3**	**18**	**0**	**0**	**0**
TOTAL RECEIPTS	**5,336**	**5,610**	**5,854**	**5,949**	**6,049**
Surcharges	2,723	2,818	2,918	3,013	3,111
Covered Lives Assessment	1,045	1,045	1,045	1,045	1,045
Cigarette Tax Revenue	1,108	1,060	1,041	1,018	995
Conversion Proceeds	0	175	300	300	300
Hospital Assessments	330	340	360	376	393
NYC Cigarette Tax Transfer/Other	130	172	190	197	205
TOTAL DISBURSEMENTS	**5,321**	**5,628**	**5,854**	**5,949**	**6,049**
Medicaid Assistance Account	3,219	3,437	3,812	3,878	4,040
Medicaid Costs	*1,840*	*2,138*	*2,852*	*3,229*	3,391
Family Health Plus	*682*	*650*	*311*	*0*	0
Workforce Recruitment & Retention	*157*	*197*	*197*	*197*	197
All Other	*540*	*452*	*452*	*452*	452
HCRA Program Account	459	445	444	460	460
Hospital Indigent Care	777	776	792	792	792
Elderly Pharmaceutical Insurance Coverage	105	183	220	250	271
Child Health Plus	372	386	453	385	312
Public Health Programs	128	29	0	0	0
All Other	261	372	133	184	174
ANNUAL OPERATING SURPLUS/(DEFICIT)	**15**	**(18)**	**0**	**0**	**0**
CLOSING BALANCE	**18**	**0**	**0**	**0**	**0**

MENTAL HYGIENE

The Department of Mental Hygiene is comprised of three independent agencies: OPWDD, Office of Mental Health (OMH), and the Office of Alcoholism and Substance Abuse Services (OASAS). Services are administered to adults with serious and persistent mental illness; children with serious emotional disturbances; individuals with developmental disabilities and their families; persons with chemical dependencies; and individuals with compulsive gambling problems. These agencies provide services directly to their patients through State-operated facilities and indirectly through community service providers. The costs associated with providing these services are funded by reimbursement from Medicaid, Medicare, third-party insurance and State funding. Patient care revenues are pledged first to the payment of debt service on outstanding mental hygiene bonds, which are issued to finance improvements to infrastructure at mental hygiene facilities throughout the State, with the remaining revenue used to support State operating costs.

MENTAL HYGIENE
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Updated	Change	Projected	Change	Projected	Change	Projected	Change
TOTAL STATE OPERATING FUNDS	3,602	2,833	-21.3%	3,450	21.8%	3,967	15.0%	4,173	5.2%
People with Developmental Disabilities	**2,196**	**1,420**	**-35.3%**	**1,862**	**31.1%**	**2,157**	**15.8%**	**2,220**	**2.9%**
Residential Services	1,551	1,519	-2.1%	1,630	7.3%	1,712	5.0%	1,756	2.6%
Day Programs	560	548	-2.1%	588	7.3%	618	5.1%	635	2.8%
Clinic	22	22	0.0%	23	4.5%	25	8.7%	25	0.0%
Other Local	63	61	-3.2%	66	8.2%	69	4.5%	71	2.9%
Mental Hygiene Stabilization Fund	0	(730)	0.0%	(445)	-39.0%	(267)	-40.0%	(267)	0.0%
Mental Health	**1,094**	**1,097**	**0.3%**	**1,256**	**14.5%**	**1,461**	**16.3%**	**1,590**	**8.8%**
Adult Local Services	913	917	0.4%	1,048	14.3%	1,239	18.2%	1,364	10.1%
Children Local Services	181	180	-0.6%	208	15.6%	222	6.7%	226	1.8%
Alcohol and Substance Abuse	**311**	**315**	**1.3%**	**331**	**5.1%**	**348**	**5.1%**	**362**	**4.0%**
Outpatient/Methadone	134	135	0.7%	142	5.2%	149	4.9%	155	4.0%
Residential	105	106	1.0%	112	5.7%	118	5.4%	123	4.2%
Prevention and Program Support	55	57	3.6%	60	5.3%	63	5.0%	65	3.2%
Crisis	17	17	0.0%	17	0.0%	18	5.9%	19	5.6%
CQCAPD/Justice Center	**1**	**1**	**0.0%**	**1**	**0.0%**	**1**	**0.0%**	**1**	**0.0%**

Legislation enacted in FY 2013 established the Justice Center for the Protection of People with Special Needs, which has the primary responsibility for tracking, investigating and pursuing serious abuse/neglect complaints at facilities and provider settings operated, certified, or licensed by six State agencies. The activities of the Commission on Quality of Care and Advocacy for Persons with Disabilities were subsumed by the Justice Center when it became operational on June 30, 2013.

Local assistance spending in mental hygiene accounts for nearly half of total mental hygiene spending from State Operating Funds, and is projected to grow by an average rate of 3.7 percent annually. This growth is attributable to increases in the projected State share of Medicaid costs and projected expansion of the various mental hygiene service systems, including: increases primarily associated with developing new OPWDD residential and non-residential services and supports; the New York/New York III Supportive Housing agreement; and community beds that are currently under development in the OMH pipeline. Additional outyear spending is assumed in Financial Plan estimates for costs associated with efforts to move individuals in nursing homes and other settings to the least restrictive setting possible, as well as several chemical dependence treatment and prevention initiatives for individuals receiving services through OASAS.

The Financial Plan achieves lower spending growth by authorizing the elimination of automatic inflationary factors in FY 2014, including the 1.4 percent Human Services Cost of Living Adjustment and Medicaid trend adjustment, which provides rate reimbursement adjustments for eligible providers of services to the developmentally disabled; improved program efficiencies; enhanced audit recoveries; reduced administrative costs reimbursed to OPWDD providers; and revised estimates for mental health community bed funding.

OPWDD's Medicaid-related spending estimates were revised downward in the Enacted Budget Financial Plan by $820 million in FY 2014, $535 million in FY 2015, and $357 million thereafter. These revisions are attributable to the impact of reduced Federal revenue from Medicaid reimbursement at State-operated facilities providing developmental disability services. To compensate for the reduced Federal reimbursement for services provided, the State is undertaking various actions to reduce overall costs in the least disruptive manner possible for service delivery. These actions include shifting a portion of OPWDD Medicaid costs to DOH, the impact of which is expected to be managed on a neutral Financial Plan basis through the implementation of several actions, including comprehensive program reforms consistent with other states to generate Federal reimbursement for services already being provided, and the management of certain MRT investment initiatives. These savings are valued at $730 million in FY 2014, $445 million in FY 2015, and $267 million in each of FY 2016 and FY 2017 and are part of the Mental Hygiene Stabilization Fund within the DOH global spending cap. In addition, $90 million of savings will be achieved by OPWDD through a combination of actions identified in consultation with all relevant parties. These include $50 million in savings from reduced administrative costs, improved efficiencies, and collaborative efforts to utilize lower cost community based supports and services as opposed to more costly settings such as institutions and residential schools. In addition, $40 million in savings will be generated from increased audit recoveries generated by enhanced audit activity by the OMIG related to OPWDD services provided by nonprofit agencies.

SOCIAL SERVICES

The Office of Temporary and Disability Assistance (OTDA) local assistance programs provide cash benefits and supportive services to low-income families. The State's three main programs include Family Assistance, Safety Net Assistance and SSI. The Family Assistance program, which is financed by the Federal government, provides time-limited cash assistance to eligible families. The Safety Net Assistance program, financed by the State and local districts, provides cash assistance for single adults, childless couples, and families that have exhausted their five-year limit on Family Assistance imposed by Federal law. The State SSI Supplementation program provides a supplement to the Federal SSI benefit for the elderly, visually handicapped, and disabled.

TEMPORARY AND DISABILITY ASSISTANCE
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**1,540**	**1,392**	**-9.6%**	**1,290**	**-7.3%**	**1,318**	**2.2%**	**1,328**	**0.8%**
SSI	745	766	2.8%	664	-13.3%	691	4.1%	700	1.3%
Public Assistance Benefits	636	502	-21.1%	502	0.0%	502	0.0%	502	0.0%
Welfare Initiatives	36	19	-47.2%	19	0.0%	19	0.0%	19	0.0%
All Other	123	105	-14.6%	105	0.0%	106	1.0%	107	0.9%

The decline in OTDA spending from FY 2013 results to FY 2014 Updated Financial Plan projections is driven primarily by the State's projected costs for public assistance caseload and the fact that there are no longer timing delays for payments. The average public assistance caseload is projected to total 554,011 recipients in FY 2014, a decrease of 3.5 percent from FY 2013 levels. Approximately 249,528 families are expected to receive benefits through the Family Assistance program in FY 2014, a decrease of 3.9 percent from FY 2013. In the Safety Net program an average of 118,706 families are expected to be helped in FY 2014, a decrease of 3.3 percent from FY 2013. The caseload for single adults/childless couples supported through the Safety Net program is projected at 185,777 in FY 2014, a decrease of 3.1 percent from FY 2013.

The Office of Children and Family Services (OCFS) provides funding for foster care, adoption, child protective services, preventive services, delinquency prevention, and child care. OCFS oversees the State's system of family support and child welfare services administered by social services departments and community-based organizations. Specifically, child welfare services, which are financed jointly by the Federal government, the State, and local districts, are structured to encourage local governments to invest in preventive services intended to reduce out-of-home placement of children. In addition, the Child Care Block Grant, which is also financed by a combination of Federal, State and local sources, supports child care subsidies for public assistance and low-income families. The youth facilities program serves youth directed by family or criminal courts to be placed in residential facilities.

CHILDREN AND FAMILY SERVICES
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**1,492**	**1,604**	**7.5%**	**1,760**	**9.7%**	**1,828**	**3.9%**	**1,914**	**4.7%**
Child Welfare Service	334	462	38.3%	493	6.7%	526	6.7%	560	6.5%
Foster Care Block Grant	436	436	0.0%	456	4.6%	473	3.7%	491	3.8%
Adoption	142	162	14.1%	164	1.2%	167	1.8%	171	2.4%
Day Care	216	165	-23.6%	249	50.9%	249	0.0%	249	0.0%
Youth Programs	130	152	16.9%	161	5.9%	163	1.2%	163	0.0%
Medicaid	89	87	-2.2%	90	3.4%	94	4.4%	98	4.3%
Committees on Special Education	37	30	-18.9%	33	10.0%	38	15.2%	43	13.2%
Adult Protective/Domestic Violence	34	31	-8.8%	35	12.9%	41	17.1%	48	17.1%
All Other	74	79	6.8%	79	0.0%	77	-2.5%	91	18.2%

Financial Plan growth is driven by increases in claims-based programs; an increase in General Fund spending on Day Care beginning in FY 2015, in order to keep spending on this program constant after a projected decrease in Federal funding; and the continued implementation of the New York City Close to Home Initiative. Growth in Child Welfare Services and Adult Protective/Domestic Violence reflects anticipated growth in local claims and flat Federal funding.

TRANSPORTATION

In FY 2014, the Department of Transportation (DOT) will provide $4.7 billion in local assistance to support statewide mass transit systems. This funding, financed through the collection of dedicated taxes and fees, is provided to mass transit operators throughout the State to support operating costs. The MTA, due to the size and scope of its transit system, receives the majority of the statewide mass transit operating aid. Additionally, the MTA receives operating support from the Mobility Tax and MTA Aid Trust Fund, authorized in May 2009 to collect regional taxes and fees imposed within the Metropolitan Commuter Transportation District. The State collects these taxes and fees on behalf of, and disburses the entire amount to, the MTA to support the transit system. Legislation enacted in December 2011 eliminates the MTA payroll tax for all elementary and secondary schools as well as for certain small businesses. The State compensates the MTA for the decrease in receipts from this tax reduction.

Operating aid to the MTA and other transit systems is expected to increase in FY 2014 by 10.1 percent, which reflects the impact of timing associated with availability of funding resources and growth assumed in the current receipts forecast.

TRANSPORTATION
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**4,303**	**4,739**	**10.1%**	**4,831**	**1.9%**	**4,910**	**1.6%**	**4,995**	**1.7%**
Mass Transit Operating Aid:	1,906	2,105	10.4%	2,101	-0.2%	2,101	0.0%	2,101	0.0%
Metro Mass Transit Aid	1,761	1,964	11.5%	1,960	-0.2%	1,960	0.0%	1,960	0.0%
Public Transit Aid	93	89	-4.3%	89	0.0%	89	0.0%	89	0.0%
18-B General Fund Aid	27	27	0.0%	27	0.0%	27	0.0%	27	0.0%
School Fare	25	25	0.0%	25	0.0%	25	0.0%	25	0.0%
Mobility Tax and MTA Aid Trust	1,705	1,909	12.0%	1,986	4.0%	2,061	3.8%	2,143	4.0%
Dedicated Mass Transit	647	680	5.1%	698	2.6%	702	0.6%	706	0.6%
AMTAP	45	45	0.0%	45	0.0%	45	0.0%	45	0.0%
All Other	0	0	0.0%	1	N/A	1	0.0%	0	0.0%

LOCAL GOVERNMENT ASSISTANCE

Direct aid to local governments includes the Aid and Incentive for Municipalities (AIM) program, which was created in FY 2006 to consolidate various unrestricted local aid funding streams; VLT impact aid; and Small Government Assistance and Miscellaneous Financial Assistance. In addition, the State provides incentive grants to local governments. Spending for AIM efficiency incentive grants increases over the multi-year period reflecting the implementation of the Local Government Performance and Efficiency Program enacted in FY 2012 to reward municipal efficiencies and to encourage less duplication among local governments in the delivery of services.

LOCAL GOVERNMENT ASSISTANCE
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Annual % Change	FY 2015 Projected	Annual % Change	FY 2016 Projected	Annual % Change	FY 2017 Projected	Annual % Change
TOTAL STATE OPERATING FUNDS	**754**	**764**	**1.3%**	**769**	**0.7%**	**782**	**1.7%**	**794**	**1.5%**
AIM:									
Big Four Cities	429	429	0.0%	429	0.0%	429	0.0%	429	0.0%
Other Cities	218	218	0.0%	218	0.0%	218	0.0%	218	0.0%
Towns and Villages	68	68	0.0%	68	0.0%	68	0.0%	68	0.0%
Efficiency Incentives	6	11	83.3%	20	81.8%	35	75.0%	47	34.3%
All Other Local Aid	33	38	15.2%	34	-10.5%	32	-5.9%	32	0.0%

ALL OTHER LOCAL ASSISTANCE SPENDING

Other local assistance programs and activities include criminal justice, economic development, aging, and housing. Spending in these areas is not expected to change materially over the Financial Plan period.

AGENCY OPERATIONS

Agency operating costs include personal service, non-personal service, and General State Charges (GSCs). Personal service includes salaries of State employees of the Executive, Legislative, and Judicial branches, as well as overtime payments and costs for temporary employees. Non-personal service generally accounts for the cost of operating State agencies, including real estate rental, utilities, contractual payments (i.e., consultants, information technology, and professional business services), supplies and materials, equipment, and telephone service. GSCs account for the costs of fringe benefits (i.e., pensions, health insurance) provided to State employees and retirees of the Executive, Legislative and Judicial branches, and certain fixed costs paid by the State. In addition, certain agency operations of Transportation and Motor Vehicles are included in the capital projects fund type and not reflected in the State Operating Funds personal service or non-personal service totals.

Approximately 94 percent of the State workforce is unionized. The largest unions include CSEA, which represents office support staff and administrative personnel, machine operators, skilled trade workers, and therapeutic and custodial care staff; PEF, which represents professional and technical personnel (i.e., attorneys, nurses, accountants, engineers, social workers, and institution teachers); UUP, which represents faculty and non-teaching professional staff within the State University system; and NYSCOPBA, which represents security personnel (correction officers, safety and security officers).

Selected assumptions used in preparing the spending projections for the State's major programs and activities are summarized in the following table.

FORECAST OF SELECTED PROGRAM MEASURES AFFECTING PERSONAL SERVICE AND FRINGE BENEFITS

		Forecast			
	FY 2013 Results	FY 2014 Updated	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Negotiated Base Salary Increases [1]					
CSEA/NYSCOPBA/Council 82/UUP	0	0	2%	2%	TBD
PEF / NYSPBA	0	0	2%	TBD	TBD
State Workforce[2]	119,756	120,520	120,460	120,460	120,460
ERS Pension Contribution Rate[3]					
Before Amortization (Normal/Admin/GLIP)	19.4%	21.5%	20.5%	18.0%	16.3%
After Amortization	11.5%	12.5%	13.5%	14.5%	15.5%
PFRS Pension Contribution Rate					
Before Amortization (Normal/Admin/GLIP)	26.6%	29.9%	28.6%	26.2%	24.2%
After Amortization	19.5%	20.5%	21.5%	22.5%	23.5%
Employee/Retiree Health Insurance Growth Rates	3.1%	5.4%	8.5%	8.5%	8.5%
PS/Fringe as % of Receipts (All Funds Basis)	14.5%	14.2%	14.5%	14.6%	14.4%

[1] Reflects current collective bargaining agreements with settled unions. Does not reflect potential impact of future negotiated workforce agreements.

[2] Reflects workforce that is Subject to Direct Executive Control.

[3] As Percent of Salary.

Growth in agency operating spending is concentrated in agencies that operate large facilities, such as the State University, the mental hygiene agencies, and Corrections and Community Supervision. The main causes of growth include inflationary increases in payroll and operating costs expected for food, medical care and prescription drugs, and energy costs in State facilities, offset by expected savings from enterprise procurement initiatives, including procurement reform, real estate consolidation, and consolidation of back-office functions. In most years, there are 26 bi-weekly pay periods. In FY 2016, there is one additional State institutional payroll, which results in higher spending mainly in mental hygiene and corrections. In addition, the State will begin repayment to State employees of certain amounts withheld pursuant to the DRP in FY 2012 and FY 2013 beginning in the last pay period in FY 2015.

Prior-year collective bargaining agreements with NYSCOPBA, Council 82 and UUP Lifeguards are reflected in the personal service costs in the following table and include retroactive salary increases already paid in FY 2013 for prior years.

STATE OPERATING FUNDS - AGENCY OPERATIONS[1]
(millions of dollars)

	FY 2013	FY 2014	FY 2015	FY 2016	FY 2017
	Results	Updated	Projected	Projected	Projected
SUBJECT TO DIRECT EXECUTIVE CONTROL	**9,819**	**9,774**	**9,964**	**10,320**	**10,466**
Mental Hygiene	2,914	2,893	2,911	3,027	2,981
Corrections and Community Supervision	2,741	2,553	2,610	2,746	2,701
State Police	601	651	647	660	666
Public Health	526	422	429	416	417
Tax and Finance	372	349	356	363	371
Children and Family Services	302	262	246	242	247
Environmental Conservation	231	232	231	234	236
Financial Services	193	203	205	208	208
Temporary and Disability Assistance	187	151	160	157	161
Parks, Recreation and Historic Preservation	180	180	178	180	182
Workers' Compensation Board	150	152	152	155	157
Lottery/Gaming	124	161	165	166	166
General Services	145	170	144	145	148
Information Technology Services	60	236	267	271	271
All Other	1,093	1,159	1,263	1,350	1,554
UNIVERSITY SYSTEMS	**5,552**	**5,669**	**5,777**	**5,916**	**6,054**
State University	5,451	5,581	5,687	5,824	5,960
City University	101	88	90	92	94
INDEPENDENT AGENCIES	**297**	**304**	**310**	**319**	**323**
Law	160	165	167	171	173
Audit & Control	137	139	143	148	150
TOTAL, EXCLUDING JUDICIARY AND LEGISLATURE	**15,668**	**15,747**	**16,051**	**16,555**	**16,843**
Judiciary	1,812	1,878	2,000	2,095	2,111
Legislature	203	219	224	227	231
Statewide Total	**17,683**	**17,844**	**18,275**	**18,877**	**19,185**
Personal Service	12,403	12,366	12,642	13,078	13,210
	3.0%	-0.3%	2.2%	3.4%	1.0%
Non-Personal Service	5,280	5,478	5,633	5,799	5,975
	-2.3%	3.8%	2.8%	2.9%	3.0%

[1] Beginning in FY 2013, the Financial Plan reflects the shift of information technology staff from agencies across the State to ITS as well as the transfer of business services staff to OGS.

GENERAL STATE CHARGES

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, unemployment insurance and dental and vision benefits. The majority of employee fringe benefit costs are paid centrally from statewide appropriations. However, certain agencies, including the Judiciary and SUNY, directly pay all or a portion of their employees' fringe benefit costs from their respective budgets. Employee fringe benefits paid through GSCs are paid from the General Fund in the first instance, and then partially reimbursed by revenue collected from fringe benefit assessments on Federal funds and other special revenue accounts. The largest General Fund reimbursement comes from the mental hygiene agencies.

GSCs also include certain fixed costs such as State taxes paid to local governments for certain State-owned lands, and payments related to lawsuits against the State and its public officers.

GENERAL STATE CHARGES
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
TOTAL STATE OPERATING FUNDS	**6,437**	**7,058**	**9.6%**	**7,533**	**6.7%**	**7,954**	**5.6%**	**8,287**	**4.2%**
Fringe Benefits	**6,046**	**6,669**	**10.3%**	**7,132**	**6.9%**	**7,554**	**5.9%**	**7,887**	**4.4%**
Health Insurance	3,129	3,315	5.9%	3,476	4.9%	3,711	6.8%	4,020	8.3%
Employee Health Insurance	1,720	1,824	6.0%	1,945	6.6%	2,060	5.9%	2,232	8.3%
Retiree Health Insurance	1,409	1,491	5.8%	1,531	2.7%	1,651	7.8%	1,788	8.3%
Pensions	1,601	1,982	23.8%	2,256	13.8%	2,418	7.2%	2,446	1.2%
Social Security	942	960	1.9%	978	1.9%	997	1.9%	1,015	1.8%
All Other Fringe	374	412	10.2%	422	2.4%	428	1.4%	406	-5.1%
Fixed Costs	**391**	**389**	**-0.5%**	**401**	**3.1%**	**400**	**-0.2%**	**400**	**0.0%**

GSCs are projected to increase at an average annual rate of 6.5 percent over the Financial Plan period. This is due to projected growth in health insurance and pension costs, offset by revenue collected from fringe benefit assessments, particularly from the mental hygiene agencies.

TRANSFERS TO OTHER FUNDS (GENERAL FUND BASIS)

General Fund transfers help finance the State's share of Medicaid costs for State-operated mental hygiene facilities, debt service for bonds that do not have dedicated revenues, SUNY operating costs, certain capital activities, and a range of other activities.

GENERAL FUND TRANSFERS TO OTHER FUNDS
(millions of dollars)

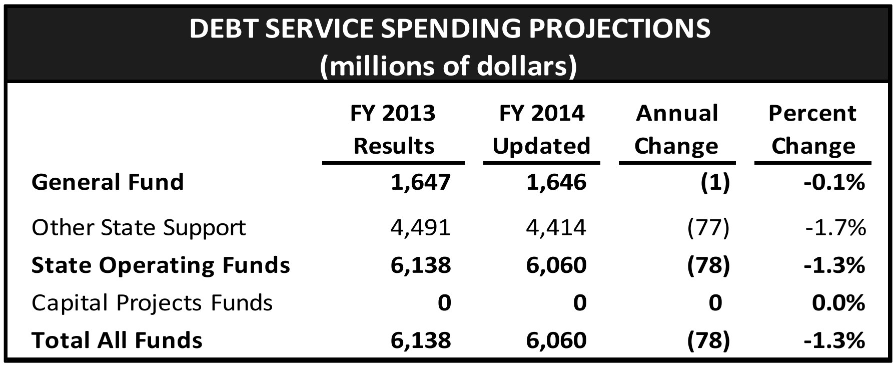
	FY 2013 Results	FY 2014 Updated	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
TOTAL TRANSFERS TO OTHER FUNDS	**6,794**	**8,702**	**8,861**	**9,682**	**10,248**
Mental Hygiene Medicaid State Share	**2,846**	**1,813**	**1,338**	**1,311**	**1,279**
Debt Service	**1,647**	**1,646**	**1,165**	**1,452**	**1,345**
SUNY University Operations	**340**	**971**	**971**	**971**	**971**
Capital Projects	**916**	**1,227**	**1,384**	**1,400**	**1,799**
Dedicated Highway and Bridge Trust Fund	519	551	592	606	720
All Other Capital	397	676	792	794	1,079
ALL OTHER TRANSFERS	**1,045**	**3,045**	**4,003**	**4,548**	**4,854**
Mental Hygiene	0	1,839	2,838	3,400	3,688
Department of Transportation (MTA Tax)	277	332	334	334	334
SUNY - Disproportionate Share	209	228	228	228	228
Judiciary Funds	112	107	108	109	109
SUNY - Hospital Operations	81	67	60	60	60
Banking Services	61	65	65	65	65
Statewide Financial System	48	53	55	55	55
Indigent Legal Services	34	40	40	40	40
Mass Transportation Operating Assistance	38	37	37	37	37
Alcoholic Beverage Control	17	18	20	20	20
Information Technology Services	14	40	14	6	10
Public Transportation Systems	12	12	12	12	12
Correctional Industries	10	10	10	10	10
All Other	132	197	182	172	186

A significant portion of the capital and operating expenses of DOT and the Department of Motor Vehicles (DMV) are funded from the DHBTF. The Fund receives various dedicated tax and fee revenues, including the petroleum business tax, motor fuel tax, and highway use taxes. The Financial Plan includes transfers from the General Fund that effectively subsidize the expenses of the DHBTF. The subsidy is required because the cumulative expenses of the fund – capital and operating expenses of DOT and DMV, debt service on certain transportation bonds – exceed current and projected revenue deposits and bond proceeds.

General Fund transfers to other funds are expected to total $8.7 billion in FY 2014 — a $1.9 billion increase from FY 2013. This increase is predominantly a function of the re-categorization of SUNY operating support, and the higher costs associated with operating mental hygiene facilities in lieu of reduced Federal revenue.

DEBT SERVICE

The State pays debt service on all outstanding State-supported bonds. These include general obligation bonds, for which the State is constitutionally obligated to pay debt service, as well as bonds issued by State public authorities (i.e., Empire State Development, DASNY, and the Thruway Authority, subject to an appropriation). Depending on the credit structure, debt service is financed by transfers from the General Fund, dedicated taxes and fees, and other resources, such as patient income revenues.



DEBT SERVICE SPENDING PROJECTIONS
(millions of dollars)

	FY 2013 Results	FY 2014 Updated	Annual Change	Percent Change
General Fund	**1,647**	**1,646**	**(1)**	**-0.1%**
Other State Support	4,491	4,414	(77)	-1.7%
State Operating Funds	**6,138**	**6,060**	**(78)**	**-1.3%**
Capital Projects Funds	**0**	**0**	**0**	**0.0%**
Total All Funds	**6,138**	**6,060**	**(78)**	**-1.3%**

Total debt service is projected at $6.1 billion in FY 2014, of which $1.6 billion is paid from the General Fund through transfers, and $4.4 billion from other State funds. The General Fund transfer finances debt service payments on general obligation and service contract bonds. Debt service is paid directly from other State funds for the State's revenue bonds, including PIT bonds, DHBTF bonds, and mental health facilities bonds.

FY 2014 spending estimates were revised with the First Quarterly Update to the Financial Plan for the assumed prepayment of $318 million of debt service that is due during FY 2015. Otherwise, debt service spending is unchanged from Enacted Budget estimates.

GAAP-BASIS RESULTS FOR PRIOR FISCAL YEARS

The Comptroller prepares Basic Financial Statements and Other Supplementary Information on a GAAP basis for governments as promulgated by the GASB. The Basic Financial Statements, released in July each year, include the Statements of Net Position and Activities; the Balance Sheet and Statement of Revenues, Expenditures and Changes in Fund Balances for the Governmental Funds; the Statements of Net Position, Revenues, Expenses and Changes in Fund Net Position and Cash Flows for the Enterprise Funds; the Statements of Fiduciary Net Position and Changes in Fiduciary Net Position; and the Combining Statements of Net Position and Activities for Discretely Presented Component Units. These statements are audited by independent certified public accountants. The Comptroller also prepares and issues a Comprehensive Annual Financial Report (CAFR), which includes a management discussion and analysis (MD&A), the Basic Financial Statements, required supplementary information, other supplementary information which includes individual fund combining statements, and a statistical section.

The following table summarizes recent governmental funds results on a GAAP basis. The State issued the Basic Financial Statements for FY 2013 in July 2013.

COMPARISON OF ACTUAL GAAP-BASIS OPERATING RESULTS
SURPLUS/(DEFICIT)
(millions of dollars)

Fiscal Year Ended	General Fund	Special Revenue Funds	Debt Service Funds	Capital Projects Funds	All Governmental Funds	Accum. General Fund Surplus/(Deficit)
March 31, 2013	1,129	(308)	(186)	(499)	136	(739)
March 31, 2012	137	56	80	346	619	(1,868)
March 31, 2011	1,529	742	198	(568)	1,901	(2,009)

SUMMARY OF NET POSITION
(millions of dollars)

Fiscal Year Ended	Governmental Activities	Business-Type Activities	Total Primary Government
March 31, 2013	26,271	(922)	25,349
March 31, 2012	26,333	(658)	25,675
March 31, 2011	27,648	(618)	27,030

The Basic Financial Statements (including Other Supplementary Information) and the CAFR can be obtained from the Office of the State Comptroller, 110 State Street, Albany, NY 12236 or at the Office of the State Comptroller's website at www.osc.state.ny.us. The Basic Financial Statements can also be accessed through EMMA at www.emma.msrb.org.

STATE RETIREMENT SYSTEMS

GENERAL

This section summarizes key information regarding the New York State and Local Retirement System (NYSLRS or the "Systems") and the Common Retirement Fund (CRF), a pooled investment vehicle in which the assets of the Systems are held and invested. Greater detail, including the independent auditor's report for the fiscal year ending March 31, 2013, is included in NYSLRS' Comprehensive Annual Financial Report (NYSLRS' CAFR) for the fiscal year ended March 31, 2013. The Systems Actuary's Annual Report to the Comptroller on Actuarial Assumptions - the contents of which explain the methodology used to determine employer contribution rates to the Systems - issued from 2007 through 2013, as well as NYSLRS' CAFR and Asset Listing, the NYSLRS' CAFR for each of the nine prior fiscal years, and benefit plan booklets describing how each of the Systems' tiers works are all available and can be accessed at www.osc.state.ny.us/retire/publications. The Systems' audited Financial Statements, CAFR and Asset Listing for the fiscal year ending March 31, 2013 can also be accessed at that web page.

The State Comptroller is the administrative head of NYSLRS, which has the powers and privileges of a corporation and comprises the New York State and Local Employees' Retirement System (ERS) and the New York State and Local Police and Fire Retirement System (PFRS). The State Comptroller promulgates rules and regulations for the administration and transaction of the business of the Systems. Pursuant to the State's Retirement and Social Security Law and Insurance Law, NYSLRS is subject to the supervision of the Superintendent of the New York State Department of Financial Services. The State Comptroller is also the trustee and custodian of the CRF, a trust created pursuant to the Retirement and Social Security Law, and, as such, is responsible for investing the assets of the Systems. Consistent with statutory limitations affecting categories of investment, the State Comptroller, as trustee of the CRF, establishes a target asset allocation and approves policies and procedures to guide and direct the investment activities of the Division of Pension Investment and Cash Management of the Office of the State Comptroller ("Division"). Division employees, outside advisors, consultants and legal counsel provide the State Comptroller with advice and oversight of investment decisions. Outside advisors and internal investment staff must sign off on investment decisions before final action by the State Comptroller. The Investment Advisory Committee and the Real Estate Advisory Committee, both made up of outside advisors, assist the State Comptroller in his investment duties. The Investment Advisory Committee advises the State Comptroller on investment policies relating to the CRF, reviews the portfolio of the CRF and makes such recommendations as the Committee deems necessary. The Real Estate Advisory Committee reviews and must approve mortgage and real estate investments for consideration by the State Comptroller.

THE SYSTEMS

The Systems provide pension benefits to public employees of the State and its localities (except employees of New York City and teachers, who are covered by separate plans). State employees made up about 35 percent of the membership during FY 2013. There were 3,029 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 many public authorities.

As of March 31, 2013, approximately 648,000 persons were members of the Systems and approximately 413,000 pensioners or beneficiaries were receiving pension benefits. Article 5, section 7 of 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."

COMPARISON OF BENEFITS BY TIER

The Systems' members are categorized into six tiers depending on date of membership. As of March 31, 2013, approximately 83 percent of ERS members were in Tiers 3 and 4 and approximately 90 percent of PFRS members were in Tier 2. Tier 5 was enacted in 2009 and included significant changes to the benefit structure for ERS members joining on or after January 1, 2010 and PFRS members joining on or after January 9, 2010. Tier 6 was enacted in 2012 and included further changes to the benefit structure for ERS and PFRS members joining on or after April 1, 2012.

Benefits paid to members vary depending on tier. Tiers vary with respect to vesting, employee contributions, retirement age, reductions for early retirement, and calculation and limitation of "final average salary" – generally the average of an employee's three consecutive highest years' salary (for Tier 6 members, final average salary is determined by taking the average of an employee's five consecutive highest years' salary). ERS members in Tiers 3 and 4 can begin receiving full retirement benefits at age 62, or at age 55 with at least 30 years of service. The amount of the benefit is based on years of service, age at retirement and the final average salary earned. The majority of PFRS members in Tier 2 are in special plans that permit them to retire after 20 or 25 years regardless of age. Charts comparing the key benefits provided to members of ERS and PFRS in most of the tiers of the Systems can be accessed at http://www.osc.state.ny.us/retire/employers/tier-6/index.php.

2010 RETIREMENT INCENTIVE PROGRAM

Legislation enacted in June 2010 provided the State and local employers with the option to offer a temporary Retirement Incentive Program for certain ERS members for periods ending no later than December 31, 2010. This program did not apply to PFRS members. The Program had two distinct parts:

- Part A was a targeted incentive. Employers identified eligible titles. Part A provided one additional month of service credit for each year of credited service an eligible member had at retirement. The maximum additional incentive service credit was three years.

- Part B was not targeted. It was open to all eligible Tier 2, 3 and 4 members unless an employer deemed a member's position critical to the maintenance of public health and safety. Part B allowed members who were at least age 55 and had 25 years or more of service credit to retire without a benefit reduction.

Participating members whose employer offered both parts of the program, and who met the eligibility requirements of both parts, had to choose between the two. The number of State employees who retired under the Early Retirement Incentive (ERI) is approximately 6,400. Three hundred ninety-nine (399) participating employers elected to participate in Part A of the ERI. Two hundred eleven (211) participating employers elected to participate in Part B of the ERI. Five thousand four hundred fifty-three (5,453) members from participating employers retired under the ERI. The cost of the incentive is borne by the State and each participating employer electing the incentive over a five-year period commencing with a payment in FY 2012. The amortized amount receivable relating to the ERI, including accrued interest, from the State as of March 31, 2013 is $123.15 million and from participating employers is $85.56 million.

CONTRIBUTIONS AND FUNDING

Contributions to the Systems are provided by employers and employees. Employers contribute on the basis of the plan or plans they provide for members. All ERS members joining from mid-1976 through 2009 were required to contribute 3 percent of their salaries. A statutory change in 2000, however, limited the contributions to the first 10 years of membership, but did not authorize refunds where contributions had already exceeded 10 years. All ERS members joining after 2009 and prior to April 1, 2012, and all PFRS members joining after January 9, 2010 and prior to April 1, 2012, are members of Tier 5. All Tier 5 ERS members and 83.5 percent of the 1,805 Tier 5 PFRS members are required to contribute 3 percent of their salaries for their career. Members joining on or after April 1, 2012 are in Tier 6, and are required to pay contributions throughout their career on a stepped basis relative to each respective member's wages. Members in Tier 6 of both ERS and PFRS earning $45,000 or less must contribute 3 percent of their gross annual wages; members earning between $45,001 and $55,000 will contribute 3.5 percent; members earning between $55,001 and $75,000 will contribute 4.5 percent; members earning between $75,001 and $100,000 will contribute 5.75 percent; and, those earning in excess of $100,000 will contribute 6 percent of their gross annual salary.

The CRF experienced significant investment losses in FY 2009. These investment losses negatively impacted the value of assets held by the CRF for the Systems. In order to protect employers from potentially volatile contributions tied directly to the value of the Systems' assets held by the CRF, the Systems utilize a multi-year smoothing procedure. One of the factors used to calculate employer contribution requirements is the assumed investment rate of return used by the Systems Actuary, which is currently 7.5 percent. The current actuarial smoothing method spreads the impact of gains or losses above or below the 7.5 percent assumed investment rate of return over a 5-year period. Thus, because of the significant investment loss in FY 2009, employer contribution rates increased for FY 2011, FY 2012, FY 2013 and FY 2014. The amount of future annual employer contribution rates will depend, in part, on the value of the assets held by the CRF as of each April 1, as well as on the present value of the anticipated benefits to be paid by the Systems as of each April 1. Final contribution rates for FY 2015 were released in late August 2013. The average ERS rate decreased from 20.9 percent of salary in FY 2014 to 20.1 percent of salary in FY 2015, while the average PFRS rate decreased from 28.9 percent of salary in FY 2014 to 27.6 percent of salary in FY 2015. Information regarding average rates for FY 2015 may be found in the 2013 Annual Report to the Comptroller on Actuarial Assumptions which is accessible at www.osc.state.ny.us/retire/publications.

Legislation enacted in May 2003 realigned the Systems' billing cycle to match participating local governments' budget cycles and also instituted a minimum annual payment of at least 4.5 percent of payroll every year. The employer contribution for a given fiscal year is based in part on the value of the CRF's assets and its liabilities on the preceding April 1. Chapter 260 of the Laws of 2004 authorized employers to amortize over ten years, at 5 percent interest, a portion of their annual bill for FY 2005, FY 2006 and FY 2007. As of March 31, 2013, the amortized amount receivable, including accrued interest, pursuant to Chapter 260 from the State is $176.17 million and from participating employers is $47.55 million. The State paid approximately $1.4 billion in contributions (including Judiciary) for FY 2013 including amortization payments of approximately $235.04 million associated with Chapter 260 of the Laws of 2004, Chapter 57 of the Laws of 2010 and the 2010 retirement incentive program.

Legislation enacted in 2010 authorized the State and participating employers to amortize a portion of their annual pension costs during periods when actuarial contribution rates exceed thresholds established by the statute. The legislation provided employers with an optional mechanism intended to reduce the budgetary volatility of employer contributions. Amortized amounts must be paid by State and participating employers in equal annual installments over a ten-year period, and employers may prepay these amounts at any time without penalty. Employers are required to pay interest on the amortized amounts at a rate determined annually by the State Comptroller that is comparable to taxable fixed income investments of a comparable duration. The interest rate on the amount an employer chooses to amortize in a particular rate year is fixed for the duration of the ten-year repayment period. Should the employer choose to amortize in the next rate year, the interest rate on that amortization will be the rate set for that year. For amounts amortized in FY 2011, FY 2012, FY 2013 and FY 2014, the interest rates are 5 percent, 3.75 percent, 3 percent and 3.67 percent, respectively. The first payment is due in the fiscal year following the decision to amortize pension costs. When contribution rates fall below legally specified levels and all outstanding amortizations have been paid, employers that elected to amortize will be required to pay additional monies into reserve funds, specific to each employer, which will be used to offset their contributions in the future. These reserve funds will be invested separately from pension assets. Over time, it is expected that this will reduce the budgetary volatility of employer contributions. As of March 31, 2013, the amortized amount receivable, including accrued interest, for the 2011 amortization is $209.75 million from the State and $36.73 million from 50 participating employers; the amortized amount receivable, including accrued interest, for the 2012 amortization is $517.03 million from the State and $194.15 million from 133 participating employers; and, the amortized amount receivable, including accrued interest, for the 2013 amortization is $780.43 million from the State and $370.73 million from 139 participating employers.

The FY 2014 Enacted Budget included an alternate contribution program (the "Alternate Contribution Stabilization Program") that provides certain participating employers with a one-time election to amortize slightly more of their required contributions than would be available for amortization under the 2010 legislation. In addition, the maximum payment period is increased from ten years to twelve years. The election is available to counties, cities, towns, villages, BOCES, school districts and the four public health care centers operated in the counties of Nassau, Westchester and Erie. The State is not eligible to participate in the Alternate Contribution Stabilization Program.

Eligible employers have a one-time only option to elect to participate in the Alternate Contribution Stabilization Program, which begins with FY 2014. For those eligible employers electing the Alternate Contribution Stabilization Program, the graded contribution rate for fiscal years ending 2014 and 2015 is 12 percent of salary for ERS and 20 percent of salary for PFRS. Thereafter, the graded contribution rate will increase one half of one percent per year towards the actuarially required rate. Electing employers may amortize the difference between the graded rate and the actuarially required rate over a twelve year period at an interpolated twelve year U.S. Treasury Security rate (3.76 percent for FY 2014). As with the original Contribution Stabilization Program, when contribution rates fall below legally specified levels and all outstanding amortizations have been paid, employers that elect to amortize under the alternate program will be required to pay additional monies into reserve funds, specific to each employer, which will be used to offset their contributions in the future.

The estimated total State payment (including Judiciary) for FY 2014 is approximately $2.8 billion. As of November 1, 2013, the State has prepaid approximately $1.1 billion and has been credited with the related interest adjustment. If the State (including Judiciary) opts to amortize the maximum amount permitted, it would reduce the required March 1, 2014 payment by $948.2 million. The State payment for FY 2014 is an estimate. If this amount changes, then the amount that can be amortized would also change. Amounts amortized are treated as receivables for purposes of calculating assets of the CRF as further described below under "Pension Assets and Liabilities".

PENSION ASSETS AND LIABILITIES

The Systems' assets are held by the CRF for the exclusive benefit of members, pensioners and beneficiaries. Investments for the Systems are made by the State Comptroller as trustee of the CRF. The Systems report that the net position restricted for pension benefits as of March 31, 2013 was $164.2 billion (including $4.4 billion in receivables, which consist of employer contributions, amortized amounts, member contributions, member loans, accrued interest and dividends, investment sales and other miscellaneous receivables), an increase of $10.8 billion or 7 percent from the FY 2012 level of $153.4 billion. The increase in net position restricted for pension benefits from FY 2012 to FY 2013 reflects, in large part, equity market performance[4]. The valuation used by the Systems Actuary was based on audited net assets available for benefits as of March 31, 2013. The audited Financial Statement reports a gain of 10.38 percent for FY 2013.

Consistent with statutory limitations affecting categories of investment, the State Comptroller, as trustee of the CRF, establishes a target asset allocation and approves policies and procedures to guide and direct the investment activities of the Division of Pension Investment and Cash Management. The purpose of this asset allocation strategy is to identify the optimal diversified mix of assets to meet the requirements of pension payment obligations to members. In the fiscal year ended March 31, 2010, an asset liability analysis was completed and a long-term policy allocation was adopted. The current long-term policy allocation seeks a mix that includes 43 percent equities (30 percent domestic and 13 percent international); 22 percent bonds, cash and mortgages; 8 percent inflation indexed bonds and 27 percent alternative investments (10 percent private equity, 6 percent real estate, 4 percent absolute return or hedge funds, 4 percent opportunistic and 3 percent real assets). Since the implementation of the long-term policy allocation will take several years, transition targets have been established to aid in the asset rebalancing process.[5]

The Systems report that the present value of anticipated benefits for current members, retirees, and beneficiaries increased from $198.6 billion on April 1, 2012 to $204.5 billion (including $93.7 billion for current retirees and beneficiaries) on April 1, 2013. The funding method used by the Systems anticipates that the plan net position, 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 differed from plan net position on April 1, 2013 in that the determination of actuarial assets utilized a smoothing method which recognized 20 percent of the unexpected gain for FY 2013, 40 percent of the unexpected loss for FY 2012, 60 percent of the unexpected gain for FY 2011 and 80 percent of the unexpected gain for FY 2010[6]. Effective April 1, 2013, the asset valuation method smoothes gains and losses based on the market value of all investments. Prior valuation of non-fixed income assets smoothed gains and losses based on market value, but fixed income assets were based on amortized cost. Actuarial assets increased from $147.8 billion on April 1, 2012 to $155.4 billion on April 1, 2013. The funded ratio, as of April 1,

[4] On November 19, 2013, the State Comptroller released a statement indicating that the value of the Systems' invested assets posted a 4.61 percent return for the quarter ending September 30, 2013. This report reflects unaudited data for assets invested for the Systems. The value of invested assets changes daily.

[5] More detail on the CRF's asset allocation as of March 31, 2013, long-term policy allocation and transition target allocation can be found on page 76 of the NYSLRS' CAFR for the fiscal year ending March 31, 2013.

[6] The current actuarial smoothing method spreads the impact of gains or losses above or below the 7.5 percent assumed investment rate of return over a 5-year period.

2013, calculated by the Systems Actuary in August 2013 using the entry age normal funding method and actuarial assets, was 89 percent[7].

In June 2012, GASB approved two related Statements that make changes to the accounting and financial reporting of pensions by state and local governments and pension plans. These statements impact neither the Systems' actuarial funding method nor the calculation of rates.

Statement No. 67, Financial Reporting for Pension Plans, addresses financial reporting for state and local government pension plans. Statement No. 68, Accounting and Financial Reporting for Pensions, establishes new accounting and financial reporting requirements for governments that provide their employees with pensions.

The standards for public plans' financial statements go into effect for fiscal years beginning on or after June 15, 2013 (e.g. NYSLRS March 31, 2015 financial statement). The standards for employers are effective for fiscal years beginning on or after June 15, 2014. For example, it would be effective for the State's fiscal year ending March 31, 2016.

Under the new standards, participating employers will be required to report a new liability (Net Pension Liability) in their financial statements. The Systems are currently evaluating the impact of the new standards and implementation considerations.

Statement 67 replaces the requirements of Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, for most public employee pension plans. Statement 68 replaces the requirements of Statement No. 27, Accounting for Pensions by State and Local Governmental Employers, for most government employers. The new Statements also replace the requirements of Statement No. 50, Pension Disclosures, for those governments and pension plans.

[7] Detail on the funded ratios of ERS and PFRS as of April 1 for each of the 5 years previous to the fiscal year ended March 31, 2013 can be found on page 56 of the NYSLRS' CAFR for the fiscal year ending March 31, 2013. Detail regarding employers' Annual Required Contributions for FY 2013 and each of the five previous fiscal years can be found on page 57 of the NYSLRS' CAFR for the fiscal year ending March 31, 2013.

The tables that follow show net assets, benefits paid and the actuarially determined contributions that have been made over the last ten years. See also "State Retirements Systems — Contributions and Funding" above.

CONTRIBUTIONS AND BENEFITS
NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS[1]
(millions of dollars)

Fiscal Year	Contributions Recorded				Total
Ended	All Participating	Local			Benefits
March 31	Employers[1][2]	Employers[1][2]	State[1][2]	Employees	Paid[3]
2004	1,287	832	455	222	5,424
2005	2,965	1,877	1,088	227	5,691
2006	2,782	1,714	1,068	241	6,073
2007	2,718	1,730	988	250	6,432
2008	2,649	1,641	1,008	266	6,883
2009	2,456	1,567	889	273	7,265
2010	2,344	1,447	897	284	7,719
2011	4,165	2,406	1,759	286	8,520
2012	4,585	2,799	1,786	273	8,938
2013	5,336	3,385	1,950	269	9,521

Sources: State and Local Retirement Systems.

[1] Contributions recorded include the full amount of unpaid amortized contributions.

[2] The annual required contributions (ARC) include the employers' normal costs, the Group Life Insurance Plan amounts, and other supplemental amounts. Additional information on the ARC can be accessed on page 57 of the NYSLRS CAFR for fiscal year ending March 31, 2013.

[3] Includes payments from Group Life Insurance Plan, which funds the first $50,000 of any death benefit paid.

NET ASSETS AVAILABLE FOR BENEFITS OF THE
NEW YORK STATE AND LOCAL RETIREMENT SYSTEMS [1]
(millions of dollars)

Fiscal Year Ended March 31	Net Assets	Percent Increase/ (Decrease) From Prior Year
2004	120,799	24.1
2005	128,038	6.0
2006	142,620	11.4
2007	156,625	9.8
2008	155,846	(0.5)
2009	110,938	(28.8)
2010	134,252	21.0
2011	149,549	11.4
2012	153,394	2.6
2013	164,222	7.0

Sources: State and Local Retirement Systems.

[1] Includes relatively small amounts held under Group Life Insurance Plan. Includes some employer contribution receivables. Fiscal year ending March 31, 2013 includes approximately $4.4 billion of receivables.

AUTHORITIES AND LOCALITIES

PUBLIC AUTHORITIES

For the purposes of this section, "authorities" refer to public benefit corporations or public authorities, created pursuant to State law, which are reported in the State's CAFR. Authorities are not subject to the constitutional restrictions on the incurrence of debt that apply to the State itself and may issue bonds and notes within the amounts and restrictions set forth in legislative authorization. The State's access to the public credit markets through bond issuances constituting State-supported or State-related debt issuances by certain of its authorities could be impaired and the market price of the outstanding debt issued on its behalf may be materially and adversely affected if these authorities were to default on their respective State-supported or State-related debt issuances.

The State has numerous public authorities with various responsibilities, including those which finance, construct and/or operate revenue-producing public facilities. These entities generally pay their own operating expenses and debt service costs from revenues generated by the projects they finance or operate, such as tolls charged for the use of highways, bridges or tunnels; charges for public power, electric and gas utility services; tuition and fees; rentals charged for housing units; and charges for occupancy at medical care facilities. In addition, State legislation also authorizes several financing structures, which may be utilized for the financings.

There are statutory arrangements that, under certain circumstances, authorize State local assistance payments otherwise payable to localities to be made instead to the issuing public authorities in order to secure the payment of debt service on their revenue bonds and notes. However, the State has no constitutional or statutory obligation to provide assistance to localities beyond amounts that have been appropriated therefore in any given year. Some public authorities also receive moneys from State appropriations to pay for the operating costs of certain programs.

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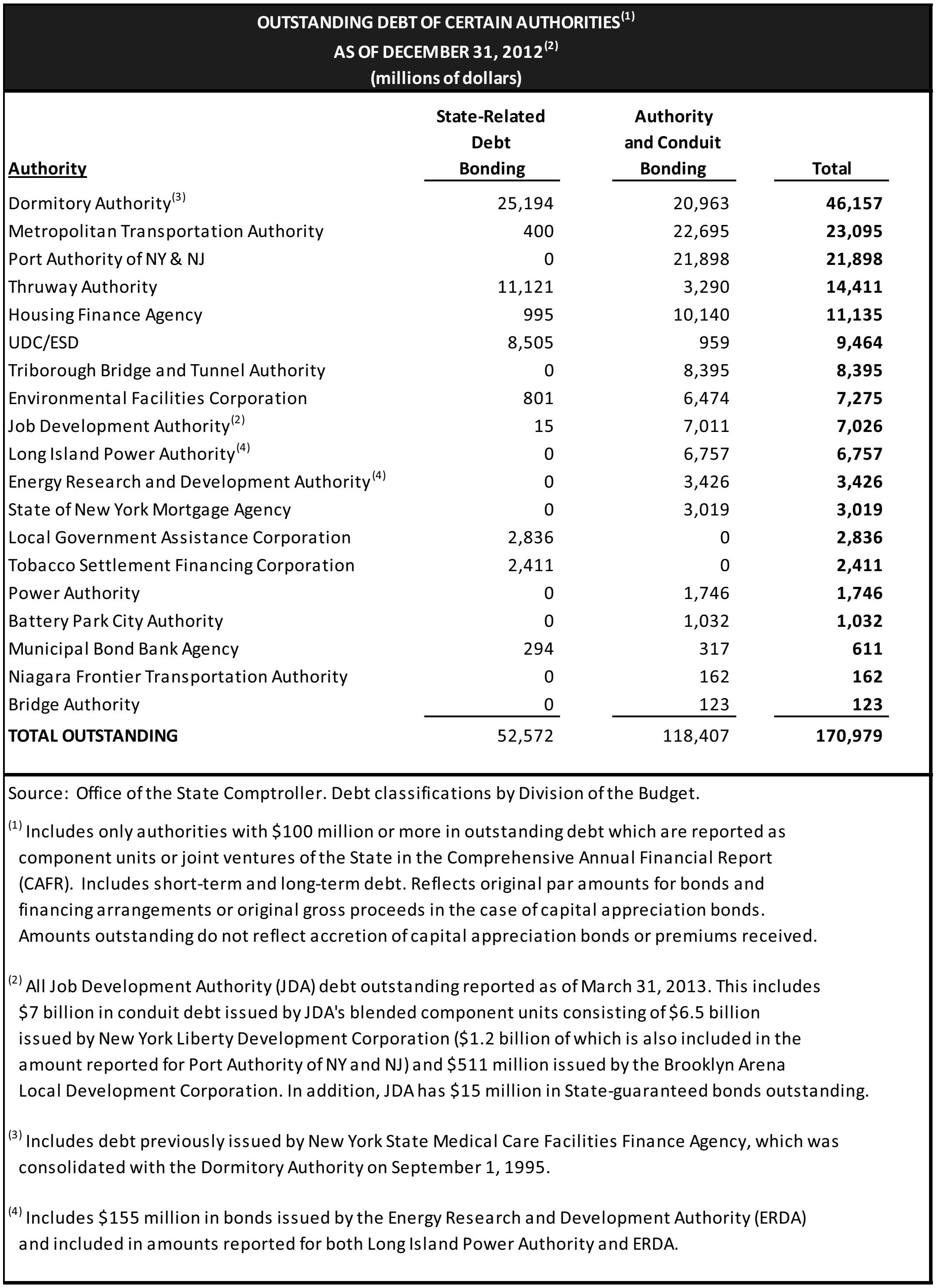
As of December 31, 2012 (with respect to Job Development Authority or "JDA", as of March 31, 2013), each of the 19 authorities listed in the following table had outstanding debt of $100 million or more, and the aggregate outstanding debt, including refunding bonds, was approximately $171 billion, only a portion of which constitutes State-supported or State-related debt. The following table summarizes the outstanding debt of these authorities.



OUTSTANDING DEBT OF CERTAIN AUTHORITIES[1]
AS OF DECEMBER 31, 2012[2]
(millions of dollars)

Authority	State-Related Debt Bonding	Authority and Conduit Bonding	Total
Dormitory Authority[3]	25,194	20,963	**46,157**
Metropolitan Transportation Authority	400	22,695	**23,095**
Port Authority of NY & NJ	0	21,898	**21,898**
Thruway Authority	11,121	3,290	**14,411**
Housing Finance Agency	995	10,140	**11,135**
UDC/ESD	8,505	959	**9,464**
Triborough Bridge and Tunnel Authority	0	8,395	**8,395**
Environmental Facilities Corporation	801	6,474	**7,275**
Job Development Authority[2]	15	7,011	**7,026**
Long Island Power Authority[4]	0	6,757	**6,757**
Energy Research and Development Authority[4]	0	3,426	**3,426**
State of New York Mortgage Agency	0	3,019	**3,019**
Local Government Assistance Corporation	2,836	0	**2,836**
Tobacco Settlement Financing Corporation	2,411	0	**2,411**
Power Authority	0	1,746	**1,746**
Battery Park City Authority	0	1,032	**1,032**
Municipal Bond Bank Agency	294	317	**611**
Niagara Frontier Transportation Authority	0	162	**162**
Bridge Authority	0	123	**123**
TOTAL OUTSTANDING	52,572	118,407	**170,979**

Source: Office of the State Comptroller. Debt classifications by Division of the Budget.

[1] Includes only authorities with $100 million or more in outstanding debt which are reported as component units or joint ventures of the State in the Comprehensive Annual Financial Report (CAFR). Includes short-term and long-term debt. Reflects original par amounts for bonds and financing arrangements or original gross proceeds in the case of capital appreciation bonds. Amounts outstanding do not reflect accretion of capital appreciation bonds or premiums received.

[2] All Job Development Authority (JDA) debt outstanding reported as of March 31, 2013. This includes $7 billion in conduit debt issued by JDA's blended component units consisting of $6.5 billion issued by New York Liberty Development Corporation ($1.2 billion of which is also included in the amount reported for Port Authority of NY and NJ) and $511 million issued by the Brooklyn Arena Local Development Corporation. In addition, JDA has $15 million in State-guaranteed bonds outstanding.

[3] Includes debt previously issued by New York State Medical Care Facilities Finance Agency, which was consolidated with the Dormitory Authority on September 1, 1995.

[4] Includes $155 million in bonds issued by the Energy Research and Development Authority (ERDA) and included in amounts reported for both Long Island Power Authority and ERDA.

THE CITY OF NEW YORK

The fiscal demands on the State may be affected by the fiscal condition of New York 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 New York City, and its related issuers, to market securities successfully in the public credit markets. The official financial disclosure of the City of New York and its related issuers is available by contacting Raymond J. Orlando, City Director of Investor Relations, (212) 788-5875, or contacting the City Office of Management and Budget, 255 Greenwich Street, 8th Floor, New York, NY 10007. The State assumes no liability or responsibility for any financial information reported by the City of New York. The following table summarizes the debt of New York City and its related issuers.

DEBT OF NEW YORK CITY[1]
AS OF JUNE 30 OF EACH YEAR
(millions of dollars)

Year	General Obligation Bonds	Obligations of TFA [1]	Obligations of Municipal Assistance Corporation	Obligations of STAR Corp. [2]	Obligations of TSASC, Inc.	Hudson Yards Infrastructure Corporation	Other [3] Obligations	Treasury Obligations	Total
2004	31,378	13,364	1,758	0	1,256	0	2,561	(52)	50,265
2005	33,903	12,977	0	2,551	1,283	0	3,746	(39)	54,421
2006	35,844	12,233	0	2,470	1,334	0	3,500	0	55,381
2007	34,506	14,607	0	2,368	1,317	2,100	3,394	0	58,292
2008	36,100	14,828	0	2,339	1,297	2,067	2,556	0	59,187
2009	39,991	16,913	0	2,253	1,274	2,033	2,442	0	64,906
2010	41,555	20,094	0	2,178	1,265	2,000	2,402	0	69,494
2011	41,785	23,820	0	2,117	1,260	2,000	2,556	0	73,538
2012	42,286	26,268	0	2,054	1,253	3,000	2,457	0	77,318
2013	41,592	29,203	0	1,985	1,245	3,000	2,360	0	79,385

Source: Office of the State Comptroller.

[1] Includes amounts for Building Aid Revenue Bonds (BARBS), the debt service on which will be funded solely from future State Building Aid payments that are subject to appropriation by the State and have been assigned by the City of New York to the Transitional Finance Authority (TFA).

[2] A portion of the proceeds of the Sales Tax Asset Receivable Corporation (STARC) Bonds were used to retire outstanding Municipal Assistance Corporation bonds. The debt service on STARC bonds will be funded from annual revenues to be provided by the State, subject to annual appropriation. These revenues have been assigned to STARC by the Mayor of the City of New York.

[3] Includes bonds issued by the Fiscal Year 2005 Securitization Corporation, the New York City Educational Construction Fund and the Industrial Development Agency. Also included are bonds issued by the Dormitory Authority of the State of New York for education, health, and court capital projects and other long-term leases which will be repaid from revenues of the City or revenues that would otherwise be available to the City if not needed for debt service.

The staffs of the Financial Control Board for the City of New York (FCB), the Office of the State Deputy Comptroller (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; 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.

OTHER LOCALITIES

Certain localities other than New York City have experienced financial problems and have requested and received additional State assistance during the last several State fiscal years. While a relatively infrequent practice, deficit financing by local governments has become more common in recent years. Between 2004 and January 2012, the State Legislature passed 21 special acts authorizing, or amending authorizations for, bond issuances to finance local government operating deficits, including a total of four passed during the 2009 and 2010 legislative sessions. Legislation introduced during the regular 2012 legislative session that would have authorized Rockland County and the City of Long Beach to issue bonds to address accumulated deficits did not pass both houses of the legislature. In the 2013 regular session, similar legislation on behalf of these two entities passed both houses of the Legislature. The Rockland County legislation has been signed by the Governor and the Long Beach bill is awaiting submission for gubernatorial action. The legislation relating to Long Beach has a technical defect relating to the timing of the issuance of the bonds, and a bill correcting the defect has been introduced for future consideration by the Legislature. In addition to deficit financing authorizations, the State has periodically enacted legislation to create oversight boards in order to address deteriorating fiscal conditions within a locality.

The Buffalo Fiscal Stability Authority has exercised Control Period powers with respect to the City of Buffalo since the City's 2004 fiscal year, but transitioned to Advisory Period powers commencing on July 1, 2012.

In January 2011, the Nassau County Interim Finance Authority (NIFA) declared that it was entering a Control Period, citing the "substantial likelihood and imminence" that Nassau County would incur a major operating funds deficit of 1 percent or more during the County's 2011 fiscal year. Nassau County challenged NIFA's determination and authority to impose a Control Period in State Supreme Court but did not prevail. NIFA is now exercising Control Period powers over Nassau County.

On February 14, 2013, the U.S. District Court for the Eastern District of New York issued an opinion in *Carver, et al. v. Nassau County Interim Finance Authority, et al.* granting the plaintiffs' (law enforcement unions) motion for summary judgment seeking to nullify NIFA's imposition of a wage freeze during the control period in 2011. The court stated that the operation of its judgment shall be stayed pending an appeal, by NIFA to the United States Court of Appeals for the Second Circuit. Both NIFA and the County appealed. On September 20, 2013, the Second Circuit held that the District Court should not have exercised jurisdiction to decide the issue because it raised an unresolved question of State law, and remanded the case to the District Court with instructions to dismiss the State law claim but retain jurisdiction over the Federal claim. At the request of the District Court, the Plaintiffs informed the District Court of their intent to commence a State action. The District Court, on October 3, 2013, exercised its discretion to stay the Federal action pending completion of the State court proceedings which have since commenced.

On July 9, 2013, State Supreme Court, Nassau County issued a decision in *Nassau County et al. v Nassau County Interim Finance Authority*, dismissing litigation challenging NIFA's authority to review a plan developed by the County for making real property tax refunds and NIFA's disapproval of certain personal services contracts. Erie County has a Fiscal Stability Authority, the City of New York has a Financial Control Board, and the City of Troy has a Supervisory Board, all of which presently perform certain review and advisory functions. The City of Yonkers no longer operates under an oversight board but must adhere to a Special Local Finance and Budget Act. The City of Newburgh operates under fiscal monitoring by the State Comptroller pursuant to special State legislation. The potential impact on the

State of any future requests by localities for additional oversight or financial assistance is not included in the projections of the State's receipts and disbursements for the State's FY 2013 or thereafter.

Legislation enacted earlier in 2013 created the Fiscal Restructuring Board for Local Governments. The Restructuring Board, upon the request of a "fiscally eligible municipality," is authorized to perform a number of functions including reviewing the municipality's operations and finances, making recommendations on reforming and restructuring the municipality's operations, proposing that the municipality agree to fiscal accountability measures, and making available certain grants and loans. The Restructuring Board is also authorized to resolve labor impasses between municipal employers and employee organizations for police, fire and certain other employees in lieu of binding arbitration before a public arbitration panel. Other portions of the legislation amended and extended for three years the binding arbitration provisions applicable to labor impasses between municipal employers and employee organizations representing police, fire and certain other employees. In the case of a "fiscally eligible municipality," a public arbitration panel must assign a weight of seventy percent to the municipality's ability to pay.

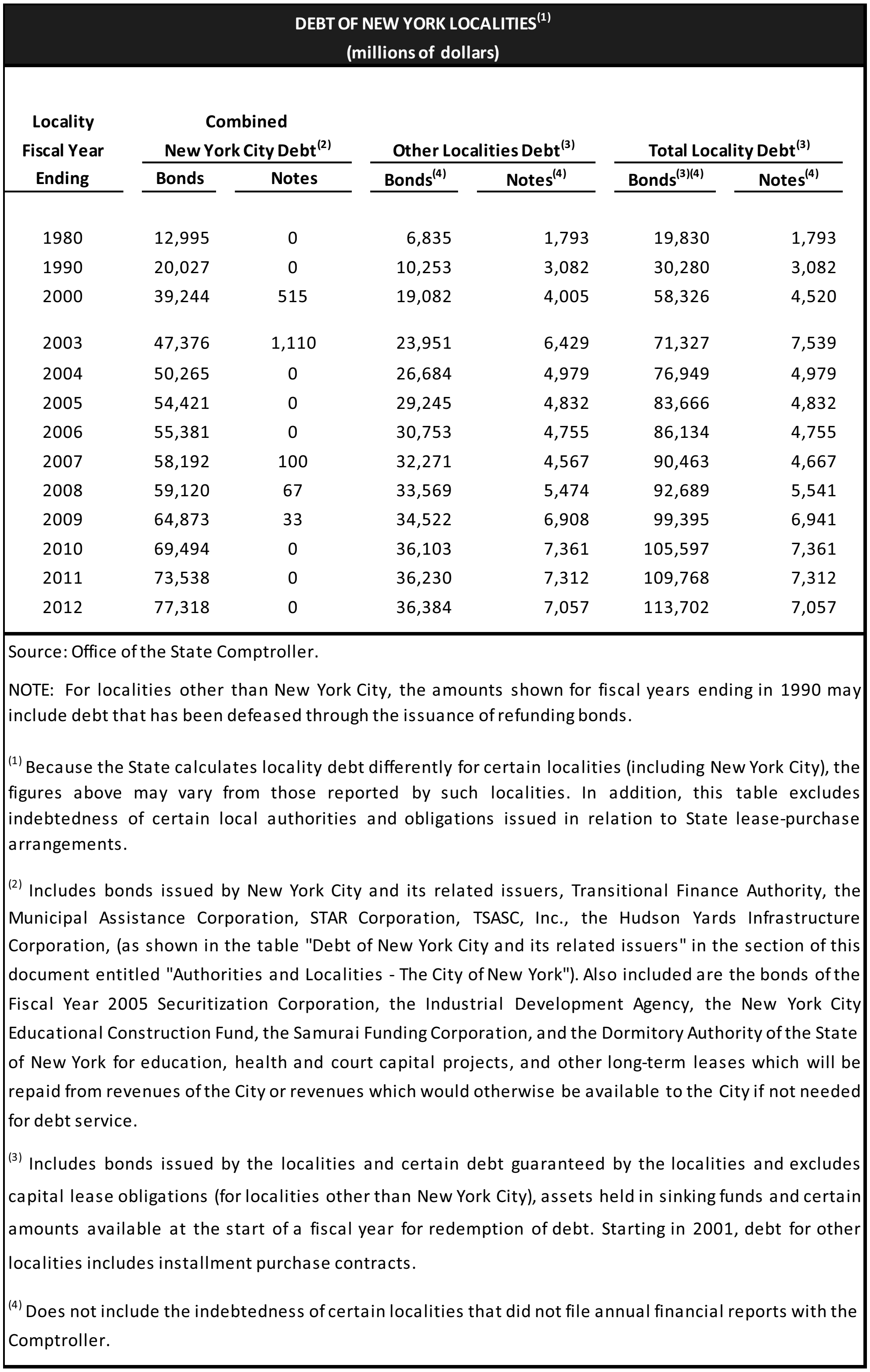
In June of 2013, OSC unveiled its Fiscal Stress Monitoring System—an early warning system that is intended to identify stress conditions in local communities, utilizing a number of fiscal and environmental indicators. Fiscal indicators consider measures of budgetary solvency while environmental indicators consider measures such as population, poverty, and tax base trends. Individual entities are then scored according to their performance on these indicators. An entity's score on the fiscal components will determine whether or not it is classified in one of three levels of stress: significant, moderate or susceptible. Entities that do not meet established scoring thresholds are classified as "no designation."

Like the State, local governments must respond to changing political, economic and financial influences over which they have little or no control, but which can adversely affect their financial condition. For example, the State or Federal government may reduce (or, in some cases, eliminate) funding of local programs, thus requiring local governments to pay these expenditures using their own resources. Similarly, past cash flow problems for the State have resulted in delays in State aid payments to localities. In some cases, these delays have necessitated short-term borrowing at the local level.

Other factors that have had, or could have, an impact on the fiscal condition of local governments and school districts include: the loss of temporary Federal stimulus funding; constitutional and statutory limitations on the imposition by local governments and school districts of property, sales and other taxes; and for some communities, the significant upfront costs for rebuilding and clean-up in the wake of a natural disaster. Localities may also face unanticipated problems resulting from certain pending litigation, judicial decisions and long-range economic trends. Other large-scale potential problems, such as declining urban populations, declines in the real property tax base, increasing pension, health care and other fixed costs, or the loss of skilled manufacturing jobs may also adversely affect localities and necessitate requests for State assistance.

Ultimately, localities as well as local public authorities may suffer serious financial difficulties that could jeopardize local access to the public credit markets, which may adversely affect the marketability of notes and bonds issued by localities within the State.

The following table summarizes the debt of New York City and its related issuers and all other New York State localities from 1980 to 2012.



DEBT OF NEW YORK LOCALITIES[1]
(millions of dollars)

Locality	Combined					
Fiscal Year	New York City Debt[2]		Other Localities Debt[3]		Total Locality Debt[3]	
Ending	Bonds	Notes	Bonds[4]	Notes[4]	Bonds[3][4]	Notes[4]
1980	12,995	0	6,835	1,793	19,830	1,793
1990	20,027	0	10,253	3,082	30,280	3,082
2000	39,244	515	19,082	4,005	58,326	4,520
2003	47,376	1,110	23,951	6,429	71,327	7,539
2004	50,265	0	26,684	4,979	76,949	4,979
2005	54,421	0	29,245	4,832	83,666	4,832
2006	55,381	0	30,753	4,755	86,134	4,755
2007	58,192	100	32,271	4,567	90,463	4,667
2008	59,120	67	33,569	5,474	92,689	5,541
2009	64,873	33	34,522	6,908	99,395	6,941
2010	69,494	0	36,103	7,361	105,597	7,361
2011	73,538	0	36,230	7,312	109,768	7,312
2012	77,318	0	36,384	7,057	113,702	7,057

Source: Office of the State Comptroller.

NOTE: For localities other than New York City, the amounts shown for fiscal years ending in 1990 may include debt that has been defeased through the issuance of refunding bonds.

[1] Because the State calculates locality debt differently for certain localities (including New York City), the figures above may vary from those reported by such localities. In addition, this table excludes indebtedness of certain local authorities and obligations issued in relation to State lease-purchase arrangements.

[2] Includes bonds issued by New York City and its related issuers, Transitional Finance Authority, the Municipal Assistance Corporation, STAR Corporation, TSASC, Inc., the Hudson Yards Infrastructure Corporation, (as shown in the table "Debt of New York City and its related issuers" in the section of this document entitled "Authorities and Localities - The City of New York"). Also included are the bonds of the Fiscal Year 2005 Securitization Corporation, the Industrial Development Agency, the New York City Educational Construction Fund, the Samurai Funding Corporation, and the Dormitory Authority of the State of New York for education, health and court capital projects, and other long-term leases which will be repaid from revenues of the City or revenues which would otherwise be available to the City if not needed for debt service.

[3] Includes bonds issued by the localities and certain debt guaranteed by the localities and excludes capital lease obligations (for localities other than New York City), assets held in sinking funds and certain amounts available at the start of a fiscal year for redemption of debt. Starting in 2001, debt for other localities includes installment purchase contracts.

[4] Does not include the indebtedness of certain localities that did not file annual financial reports with the Comptroller.

LITIGATION AND ARBITRATION

REAL PROPERTY CLAIMS

There are several cases in which Native American tribes have asserted possessory interests in real property or sought monetary damages as a result of claims that certain transfers of property from the tribes or their predecessors-in-interest in the 18th and 19th centuries were illegal.

In *Oneida Indian Nation of New York v. State of New York,* 74-CV-187 (NDNY)*,* the plaintiff, alleged successors-in-interest to the historic Oneida Indian Nation, sought a declaration that they hold a current possessory interest in approximately 250,000 acres of lands that the tribe sold to the State in a series of transactions that took place between 1795 and 1846, money damages, and the ejectment of the State and Madison and Oneida Counties from all publicly-held lands in the claim area. In 1998, the United States intervened in support of plaintiff.

During the pendency of this case, significant decisions were rendered by the United States Supreme Court and the Second Circuit Court of Appeals which changed the legal landscape pertaining to ancient land claims: *City of Sherrill v. Oneida Indian Nation of New York,* 544 U.S. 197 (2005), and *Cayuga Indian Nation of New York v. Pataki,* 413 F.3d 266 (2d Cir. 2005), *cert. denied*, 547 U.S. 1128 (2006). Taken together, these cases have made clear that the equitable doctrines of laches, acquiescence, and impossibility can bar ancient land claims.

Relying on these decisions, in *Oneida Indian Nation et al. v. County of Oneida et al.,* 617 F.3d 114 (2d Cir. 2010), the Second Circuit Court of Appeals dismissed the *Oneida* land claim. On October 17, 2011, the United States Supreme Court denied plaintiffs' petitions for certiorari to review the decision of the Second Circuit. See 132 S. Ct. 452 (2011).

On May 16, 2013, the State, Madison and Oneida Counties, and the Oneida Indian Nation signed a settlement agreement covering many issues. As pertinent here, the agreement would place a cap on the amount of land the tribe could reacquire and have taken into trust for its benefit by the United States. The agreement has been approved by the State Legislature, but is still pending approval, where applicable, by the New York State Office of the Attorney General and the Federal court.

In *Canadian St. Regis Band of Mohawk Indians, et al. v. State of New York, et al.* (NDNY), plaintiffs seek ejectment and monetary damages for their claim that approximately 15,000 acres in Franklin and St. Lawrence Counties were illegally transferred from their predecessors-in-interest. The defendants' motion for judgment on the pleadings, relying on the decisions in *Sherrill, Cayuga,* and *Oneida* was granted in great part through decisions on July 8, 2013 and July 23, 2013, holding that all claims are dismissed except for claims over the area known as the Hogansburg Triangle and a right of way claim against Niagara Mohawk, which will now proceed through discovery and additional motion practice.

On May 21, 2013, the State, Franklin and St. Lawrence Counties, and the tribe signed an agreement resolving a gaming exclusivity dispute, which agreement provides that the parties will work towards a mutually agreeable resolution of the tribe's land claim.

In *The Onondaga Nation v. The State of New York, et al.* (NDNY), plaintiff seeks a judgment declaring that certain lands allegedly constituting the aboriginal territory of the Onondaga Nation within the State are the property of the Onondaga Nation and the Haudenosaunee, or "Six Nations Iroquois Confederacy," and that conveyances of portions of that land during the period 1788 to 1822 are null and void. The "aboriginal territory" described in the complaint consists of an area or strip of land running generally north and south from the St. Lawrence River in the north, along the east side of Lake Ontario, and south as far as the Pennsylvania border, varying in width from about 10 miles to more than 40 miles, including the area constituting the City of Syracuse. On September 22, 2010, the District Court granted defendants' motion to dismiss the action for laches, based on the *Oneida, Sherrill* and *Cayuga* decisions. That decision was affirmed by the Second Circuit Court of Appeals on October 19, 2012. The Plaintiff's motion for rehearing or rehearing *en banc* was denied by the Second Circuit on December 21, 2012, and on October 15, 2013, the petition for writ of certiorari was denied by the United States Supreme Court.

In *Shinnecock Indian Nation v. State of New York, et al*. (EDNY), plaintiff seeks ejectment, monetary damages, and declaratory and injunctive relief for its claim that approximately 3,600 acres in the Town of Southampton were illegally transferred from its predecessors-in-interest. On December 5, 2006, the District Court granted defendants' motion to dismiss, based on the *Sherrill* and *Cayuga* decisions. Plaintiff moved for reconsideration before the District Court and also appealed to the Second Circuit Court of Appeals. The motion for reconsideration has been withdrawn, but a motion to amend the complaint remains pending in the District Court and stayed through at least December 1, 2013. The *Shinnecock* appeal to the Second Circuit also remains stayed.

WEST VALLEY LITIGATION

In *State of New York, et al. v. The United States of America, et al*., 06-CV-810 (WDNY), the parties have sought to resolve the relative responsibilities of the State and Federal governments for the cost of remediating the Western New York Nuclear Service Center (the "Center" or "Site"), located in West Valley, Cattaraugus County, New York. The Center was established by the State in the 1960s in response to a Federal call to commercialize the reprocessing of spent nuclear fuel from power reactors. The private company that had leased the Site ceased operations in 1972, leaving behind two disposal areas and lagoons, highly contaminated buildings, and 600,000 gallons of liquid high level radioactive waste (HLRW) generated by reprocessing activities.

Congress enacted the West Valley Demonstration Project Act (the "Act") in 1980, directing the Federal government to solidify the HLRW and transport it to a Federal repository, decontaminate and decommission the facilities and dispose of the low-level waste produced from the Demonstration Project. The Act directed the State to pay 10 percent of the Demonstration Project costs. However, for many years the two governments disputed what additional cleanup is needed; which cleanup activities are covered by the Act (and thus subject to the 90/10 split); who bears the long-term responsibility for maintaining, repairing or replacing and monitoring tanks or other facilities that are decommissioned in place at the Site; and who pays for the offsite disposal fee for the solidified HLRW. The combined Federal and State cost expenditures to date amount to approximately $2.6 billion. The State's expenditures at the Center are now approaching $320 million.

In order to resolve these disputes, the State and the New York State ERDA (which owns the Center on behalf of New York State) filed suit in December 2006, seeking a declaration: (1) that the Federal government (which sent wastes from various Federal facilities to the Center) is liable under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA, or Federal Superfund law) for the State's cleanup costs and for damages to the State's natural resources, and a judgment reimbursing the State for these costs and damages, (2) of the scope of the Federal government's responsibilities under the Act to decontaminate and decommission the Site and for further Site monitoring and maintenance, and (3) that the US is responsible under the Nuclear Waste Policy Act for paying the fees for disposal of solidified HLRW at the Site. After commencement of the action, the parties engaged in court-ordered mediation, as a result of which a Consent Decree was approved and entered on August 17, 2010, resolving several key claims in the litigation.

The Consent Decree identifies a specific cost share for each government for specified facilities and known areas of contamination, and sets forth a process for determining cost shares for contamination that may be identified in the future. The Consent Decree does not select or advocate the selection of any particular cleanup program for the Site-cleanup decisions are being made via the ongoing Environmental Impact Statement (EIS) process.

The Consent Decree also does not resolve two claims raised in the State's lawsuit - the State's natural resource damages claim and its Nuclear Waste Policy Act claim. The first claim, which the Federal government has agreed to toll, will be pursued by the New York State Department of Environmental Conservation (DEC) (as trustee of the State's natural resources) and the Attorney General's office. Regarding the latter claim, the State asserts that the Federal government bears sole responsibility for the cost of disposing of the 275 canisters of vitrified HLRW waste remaining at the Site at a Federal repository once one becomes available. This claim was neither settled nor dismissed and remains in litigation. Pursuant to an agreed briefing schedule, the parties have now submitted to the Court their opening and responsive briefs for competing motions to dismiss the Nuclear Waste Policy Act claim.

METROPOLITAN TRANSPORTATION AUTHORITY

There are several cases in which the plaintiffs challenge the constitutionality of Chapter 25 of the Laws of 2009, which imposed certain taxes and fees, including a regional payroll tax, in that portion of the State lying within the Metropolitan Commuter Transportation District. The revenues derived from this statute are intended to assist the Metropolitan Transportation Authority, which a State commission concluded was facing substantial financial pressure. The plaintiffs seek judgments declaring that the enactment of Chapter 25 violated State constitutional provisions relating to the need for a home rule message, supermajority requirements for enactment of special or local laws, single purpose appropriation bill, and liability for the debts of public authorities. Some of the plaintiffs also seek a judgment declaring that the enactment of Chapter 25 violated provisions of Public Authority Law §1266 requiring that the Metropolitan Transportation Authority be self-sustaining. These cases include *Hampton Transportation Ventures, Inc. et al. v. Silver et al. (*transferred to *Sup. Ct., Albany Co.), William Floyd Union Free School District v. State (*transferred to *Sup. Ct., New York Co.), Town of Brookhaven v. Silver, et al.* transferred to *Sup. Ct., Albany Co.), Town of Southampton and Town of Southold v. Silver* transferred to *Sup. Ct. Albany Co.), Town of Huntington v. Silver (*transferred to *Sup. Ct. Albany Co.), Mangano v. Silver (Sup. Ct. Nassau Co.), Town of Smithtown v. Silver (*now part of the *Mangano* case in *Sup. Ct. Nassau Co.),* and *Vanderhoef v. Silver (now in Sup. Ct. Albany Co.).* Suffolk County, Westchester County, the Orange County Chamber of Commerce, and a number of additional towns and a village also joined the *Mangano* case as plaintiffs.

The defendants sought to change the venue of all of these cases to Albany County or New York County and venue was changed in most of the cases. In *Vanderhoef, Huntington, Floyd, Brookhaven, Southampton/Southold* and *Hampton,* the defendants moved for judgment in their favor. The plaintiffs in *Hampton* then voluntarily stipulated to discontinue their case, as did the plaintiff in *Floyd* after legislative amendment of the applicable statute that exempted school districts from the "mobility tax" imposed by this statute on employers in the Metropolitan Commuter Transportation District. The Supreme Court, Albany County issued decisions granting summary judgment to defendants in *Brookhaven, Huntington, Southampton/Southold* and *Vanderhoef*. The plaintiffs in *Brookhaven*, *Huntington* and *Vanderhoef* appealed from those decisions in their cases but failed to perfect their appeals within nine months after the date of their notices of appeal, which, pursuant to the Rules of the Third Department, means their appeals are deemed abandoned. The plaintiffs in *Vanderhoef* attempted to file an appellate brief, which was rejected by the Appellate Division, Third Department, as untimely. They then moved for leave to perfect their appeal notwithstanding their delay and the Appellate Division granted their request; their appeal was argued on November 12, 2013, when the plaintiffs conceded that their constitutional claim had been disposed of by the Second Department decision in the *Mangano* case described below and only argued their common law claims.

In *Mangano*, the Supreme Court, Nassau County denied defendants' motion for change of venue. All parties moved for summary judgment in Supreme Court, Nassau County. By decision dated August 22, 2012, the Supreme Court (a) granted summary judgment to the defendants to the extent of dismissing the claims against certain of the individual State defendants on the ground of legislative immunity, but (b) granted summary judgment to plaintiffs to the extent that it held the MTA payroll tax unconstitutionally impinged on the home rule powers guaranteed under Article IX of the New York State Constitution. Judgment in accordance with that decision was entered October 1, 2012. All defendants appealed and in a Decision and Order dated June 26, 2013, the Appellate Division, Second Department, reversed the decision of Supreme Court, Nassau County, held that the Tax Law article in question was constitutional, and granted the defendants' motion for summary judgment. All plaintiffs have appealed to the New York Court of Appeals. In response to that Court's direction that the parties submit letters on whether the case presents a substantial constitutional question, the defendants have argued that it does not because the claims are controlled by existing precedent and that therefore the Court of Appeals lacks jurisdiction. On October 10, 2013, the Court of Appeals dismissed the plaintiffs' appeal on the ground that the case presented no substantial constitutional question. Notwithstanding that ruling, the plaintiffs have moved for leave to appeal to the Court of Appeals and the State defendants' opposition to that motion is due November 25, 2013. On or about October 26, 2012, the Towns of Southampton and Southold, whose previous litigation challenging the tax had been decided against them, commenced an action in the New York Court of Claims entitled *The Town of Southampton and the Town of Southold v. The State of New York, et al.,* in which they seek, based on the Supreme Court decision in *Mangano*, refund of all moneys they have paid under the payroll tax, as well as a declaration and injunction barring further collection of the tax from them. The State's motion to dismiss the claim in the Court of Claims has been fully briefed, but the Court had adjourned the motion to await the decision of the Court of Appeals whether to accept jurisdiction in the *Mangano* case. The Court scheduled a telephone conference with counsel for January 9, 2014.

SCHOOL AID

In *Maisto v. State of New York* (formerly identified as *Hussein v. State of New York*)*,* plaintiffs seek a judgment declaring that the State's system of financing public education violates section 1 of article 11 of the State Constitution, on the ground that it fails to provide a sound basic education (SBE). In a decision and order dated July 21, 2009, Supreme Court, Albany County, denied the State's motion to dismiss the action. On January 13, 2011, the Appellate Division, Third Department, affirmed the denial of the motion to dismiss. On May 6, 2011, the Third Department granted defendants leave to appeal to the Court of Appeals. On June 26, 2012, the Court of Appeals affirmed the denial of the State's motion to dismiss.

Depositions have been completed. The discovery deadline was May 3, 2013. The note of issue was filed on May 13, 2013. A pretrial conference is scheduled for December 5, 2013.

In *Aristy-Farer, et al. v. The State of New York, et al. (Sup. Ct., N.Y. Co.),* commenced February 6, 2013, plaintiffs seek a judgment declaring that the provisions of L. 2012, Chapter 53 and L. 2012, Chapter 57, Part A § 1, linking payment of State school aid increases for 2012-2013 school year to submission by local school districts of approvable teacher evaluation plans violates, among other provisions of the State Constitution, Article XI, § 1, because implementation of the statutes would prevent students from receiving a sound basic education. Plaintiffs moved for a preliminary injunction enjoining the defendants from taking any actions to carry out the statutes to the extent that they would reduce payment of State aid disbursements referred to as General Support for Public Schools (GSPS) to the City of New York pending a final determination. The State opposed this motion. By order dated February 19, 2013, the Court granted the motion for preliminary injunction. The State appealed. On May 21, 2013, the Appellate Division, First Department, denied plaintiffs motion for a stay pending appeal. As a result, plaintiffs have agreed to vacate their preliminary injunction and the State will withdraw its appeal. The action remains pending in Supreme Court, New York County.

In *New York State United Teachers, et al. v. The State of New York, et al. (Sup. Ct., Albany Co.)*, commenced February 20, 2013, plaintiffs seek a judgment declaring that the provisions of Education Law § 2023-a, which imposes a 60 percent super-majority requirement on school districts which seek to raise their tax levies above the previous year's levy by the lesser of 2 percent or the rate of inflation violates, among other provisions of the State Constitution, Article XI, § 1, because implementation of the statute would interfere with local control of education financing and impair the right of plaintiffs to substantially control school district finances. Plaintiffs also seek injunctive relief barring application of the statutory tax cap to local education funding. Defendants' motion to dismiss the amended complaint is returnable December 12, 2013.

MEDICAID NURSING HOME RATE METHODOLOGY

In *Kateri Residence v. Novello (Sup. Ct., New York Co*.) and several other cases, the plaintiffs challenge several nursing home rate methodologies, including the "reserve bed patient day adjustment," which regulates payments to nursing homes when long term care patients are receiving off-site care. Supreme Court, New York County, granted partial summary judgment to plaintiffs in *Kateri*, holding that the reserve bed patient day adjustment rate methodology was improper. The Appellate Division, First Department affirmed Supreme Court's partial summary judgment decision on interlocutory appeal and remanded the case to Supreme Court for further proceedings. The Court of Appeals denied leave to appeal on the grounds that the decision was not final. Supreme Court directed the defendant to re-compute Medicaid rates for the plaintiff's facilities, and that re-computation was completed in October 2013. The next court conference is scheduled on January 15, 2014. The parties are presently conducting discovery.

INSURANCE DEPARTMENT ASSESSMENTS

In *New York Insurance Association, Inc. v. State (Sup. Ct., Albany Co.),* several insurance companies and an association of insurance companies seek a declaration that certain assessments issued against the plaintiff insurance companies by the Insurance Department pursuant to Insurance Law § 332 violate the Insurance Law and the State and Federal Constitutions. The plaintiff insurance companies argue, among other things, that these assessments constitute an unlawful tax because they include amounts for items that are not the legitimate direct and indirect costs of the Insurance Department. Depositions have been completed. The note of issue was filed on June 3, 2013. The parties have moved for summary judgment and the motions are returnable January 31, 2014.

TOBACCO MASTER SETTLEMENT AGREEMENT (MSA)

In 1998, the attorneys general of 46 states, including New York, and several territories (collectively the "Settling States") and the then four largest United States tobacco manufacturers (the "Original Participating Manufacturers" or "OPMs"), entered into a Master Settlement Agreement (the "MSA") to resolve cigarette smoking-related litigation between the Settling States and the OPMs. Approximately 30 additional tobacco companies have entered into the settlement (the "Subsequent Participating

Manufacturers" or "SPMs"; together they are the "Participating Manufacturers" or "PMs"). The MSA released the PMs from past and present smoking-related claims by the Settling States, and provided for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States, and the imposition of certain tobacco advertising and marketing restrictions among other things.

ARBITRATION

The Participating Manufacturers have also brought a nationwide arbitration proceeding against the Settling States (excluding Montana). The MSA provides that each year, in perpetuity, the PMs pay the Settling States a base payment, subject to certain adjustments, to compensate for financial harm suffered by the Settling States due to smoking-related illness. In order to keep the base payment under the MSA, each Settling State must pass and diligently enforce a statute that requires tobacco manufacturers who are not party to the MSA ("Non-Participating Manufacturers" or NPMs) to deposit in escrow an amount roughly equal to the amount that PMs pay per pack sold. New York's allocable share of the total base payment is approximately 12.8 percent of the total, or approximately $800 million annually.

The arbitration proceeding brought by the PMs asserts that the Settling States involved failed to diligently enforce their escrow statutes in 2003. The PMs seek a downward adjustment of the payment due in that year (an "NPM Adjustment") which would serve as a credit against future payments. Any such claim for NPM Adjustment for years prior to 2003 was settled in 2003. The PMs have raised the same claim for years 2004-2006, but none of those years is yet in arbitration.

The arbitration panel (the "Panel") has thus far ruled, among other things, that the Settling States involved have the burden of proof in establishing diligent enforcement of the escrow statutes and that the 2003 settlement of prior NPM Adjustment claims does not preclude the PMs from basing their claim for a 2003 NPM Adjustment on 2002 NPM sales. A hearing on issues common to all states took place in Chicago April 16-24, 2012. State-specific hearings commenced in May 2012, with the hearings involving Missouri and Illinois. New York's diligent enforcement hearings took place June 25-29, 2012. The last state-specific "diligent" enforcement hearing took place May 21-24, 2013. The Panel issued its awards on September 11, 2013. New York was found to have diligently enforced its qualifying statute in 2003 and, thus, is not subject to an NPM Adjustment for 2003. Nine states, including New York, were found to be "diligent"; six states were found to have been "not diligent".

In December 2012, the PMs and 19 states (collectively the "Signatory Parties") agreed to a term sheet purportedly settling the NPM Adjustment disputes for 2003-2012 (3 additional states joined later). New York and 31 (later became 28) other states and territories rejected the term sheet. The Signatory Parties then sought the approval of the Panel in order to obtain an early release of MSA annual payments currently being held in a disputed payments account. The non-joining states objected to approval of the term sheet because its terms negatively impact the non-joining states. Under the MSA reallocation provision, every state is either "diligent" or "not diligent" and only "diligent" states are exempt from the NPM Adjustment. For every state found diligent, its allocable share of the NPM Adjustment is shifted to any remaining non-diligent states. The non-joining states sought to have the signatory states treated as non-diligent for purposes of allocation of the NPM Adjustment. The Panel held a status conference on January 22, 2013, and a hearing of March 7, 2013, to discuss the term sheet. On March 13, 2013, the Panel issued a Partial Stipulated Settlement Award ("Partial Award") based on the provisions of the term sheet. In so doing, the Panel deemed the 20 states (collectively, the "Signatory States") "diligent" for purposes of allocation of the NPM Adjustment. The Panel also established a mechanism for reallocating any NPM Adjustment among non-diligent states that alters the terms of the MSA itself. Thus, had New York been found to have been "not diligent" in its enforcement of its escrow statute in 2003, New York would have exposure not only for its share of the NPM adjustment but also for its proportionate share of the NPM Adjustment attributable to the Signatory States. New York, as well as several other states, have moved in its state court to vacate or modify the Partial Award notwithstanding the Panel's finding. New York is still pursuing this motion.

FINANCIAL PLAN TABLES

The cash financial plan tables listed below appear on the following pages and summarize actual General Fund receipts and disbursements for fiscal year 2013 and projected receipts and disbursements for fiscal years 2014 through 2017 on a General Fund, State Operating Funds and All Governmental Funds basis.

GENERAL FUND - TOTAL BUDGET

Financial Plan, Annual Change from FY 2013 to FY 2014
Financial Plan Projections FY 2014 through FY 2017
Update to FY 2014
Update to FY 2015
Update to FY 2016
Update to FY 2017

GENERAL FUND - RECEIPTS DETAIL (EXCLUDING TRANSFERS)

Financial Plan Projections FY 2014 through FY 2017

STATE OPERATING FUNDS BUDGET

FY 2014
FY 2015
FY 2016
FY 2017

ALL GOVERNMENTAL FUNDS - TOTAL BUDGET

FY 2014
FY 2015
FY 2016
FY 2017

CASHFLOW - FY 2014 MONTHLY PROJECTIONS

General Fund

CASH FINANCIAL PLAN
GENERAL FUND
ANNUAL CHANGE
(millions of dollars)

	FY 2013 Results	FY 2014 Projected	Annual $ Change	Annual % Change
Opening Fund Balance	1,787	1,610	(177)	-9.9%
Receipts:				
Taxes:				
Personal Income Tax	26,884	28,488	1,604	6.0%
User Taxes and Fees	9,112	6,548	(2,564)	-28.1%
Business Taxes	6,253	6,348	95	1.5%
Other Taxes	1,034	1,069	35	3.4%
Miscellaneous Receipts	3,504	3,306	(198)	-5.7%
Federal Receipts	62	2	(60)	-96.8%
Transfers from Other Funds:				
PIT in Excess of Revenue Bond Debt Service	8,328	8,840	512	6.1%
Tax in Excess of LGAC	2,416	2,545	129	5.3%
Sales Tax Debt Service	0	2,894	2,894	-
Real Estate Taxes in Excess of CW/CA Debt Service	541	532	(9)	-1.7%
All Other Transfers	649	1,071	422	65.0%
Total Receipts	58,783	61,643	2,860	4.9%
Disbursements:				
Local Assistance Grants	39,760	40,258	498	1.3%
Departmental Operations:				
Personal Service	6,130	5,686	(444)	-7.2%
Non-Personal Service	1,726	1,882	156	9.0%
General State Charges	4,550	4,922	372	8.2%
Transfers to Other Funds:				
Debt Service	1,647	1,646	(1)	-0.1%
Capital Projects	916	1,227	311	34.0%
State Share Medicaid	2,846	1,813	(1,033)	-36.3%
SUNY Operations	340	971	631	185.6%
Other Purposes	1,045	3,045	2,000	191.4%
Total Disbursements	58,960	61,450	2,490	4.2%
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(177)	193	370	209.0%
Closing Fund Balance	1,610	1,803	193	12.0%
Statutory Reserves				
Tax Stabilization Reserve Fund	1,131	1,131	0	
Rainy Day Reserve Fund	175	175	0	
Contingency Reserve Fund	21	21	0	
Community Projects Fund	93	68	(25)	
Reserves/Reserved For:				
Prior-Year Labor Agreements (2007-2011)	77	45	(32)	
Debt Management	13	263	250	
Undesignated Fund Balance	100	100	0	

Source: NYS DOB.

CASH FINANCIAL PLAN
GENERAL FUND
FY 2014 through FY 2017
(millions of dollars)

	FY 2014 Projected	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Receipts:				
Taxes:				
Personal Income Tax	28,488	29,397	31,492	33,545
User Taxes and Fees	6,548	6,806	7,085	7,265
Business Taxes	6,348	5,811	6,301	6,523
Other Taxes	1,069	1,144	1,159	1,169
Miscellaneous Receipts	3,306	3,595	2,776	2,797
Federal Receipts	2	0	0	0
Transfers from Other Funds:				
PIT in Excess of Revenue Bond Debt Service	8,840	9,115	9,556	10,041
Tax in Excess of LGAC	2,545	2,661	2,803	2,916
Sales Tax Debt Service	2,894	2,934	2,971	2,955
Real Estate Taxes in Excess of CW/CA Debt Service	532	608	683	739
All Other Transfers	1,071	768	723	726
Total Receipts	61,643	62,839	65,549	68,676
Disbursements:				
Local Assistance Grants	40,258	42,598	45,056	47,276
Departmental Operations:				
Personal Service	5,686	5,852	6,113	6,129
Non-personal Service	1,882	1,967	2,004	2,085
General State Charges	4,922	5,328	5,604	5,873
Transfers to Other Funds:				
Debt Service	1,646	1,165	1,452	1,345
Capital Projects	1,227	1,384	1,400	1,799
State Share Medicaid	1,813	1,338	1,311	1,279
SUNY Operations	971	971	971	971
Other Purposes	3,045	4,003	4,548	4,854
Total Disbursements	61,450	64,606	68,459	71,611
Reserves/Reserved For:				
Community Projects Fund	(25)	(35)	(33)	0
Prior-Year Labor Agreements (2007-2011)	(32)	10	12	13
Debt Management	250	0	0	0
Undesignated Fund Balance	0	0	0	0
Increase (Decrease) in Reserves	193	(25)	(21)	13
Excess (Deficiency) of Receipts Over Disbursements and Reserves	0	(1,742)	(2,889)	(2,948)

Source: NYS DOB.

CASH FINANCIAL PLAN
GENERAL FUND
FY 2014
(millions of dollars)

	Enacted	Change	First Quarter	Change	Mid-Year
Receipts:					
Taxes:					
Personal Income Tax	28,488	0	28,488	0	28,488
User Taxes and Fees	6,548	0	6,548	0	6,548
Business Taxes	6,375	(27)	6,348	0	6,348
Other Taxes	1,069	0	1,069	0	1,069
Miscellaneous Receipts	3,096	257	3,353	(47)	3,306
Federal Receipts	2	0	2	0	2
Transfers from Other Funds:					
PIT in Excess of Revenue Bond Debt Service	8,840	0	8,840	0	8,840
Tax in Excess of LGAC	2,546	(1)	2,545	0	2,545
Sales Tax Debt Service	2,894	0	2,894	0	2,894
Real Estate Taxes in Excess of CW/CA Debt Service	532	0	532	0	532
All Other	866	205	1,071	0	1,071
Total Receipts	61,256	434	61,690	(47)	61,643
Disbursements:					
Local Assistance Grants	40,258	16	40,274	(16)	40,258
Departmental Operations:					
Personal Service	5,681	5	5,686	0	5,686
Non-Personal Service	1,883	(1)	1,882	0	1,882
General State Charges	4,953	0	4,953	(31)	4,922
Transfers to Other Funds:					
Debt Service	1,328	318	1,646	0	1,646
Capital Projects	1,227	0	1,227	0	1,227
State Share Medicaid	1,813	0	1,813	0	1,813
SUNY Operations	971	0	971	0	971
Other Purposes	3,043	2	3,045	0	3,045
Total Disbursements	61,157	340	61,497	(47)	61,450
Reserves/Reserved For:					
Community Projects Fund	(25)	0	(25)	0	(25)
Prior-Year Labor Agreements (2007-2011)	(26)	(6)	(32)	0	(32)
Debt Management	250	0	250	0	250
Undesignated Fund Balance	(100)	100	0	0	0
Increase (Decrease) in Reserves	99	94	193	0	193
Excess (Deficiency) of Receipts Over Disbursements and Reserves	0	0	0	0	0

Source: NYS DOB.

CASH FINANCIAL PLAN
GENERAL FUND
FY 2015
(millions of dollars)

	Enacted	Change	First Quarter	Change	Mid-Year
Receipts:					
Taxes:					
Personal Income Tax	29,423	(26)	29,397	0	29,397
User Taxes and Fees	6,814	(8)	6,806	0	6,806
Business Taxes	5,854	(43)	5,811	0	5,811
Other Taxes	1,144	0	1,144	0	1,144
Miscellaneous Receipts	3,551	44	3,595	0	3,595
Transfers from Other Funds:					
PIT in Excess of Revenue Bond Debt Service	9,124	(9)	9,115	0	9,115
Tax in Excess of LGAC	2,664	(3)	2,661	0	2,661
Sales Tax Debt Service	2,938	(4)	2,934	0	2,934
Real Estate Taxes in Excess of CW/CA Debt Service	608	0	608	0	608
All Other	764	4	768	0	768
Total Receipts	62,884	(45)	62,839	0	62,839
Disbursements:					
Local Assistance Grants	42,598	0	42,598	0	42,598
Departmental Operations:					
Personal Service	5,850	2	5,852	0	5,852
Non-Personal Service	1,968	(1)	1,967	0	1,967
General State Charges	5,328	0	5,328	0	5,328
Transfers to Other Funds:					
Debt Service	1,483	(318)	1,165	0	1,165
Capital Projects	1,384	0	1,384	0	1,384
State Share Medicaid	1,338	0	1,338	0	1,338
SUNY Operations	971	0	971	0	971
Other Purposes	4,003	0	4,003	0	4,003
Total Disbursements	64,923	(317)	64,606	0	64,606
Reserves/Reserved For:					
Community Projects Fund	(35)	0	(35)	0	(35)
Prior-Year Labor Agreements (2007-2011)	10	0	10	0	10
Increase (Decrease) in Reserves	(25)	0	(25)	0	(25)
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(2,014)	272	(1,742)	0	(1,742)

Source: NYS DOB.

CASH FINANCIAL PLAN
GENERAL FUND
FY 2016
(millions of dollars)

			First		
	Enacted	Change	Quarter	Change	Mid-Year
Receipts:					
Taxes:					
Personal Income Tax	31,541	(49)	31,492	0	31,492
User Taxes and Fees	7,094	(9)	7,085	0	7,085
Business Taxes	6,349	(48)	6,301	0	6,301
Other Taxes	1,159	0	1,159	0	1,159
Miscellaneous Receipts	2,682	94	2,776	0	2,776
Transfers from Other Funds:					
PIT in Excess of Revenue Bond Debt Service	9,572	(16)	9,556	0	9,556
Tax in Excess of LGAC	2,808	(5)	2,803	0	2,803
Sales Tax Debt Service	2,976	(5)	2,971	0	2,971
Real Estate Taxes in Excess of CW/CA Debt Service	683	0	683	0	683
All Other	719	4	723	0	723
Total Receipts	65,583	(34)	65,549	0	65,549
Disbursements:					
Local Assistance Grants	45,056	0	45,056	0	45,056
Departmental Operations:					
Personal Service	6,111	2	6,113	0	6,113
Non-Personal Service	2,005	(1)	2,004	0	2,004
General State Charges	5,604	0	5,604	0	5,604
Transfers to Other Funds:					
Debt Service	1,452	0	1,452	0	1,452
Capital Projects	1,400	0	1,400	0	1,400
State Share Medicaid	1,311	0	1,311	0	1,311
SUNY Operations	971	0	971	0	971
Other Purposes	4,548	0	4,548	0	4,548
Total Disbursements	68,458	1	68,459	0	68,459
Reserves/Reserved For:					
Community Projects Fund	(33)	0	(33)	0	(33)
Prior-Year Labor Agreements (2007-2011)	14	(2)	12	0	12
Increase (Decrease) in Reserves	(19)	(2)	(21)	0	(21)
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(2,856)	(33)	(2,889)	0	(2,889)

Source: NYS DOB.

CASH FINANCIAL PLAN
GENERAL FUND
FY 2017
(millions of dollars)

	Enacted	Change	First Quarter	Change	Mid-Year
Receipts:					
Taxes:					
Personal Income Tax	33,619	(74)	33,545	0	33,545
User Taxes and Fees	7,275	(10)	7,265	0	7,265
Business Taxes	6,579	(56)	6,523	0	6,523
Other Taxes	1,169	0	1,169	0	1,169
Miscellaneous Receipts	2,653	144	2,797	0	2,797
Transfers from Other Funds:					
PIT in Excess of Revenue Bond Debt Service	10,066	(25)	10,041	0	10,041
Tax in Excess of LGAC	2,921	(5)	2,916	0	2,916
Sales Tax Debt Service	2,960	(5)	2,955	0	2,955
Real Estate Taxes in Excess of CW/CA Debt Service	739	0	739	0	739
All Other	722	4	726	0	726
Total Receipts	68,703	(27)	68,676	0	68,676
Disbursements:					
Local Assistance Grants	47,276	0	47,276	0	47,276
Departmental Operations:					
Personal Service	6,127	2	6,129	0	6,129
Non-Personal Service	2,086	(1)	2,085	0	2,085
General State Charges	5,873	0	5,873	0	5,873
Transfers to Other Funds:					
Debt Service	1,345	0	1,345	0	1,345
Capital Projects	1,799	0	1,799	0	1,799
State Share Medicaid	1,279	0	1,279	0	1,279
SUNY Operations	971	0	971	0	971
Other Purposes	4,853	1	4,854	0	4,854
Total Disbursements	71,609	2	71,611	0	71,611
Reserves/Reserved For:					
Prior-Year Labor Agreements (2007-2011)	14	(1)	13	0	13
Increase (Decrease) in Reserves	14	(1)	13	0	13
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(2,920)	(28)	(2,948)	0	(2,948)

Source: NYS DOB.

CASH RECEIPTS
CURRENT STATE RECEIPTS
GENERAL FUND
FY 2014 THROUGH FY 2017
(millions of dollars)

	FY 2014 Projected	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Taxes:				
Withholdings	33,066	35,399	37,709	39,941
Estimated Payments	13,888	13,735	14,825	15,759
Final Payments	2,311	2,276	2,376	2,476
Other Payments	1,231	1,268	1,308	1,353
Gross Collections	50,496	52,678	56,218	59,529
State/City Offset	(498)	(323)	(273)	(223)
Refunds	(7,455)	(8,356)	(9,017)	(9,506)
Reported Tax Collections	42,543	43,999	46,928	49,800
STAR (Dedicated Deposits)	(3,419)	(3,602)	(3,704)	(3,805)
RBTF (Dedicated Transfers)	(10,636)	(11,000)	(11,732)	(12,450)
Personal Income Tax	28,488	29,397	31,492	33,545
Sales and Use Tax	11,734	12,252	12,813	13,178
Cigarette and Tobacco Taxes	431	425	418	410
Motor Fuel Tax	0	0	0	0
Alcoholic Beverage Taxes	251	256	261	266
Highway Use Tax	0	0	0	0
Auto Rental Tax	0	0	0	0
Taxicab Surcharge	0	0	0	0
Gross Utility Taxes and Fees	12,416	12,933	13,492	13,854
LGAC/STBF (Dedicated Transfers)	(5,868)	(6,127)	(6,407)	(6,589)
User Taxes and Fees	6,548	6,806	7,085	7,265
Corporation Franchise Tax	2,914	2,220	2,573	2,691
Corporation and Utilities Tax	596	620	636	652
Insurance Taxes	1,418	1,468	1,523	1,540
Bank Tax	1,420	1,503	1,569	1,640
Petroleum Business Tax	0	0	0	0
Business Taxes	6,348	5,811	6,301	6,523
Estate Tax	1,050	1,125	1,140	1,150
Real Estate Transfer Tax	740	810	885	940
Gift Tax	0	0	0	0
Real Property Gains Tax	0	0	0	0
Pari-Mutuel Taxes	18	18	18	18
Other Taxes	1	1	1	1
Gross Other Taxes	1,809	1,954	2,044	2,109
Real Estate Transfer Tax (Dedicated)	(740)	(810)	(885)	(940)
Other Taxes	1,069	1,144	1,159	1,169
Payroll Tax	0	0	0	0
Total Taxes	42,453	43,158	46,037	48,502
Licenses, Fees, Etc.	681	747	638	644
Abandoned Property	650	655	655	655
Motor Vehicle Fees	26	26	26	26
ABC License Fee	56	52	58	54
Reimbursements	231	231	231	232
Investment Income	5	30	30	30
Other Transactions	1,657	1,854	1,138	1,156
Miscellaneous Receipts	3,306	3,595	2,776	2,797
Federal Receipts	2	0	0	0
Total	45,761	46,753	48,813	51,299

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2014
(millions of dollars)

	General Fund	State Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Opening Fund Balance	1,610	2,368	381	4,359
Receipts:				
Taxes	42,453	8,347	17,124	67,924
Miscellaneous Receipts	3,306	15,675	797	19,778
Federal Receipts	2	1	72	75
Total Receipts	45,761	24,023	17,993	87,777
Disbursements:				
Local Assistance Grants	40,258	19,438	0	59,696
Departmental Operations:				
Personal Service	5,686	6,680	0	12,366
Non-Personal Service	1,882	3,556	40	5,478
General State Charges	4,922	2,136	0	7,058
Debt Service	0	0	6,060	6,060
Capital Projects	0	11	0	11
Total Disbursements	52,748	31,821	6,100	90,669
Other Financing Sources (Uses):				
Transfers from Other Funds	15,882	8,705	5,208	29,795
Transfers to Other Funds	(8,702)	(1,204)	(17,041)	(26,947)
Net Other Financing Sources (Uses)	7,180	7,501	(11,833)	2,848
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	193	(297)	60	(44)
Closing Fund Balance	1,803	2,071	441	4,315

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2015
(millions of dollars)

	General Fund	State Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	43,158	8,697	17,817	69,672
Miscellaneous Receipts	3,595	15,739	976	20,310
Federal Receipts	0	1	72	73
Total Receipts	46,753	24,437	18,865	90,055
Disbursements:				
Local Assistance Grants	42,598	19,621	0	62,219
Departmental Operations:				
Personal Service	5,852	6,790	0	12,642
Non-Personal Service	1,967	3,626	40	5,633
General State Charges	5,328	2,205	0	7,533
Debt Service	0	0	5,805	5,805
Capital Projects	0	5	0	5
Total Disbursements	55,745	32,247	5,845	93,837
Other Financing Sources (Uses):				
Transfers from Other Funds	16,086	8,588	4,288	28,962
Transfers to Other Funds	(8,861)	(683)	(17,313)	(26,857)
Net Other Financing Sources (Uses)	7,225	7,905	(13,025)	2,105
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(1,767)	95	(5)	(1,677)
Designated General Fund Reserves/Reserved For:				
Community Projects Fund	(35)			
Prior-Year Labor Agreements (2007-2011)	10			
Increase (Decrease) in Reserves	(25)			
Net General Fund Deficit	(1,742)			

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2016
(millions of dollars)

	General Fund	State Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	46,037	8,941	18,905	73,883
Miscellaneous Receipts	2,776	15,869	824	19,469
Federal Receipts	0	1	72	73
Total Receipts	48,813	24,811	19,801	93,425
Disbursements:				
Local Assistance Grants	45,056	19,816	0	64,872
Departmental Operations:				
Personal Service	6,113	6,965	0	13,078
Non-Personal Service	2,004	3,755	40	5,799
General State Charges	5,604	2,350	0	7,954
Debt Service	0	0	6,482	6,482
Capital Projects	0	5	0	5
Total Disbursements	58,777	32,891	6,522	98,190
Other Financing Sources (Uses):				
Transfers from Other Funds	16,736	8,923	4,534	30,193
Transfers to Other Funds	(9,682)	(639)	(17,820)	(28,141)
Net Other Financing Sources (Uses)	7,054	8,284	(13,286)	2,052
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,910)	204	(7)	(2,713)
Designated General Fund Reserves/Reserved For:				
Community Projects Fund	(33)			
Prior-Year Labor Agreements (2007-2011)	12			
Increase (Decrease) in Reserves	(21)			
Net General Fund Deficit	(2,889)			

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2017
(millions of dollars)

	General Fund	State Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	48,502	9,185	19,860	77,547
Miscellaneous Receipts	2,797	16,068	793	19,658
Federal Receipts	0	1	72	73
Total Receipts	51,299	25,254	20,725	97,278
Disbursements:				
Local Assistance Grants	47,276	20,013	0	67,289
Departmental Operations:				
Personal Service	6,129	7,081	0	13,210
Non-Personal Service	2,085	3,850	40	5,975
General State Charges	5,873	2,414	0	8,287
Debt Service	0	0	6,783	6,783
Capital Projects	0	5	0	5
Total Disbursements	61,363	33,363	6,823	101,549
Other Financing Sources (Uses):				
Transfers from Other Funds	17,377	9,021	4,403	30,801
Transfers to Other Funds	(10,248)	(644)	(18,284)	(29,176)
Net Other Financing Sources (Uses)	7,129	8,377	(13,881)	1,625
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,935)	268	21	(2,646)
Designated General Fund Reserves/Reserved For:				
Prior-Year Labor Agreements (2007-2011)	13			
Increase (Decrease) in Reserves	13			
Net General Fund Deficit	(2,948)			

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2014
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Opening Fund Balance	1,610	2,371	(485)	381	3,877
Receipts:					
Taxes	42,453	8,347	1,400	17,124	69,324
Miscellaneous Receipts	3,306	15,861	4,211	797	24,175
Federal Receipts	2	45,138	2,221	72	47,433
Total Receipts	45,761	69,346	7,832	17,993	140,932
Disbursements:					
Local Assistance Grants	40,258	59,714	2,104	0	102,076
Departmental Operations:					
Personal Service	5,686	7,333	0	0	13,019
Non-Personal Service	1,882	4,628	0	40	6,550
General State Charges	4,922	2,454	0	0	7,376
Debt Service	0	0	0	6,060	6,060
Capital Projects	0	11	5,882	0	5,893
Total Disbursements	52,748	74,140	7,986	6,100	140,974
Other Financing Sources (Uses):					
Transfers from Other Funds	15,882	7,893	1,607	5,208	30,590
Transfers to Other Funds	(8,702)	(3,396)	(1,515)	(17,041)	(30,654)
Bond and Note Proceeds	0	0	338	0	338
Net Other Financing Sources (Uses)	7,180	4,497	430	(11,833)	274
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	193	(297)	276	60	232
Closing Fund Balance	1,803	2,074	(209)	441	4,109

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2015
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	43,158	8,697	1,429	17,817	71,101
Miscellaneous Receipts	3,595	15,925	4,507	976	25,003
Federal Receipts	0	45,162	2,028	72	47,262
Total Receipts	46,753	69,784	7,964	18,865	143,366
Disbursements:					
Local Assistance Grants	42,598	60,970	1,716	0	105,284
Departmental Operations:					
Personal Service	5,852	7,436	0	0	13,288
Non-Personal Service	1,967	4,583	0	40	6,590
General State Charges	5,328	2,523	0	0	7,851
Debt Service	0	0	0	5,805	5,805
Capital Projects	0	5	6,417	0	6,422
Total Disbursements	55,745	75,517	8,133	5,845	145,240
Other Financing Sources (Uses):					
Transfers from Other Funds	16,086	8,169	1,447	4,288	29,990
Transfers to Other Funds	(8,861)	(2,341)	(1,521)	(17,313)	(30,036)
Bond and Note Proceeds	0	0	306	0	306
Net Other Financing Sources (Uses)	7,225	5,828	232	(13,025)	260
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(1,767)	95	63	(5)	(1,614)
Designated General Fund Reserves/Reserved For:					
Community Projects Fund	(35)				
Prior-Year Labor Agreements (2007-2011)	10				
Increase (Decrease) in Reserves	(25)				
Net General Fund Deficit	(1,742)				

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2016
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	46,037	8,941	1,449	18,905	75,332
Miscellaneous Receipts	2,776	16,055	4,890	824	24,545
Federal Receipts	0	46,510	1,660	72	48,242
Total Receipts	48,813	71,506	7,999	19,801	148,119
Disbursements:					
Local Assistance Grants	45,056	62,518	1,405	0	108,979
Departmental Operations:					
Personal Service	6,113	7,643	0	0	13,756
Non-Personal Service	2,004	4,688	0	40	6,732
General State Charges	5,604	2,683	0	0	8,287
Debt Service	0	0	0	6,482	6,482
Capital Projects	0	5	6,615	0	6,620
Total Disbursements	58,777	77,537	8,020	6,522	150,856
Other Financing Sources (Uses):					
Transfers from Other Funds	16,736	8,504	1,463	4,534	31,237
Transfers to Other Funds	(9,682)	(2,269)	(1,525)	(17,820)	(31,296)
Bond and Note Proceeds	0	0	120	0	120
Net Other Financing Sources (Uses)	7,054	6,235	58	(13,286)	61
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,910)	204	37	(7)	(2,676)
Designated General Fund Reserves/Reserved For:					
Community Projects Fund	(33)				
Prior-Year Labor Agreements (2007-2011)	12				
Increase (Decrease) in Reserves	(21)				
Net General Fund Deficit	(2,889)				

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2017
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	48,502	9,185	1,455	19,860	79,002
Miscellaneous Receipts	2,797	16,254	4,199	793	24,043
Federal Receipts	0	49,276	1,617	72	50,965
Total Receipts	51,299	74,715	7,271	20,725	154,010
Disbursements:					
Local Assistance Grants	47,276	65,655	1,137	0	114,068
Departmental Operations:					
Personal Service	6,129	7,768	0	0	13,897
Non-Personal Service	2,085	4,698	0	40	6,823
General State Charges	5,873	2,752	0	0	8,625
Debt Service	0	0	0	6,783	6,783
Capital Projects	0	5	6,581	0	6,586
Total Disbursements	61,363	80,878	7,718	6,823	156,782
Other Financing Sources (Uses):					
Transfers from Other Funds	17,377	8,602	1,862	4,403	32,244
Transfers to Other Funds	(10,248)	(2,170)	(1,607)	(18,284)	(32,309)
Bond and Note Proceeds	0	0	65	0	65
Net Other Financing Sources (Uses)	7,129	6,432	320	(13,881)	0
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,935)	269	(127)	21	(2,772)
Designated General Fund Reserves/Reserved For:					
Prior-Year Labor Agreements (2007-2011)	13				
Increase (Decrease) in Reserves	13				
Net General Fund Deficit	(2,948)				

Source: NYS DOB.

CASHFLOW
GENERAL FUND
FY 2014
(dollars in millions)

	2013 April Results	May Results	June Results	July Results	August Results	September Results	October Projected	November Projected	December Projected	2014 January Projected	February Projected	March Projected	Total
OPENING BALANCE	1,610	6,379	3,744	4,805	4,407	3,642	6,273	5,478	4,076	5,747	7,190	6,481	1,610
RECEIPTS:													
Personal Income Tax	4,993	1,790	2,448	1,812	1,662	2,866	1,771	1,460	2,937	2,894	2,002	1,853	28,488
User Taxes and Fees	540	431	664	525	506	657	502	477	673	543	457	573	6,548
Business Taxes	355	109	946	87	65	1,007	109	90	1,286	131	83	2,080	6,348
Other Taxes	91	111	75	138	76	112	203	52	52	52	52	55	1,069
Total Taxes	5,979	2,441	4,133	2,562	2,309	4,642	2,585	2,079	4,948	3,620	2,594	4,561	42,453
Abandoned Property	0	0	0	1	4	54	14	130	25	35	80	307	650
ABC License Fee	6	6	5	6	6	6	6	3	3	3	3	3	56
Investment Income	0	0	0	0	0	0	1	1	0	0	1	2	5
Licenses, Fees, etc.	41	82	70	61	63	74	40	40	61	40	40	69	681
Motor Vehicle Fees	28	(24)	(4)	0	0	0	0	0	0	3	10	13	26
Reimbursements	8	1	56	10	10	51	10	8	35	10	10	22	231
Other Transactions	38	2	580	29	(7)	291	67	18	142	47	20	430	1,657
Total Miscellaneous Receipts	121	67	707	107	76	476	138	200	266	138	164	846	3,306
Federal Receipts	0	0	0	0	0	0	0	0	0	0	0	2	2
PIT in Excess of Revenue Bond Debt Service	1,664	421	956	393	202	1,140	418	177	1,045	1,001	400	1,023	8,840
Tax in Excess of LGAC	214	47	464	227	167	297	222	212	305	239	3	148	2,545
Sales Tax Bond Fund	163	271	302	226	226	297	215	205	299	231	199	260	2,894
Real Estate Taxes in Excess of CW/CA Debt Service	41	57	34	54	61	72	73	31	32	31	29	17	532
All Other	35	59	18	(16)	1	219	32	2	174	79	59	409	1,071
Total Transfers from Other Funds	2,117	855	1,774	884	657	2,025	960	627	1,855	1,581	690	1,857	15,882
TOTAL RECEIPTS	8,217	3,363	6,614	3,553	3,042	7,143	3,683	2,906	7,069	5,339	3,448	7,266	61,643
DISBURSEMENTS:													
School Aid	188	2,489	1,617	169	600	1,379	638	1,178	1,625	275	450	6,682	17,290
Higher Education	19	8	598	450	132	54	442	33	213	39	338	466	2,792
All Other Education	23	261	52	151	75	72	337	32	298	54	307	357	2,019
Medicaid - DOH	973	1,253	803	1,016	1,145	598	893	1,208	960	917	815	651	11,232
Public Health	23	46	23	24	139	48	23	57	39	65	87	109	683
Mental Hygiene	2	0	235	1	2	234	160	1	235	101	121	247	1,339
Children and Families	62	58	170	30	104	262	66	80	127	191	75	375	1,600
Temporary & Disability Assistance	151	105	164	105	109	99	101	105	105	109	43	196	1,392
Transportation	0	23	1	0	25	0	0	24	13	0	11	1	98
Unrestricted Aid	0	11	387	2	1	91	11	1	188	1	1	70	764
All Other	8	19	196	25	38	37	(16)	42	44	207	216	233	1,049
Total Local Assistance Grants	1,449	4,273	4,246	1,973	2,370	2,874	2,655	2,761	3,847	1,959	2,464	9,387	40,258
Personal Service	447	525	435	578	440	437	510	432	563	438	432	449	5,686
Non-Personal Service	116	154	112	141	153	119	121	161	168	180	278	179	1,882
Total Departmental Operations	563	679	547	719	593	556	631	593	731	618	710	628	7,568
General State Charges	443	603	113	619	384	235	618	559	16	632	713	(13)	4,922
Debt Service	567	(187)	(61)	397	(2)	(253)	594	0	(2)	420	(18)	191	1,646
Capital Projects	66	111	95	(18)	126	200	(203)	26	(7)	147	174	510	1,227
State Share Medicaid	40	226	301	44	235	312	1	103	98	87	93	273	1,813
SUNY Operations	210	210	210	182	0	0	0	159	0	0	0	0	971
Other Purposes	110	83	102	35	101	588	182	107	715	33	21	968	3,045
Total Transfers to Other Funds	993	443	647	640	460	847	574	395	804	687	270	1,942	8,702
TOTAL DISBURSEMENTS	3,448	5,998	5,553	3,951	3,807	4,512	4,478	4,308	5,398	3,896	4,157	11,944	61,450
Excess/(Deficiency) of Receipts over Disbursements	4,769	(2,635)	1,061	(398)	(765)	2,631	(795)	(1,402)	1,671	1,443	(709)	(4,678)	193
CLOSING BALANCE	6,379	3,744	4,805	4,407	3,642	6,273	5,478	4,076	5,747	7,190	6,481	1,803	1,803

Source: NYS DOB.

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Annual Information Statement

State of New York

June 19, 2013

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INTRODUCTION

This Annual Information Statement (AIS) is dated June 19, 2013 and contains information only through that date. This AIS constitutes the official disclosure regarding the financial position of the State of New York (the "State") and replaces the AIS dated May 11, 2012 and all updates and supplements issued in connection therewith. This AIS is scheduled to be updated on a quarterly basis and may be supplemented from time to time as developments warrant. This AIS, including the Exhibits attached hereto, should be read in its entirety, together with any current updates and supplements that may be issued during the fiscal year.

In this AIS, readers will find:

1. Information on the State's current financial projections, including summaries and extracts from the State's Enacted Budget Financial Plan (the "Financial Plan" or "Enacted Budget") for fiscal year 2014[1] (FY 2014) issued by the Division of the Budget (DOB) in May 2013. The Enacted Budget sets forth the State's official Financial Plan projections for FY 2014 through FY 2017. It includes, among other things, information on the major components of the General Fund gap-closing plan approved for FY 2014, future potential General Fund budget gaps, and multi-year projections of receipts and disbursements in the State's operating funds.

2. A discussion of issues and risks that may affect the Financial Plan during the State's current fiscal year or in future years (under the heading "Financial Plan Overview — Risks and Uncertainties Related to the State Financial Plan").

3. Information on other subjects relevant to the State's finances, including summaries of: (a) operating results for the three prior fiscal years (presented on a cash basis of accounting), (b) the State's revised economic forecast and a profile of the State economy, (c) the State's debt and other financing activities, (d) the organization of State government, and (e) activities of public authorities and localities.

4. The status of significant litigation and arbitration that has the potential to adversely affect the State's finances.

DOB is responsible for preparing the State's Financial Plan and presenting the information that appears in this AIS on behalf of the State. In preparing this AIS, DOB has also relied on information drawn from other sources, including the Office of the State Comptroller (OSC). In particular, information contained in the section entitled "State Retirement Systems" has been furnished by OSC, while information relating to matters described in the section entitled "Litigation and Arbitration" has been furnished by the State Office of the Attorney General. DOB has not undertaken any independent verification of the information contained in these sections of the AIS.

[1] The fiscal year is identified by the calendar year in which it ends. For example, FY 2014 is the FY that began on April 1, 2013 and ends on March 31, 2014.

INTRODUCTION

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 position or condition, including potential operating results for the current fiscal year and projected budget gaps for future fiscal years, that may vary materially from the information provided in this AIS, as updated or supplemented. Investors and other market participants should, however, refer to this AIS, as updated or supplemented, for the most current official information regarding the financial position of the State.

The factors affecting the State's financial condition are complex. This AIS contains forecasts, projections, and estimates that are based on expectations and assumptions, which existed at the time they were prepared. Since many factors may materially affect fiscal and economic conditions in the State, the inclusion in this AIS of forecasts, projections, and estimates should not be regarded as a representation that such forecasts, projections, and estimates will occur. Forecasts, projections, and estimates are not intended as representations of fact or guarantees of results. The words "expects", "forecasts", "projects", "intends", "anticipates", "estimates", and analogous expressions are intended to identify forward-looking statements in the AIS. Any such statements inherently are subject to a variety of risks and uncertainties that could cause actual results to differ materially and adversely from those projected. Such risks and uncertainties include, among others, general economic and business conditions; changes in political, social, economic and environmental conditions, including climate change and extreme weather events; impediments to the implementation of gap-closing actions; regulatory initiatives and compliance with governmental regulations; litigation; actions by the Federal government to reduce or disallow expected aid including Federal aid authorized or appropriated by Congress, but subject to sequestration, administrative actions, or other actions that would reduce aid to the State; and various other events, conditions and circumstances, many of which are beyond the control of the State. These forward-looking statements speak only as of the date of this AIS. Note that all FY 2013 financial results contained within this AIS are unaudited and preliminary.

The annual independent audit of this State's Basic Financial Statements is expected to be completed by July 29, 2013. Both the Comptroller's Annual Report to the Legislature on State Funds Cash Basis of Accounting and the State's Basic Financial Statements are due by July 29, 2013, at which time the FY 2013 financial results will be final. Copies may be obtained by contacting the Office of the State Comptroller, 110 State Street, Albany, NY 12236. The Basic Financial Statements for FY 2012 are available in electronic form at www.osc.state.ny.us and at www.emma.msrb.org.

In addition to regularly scheduled quarterly updates to this AIS, the State may issue AIS supplements or other disclosure notices to this AIS 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 issuances. The State has filed this AIS with the Municipal Securities Rulemaking Board through its Electronic Municipal Market Access (EMMA) system. An electronic copy of this AIS can be accessed through EMMA at www.emma.msrb.org. An official copy of this AIS may be obtained by contacting the New York State Division of the Budget, State Capitol, Albany, NY 12224, Tel: (518) 474-2302.

USAGE NOTICE

This AIS has been prepared and made available by the State pursuant to its contractual obligations under various continuing disclosure agreements (CDAs) entered into by the State in connection with financings of the State, as well as certain issuers, including public authorities of the State, that may depend in whole or in part on State appropriations as sources of payments of their respective bonds, notes or other obligations.

This AIS is available in electronic form on the DOB website (www.budget.ny.gov) and does not create any implication that there have been no changes in the financial position of the State at any time subsequent to its release date. Maintenance of this AIS on the DOB website, or on the EMMA website, is not intended as a republication of the information therein on any date subsequent to its release date.

Neither this AIS nor any portion thereof may be: (a) included in a Preliminary Official Statement, Official Statement, or other offering document, or incorporated by reference therein, unless DOB has expressly consented thereto following a written request to the State of New York, Division of the Budget, State Capitol, Albany, NY 12224, or (b) considered to be continuing disclosure in connection with any offering unless a CDA relating to the series of bonds or notes has been executed by DOB. Any such use, or incorporation by reference, of this AIS or any portion thereof in a Preliminary Official Statement, Official Statement, or other offering document or continuing disclosure filing without such consent and agreement by DOB is unauthorized and the State expressly disclaims any responsibility with respect to the inclusion, intended use, and updating of this AIS if so misused.

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OVERVIEW OF THE STATE BUDGET PROCESS AND BUDGETARY AND ACCOUNTING PRACTICES[2]

THE STATE BUDGET PROCESS

The requirements of the State budget process are set forth in Article VII of the State Constitution, the State Finance Law, and the Legislative Law. The process begins with the Governor's submission of the Executive Budget to the Legislature each January, in preparation for the start of the fiscal year on April 1. (The submission date is February 1 in years following a gubernatorial election.) The General Fund must be balanced on a cash basis, as described below, and must be accompanied by bills that: (a) set forth all proposed appropriations and reappropriations, (b) provide for any new or modified revenue measures, and (c) make any other changes to existing law necessary to implement the budget recommended by the Governor. The DOB prepares a multi-year Financial Plan ("State Financial Plan") as part of the Executive Budget. The State Financial Plan sets forth projected receipts and disbursements for the current fiscal year, the "budget" year (i.e., the upcoming fiscal year), and the three subsequent fiscal years ("outyears").

In acting on the bills submitted by the Governor, the Legislature has certain powers to alter the recommended appropriations and proposed changes to existing law. The Legislature may strike or reduce an item of appropriation recommended by the Governor. The Legislature may add distinct new items of appropriation, provided such additions are stated separately. These additional items are then subject to line-item veto by the Governor. If the Governor vetoes an appropriation or a bill (or a portion thereof) related to the budget, these items can be reconsidered in accordance with the rules of each house of the Legislature. If, upon reconsideration, the items are approved by two-thirds of the members of each house, such items will become law notwithstanding the Governor's veto.

Once the appropriation bills and other budget bills become law, DOB revises the State Financial Plan to reflect the Legislature's actions, and begins the process of implementing the enacted budget. Throughout the fiscal year, DOB monitors actual receipts and disbursements, and may adjust the estimates and projections in the State Financial Plan. Adjustments may also be made to the State Financial Plan to reflect changes in the economic outlook, updated data on program activities, new actions taken by the Governor or the Legislature, and other factors. As required by the State Finance Law, DOB issues updates to the State Financial Plan, generally issuing reports by July 30, October 30, and as part of the Executive Budget in January or February of each year.

Once the budget is adopted for the fiscal year, the Legislature may enact one multi-purpose appropriation bill and additional single-purpose appropriation bills or revenue measures (including tax law changes) during any regular session or, if called into session for that purpose, any special session. In the event additional appropriation bills or revenue measures are disapproved by the Governor, the Legislature may override the Governor's veto upon the vote of two-thirds of the members of each house of the Legislature. The Governor may present deficiency appropriations to the Legislature in any fiscal year to supplement existing appropriations or to provide new appropriations for purposes not covered by the regular and supplemental appropriations.

[2] See "Exhibit A — Selected State Government Summary" herein for more information on budgetary and accounting practices.

OVERVIEW OF THE STATE BUDGET PROCESS AND BUDGETARY AND ACCOUNTING PRACTICES

SIGNIFICANT BUDGETARY/ACCOUNTING PRACTICES

Unless clearly noted otherwise, all financial information in this AIS is presented on a cash basis of accounting.

The State's **General Fund** receives the majority of State taxes and all income not earmarked for a particular program or activity. State law requires the Governor to submit, and the Legislature to enact, a General Fund budget that is balanced on a cash basis of accounting. The State Constitution and State Finance Law do not provide a precise definition of budget balance. In practice, the General Fund is considered balanced if sufficient resources are, or are expected to be, available during the fiscal year for the State to: (a) make all planned payments, including Personal Income Tax (PIT) refunds, without the issuance of deficit notes or bonds or extraordinary cash management actions, (b) restore the balances in the Tax Stabilization Reserve and Rainy Day Reserve to levels at or above the levels on deposit when the fiscal year began, and (c) maintain other reserves, as required by law. For purposes of calculating budget balance, the General Fund includes transfers to and from other funds.

The General Fund is typically the financing source of last resort for the State's other major funds, which include the Health Care Reform Act (HCRA) funds, the Dedicated Highway and Bridge Trust Fund (DHBTF), the School Tax Relief (STAR) Fund, and the Lottery Fund. Therefore, the General Fund projections account for any estimated funding shortfalls in these funds. Since the General Fund is the fund that is required to be balanced, the focus of the State's budgetary and gap-closing discussion is generally weighted toward the General Fund.

From time to time, DOB will informally designate unrestricted balances in the General Fund for specific policy goals (e.g., the payment of costs related to potential labor contracts covering prior contract periods). These amounts are typically identified with the phrase "reserved for" and are not held in distinct accounts within the General Fund and may be used for other purposes.

State Operating Funds is a broader measure of spending for operations (as distinct from capital purposes) that is funded with State resources. It includes financial activity not only in the General Fund, but also State-funded special revenue funds and debt service funds (spending from capital project funds and Federal funds is excluded). As more financial activity has occurred in funds outside of the General Fund, State Operating Funds has become, in DOB's view, a more comprehensive measure of State-funded activities for operating purposes that are funded with State resources (e.g., taxes, assessments, fees, tuition). The State Operating Funds perspective has the advantage of eliminating certain distortions in operating activities that may be caused by, among other things, the State's complex fund structure, the transfer of money among funds, and the accounting of disbursements against appropriations in different funds. For example, the State funds its share of the Medicaid program from both the General Fund and Health Care Reform Act Funds, the latter being State Special Revenue Funds. The State Operating Funds perspective captures Medicaid disbursements from both of these fund types, giving a more complete accounting of State-funded Medicaid disbursements. For such reasons, the discussion of disbursement projections often emphasizes the State Operating Funds perspective.

The State also reports disbursements and receipts activity for **All Governmental Funds** (All Funds), which includes spending from Capital Projects Funds and State and Federal operating funds, providing the most comprehensive view of the cash-basis financial operations of the State. The State accounts for receipts and disbursements by the fund in which the activity takes place (such as the General Fund), and the broad category or purpose of that activity (such as State Operations). The Financial Plan tables sort State projections and results by fund and category.

Fund types of the State include: the General Fund; State Special Revenue Funds, which receive certain dedicated taxes, fees and other revenues that are used for a specified purpose; Federal Special Revenue Funds, which receive certain Federal grants; State and Federal Capital Projects Funds, which account for costs incurred in the construction, maintenance and rehabilitation of roads, bridges, prisons, university facilities, and other infrastructure projects; and Debt Service Funds, which account for the payment of principal, interest, and related expenses for debt issued by the State and its public authorities.

State Finance Law also requires DOB to prepare a *pro forma* financial plan using, to the extent practicable, generally accepted accounting principles (GAAP), although this requirement is for informational purposes. The GAAP-basis financial plan is not used by DOB as a benchmark for managing State finances during the fiscal year. The GAAP-basis Financial Plan follows, to the extent practicable, the accrual methodologies and fund accounting rules applied by OSC in preparation of the audited Basic Financial Statements. However, GAAP is a financial reporting regime, not a budgeting system.

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FINANCIAL PLAN OVERVIEW

The following table provides certain Financial Plan information for FY 2012, FY 2013, and FY 2014.

ENACTED BUDGET FINANCIAL PLAN AT-A-GLANCE: KEY MEASURES
(millions of dollars)

		FY 2013		FY 2014		
			Preliminary			
	FY 2012		Unaudited	Before	Executive	
	Results	Revised [1]	Results	Actions [2]	Amended [3]	Enacted
State Operating Funds Disbursements						
Size of Budget	$87,181	$89,621	$88,844	$91,926	$89,823	$90,225
Annual Growth	3.3%	2.8%	1.9%	3.5%	1.10%	1.55%
Other Disbursement Measures						
General Fund (with Transfers)	$56,489	$59,375	$58,960	$61,684	$60,888	$61,157
	2.0%	5.1%	4.4%	4.6%	3.27%	3.73%
State Funds (Including Capital)	$93,193	$95,791	$94,523	$97,908	$96,225	$96,381
	3.4%	2.8%	1.4%	3.6%	1.80%	1.97%
Capital Budget (Federal and State)	$7,836	$8,025	$7,539	$7,834	$8,242	$7,996
	-0.1%	2.4%	-3.8%	3.9%	9.32%	6.06%
Federal Operating Aid*	$38,487	$37,996	$36,714	$43,476	$42,996	$42,318
	-14.2%	-1.3%	-4.6%	18.4%	17.11%	15.26%
All Funds*	$133,504	$135,642	$133,097	$143,236	$141,061	$140,539
	-1.0%	1.6%	-0.3%	7.6%	5.98%	5.59%
Capital Budget (Including "Off-Budget")	$9,227	$9,683	$8,904	$9,398	$9,806	$9,448
	-0.6%	4.9%	-3.5%	5.5%	10.13%	6.11%
All Funds (Including "Off-Budget" Capital)*	$134,895	$137,300	$134,462	$144,800	$142,625	$141,991
	-1.0%	1.8%	-0.3%	7.7%	6.07%	5.60%
Inflation (CPI)	2.1%	1.8%	1.8%	2.1%	2.1%	2.0%
All Funds Receipts						
Taxes	$64,297	$65,922	$66,302	$69,095	$69,105	$69,351
	5.6%	2.5%	3.1%	4.2%	4.23%	4.60%
Miscellaneous Receipts	$23,837	$24,985	$24,036	$23,233	$23,889	$23,621
	3.0%	4.8%	0.8%	-3.3%	-0.61%	-1.73%
Federal Grants*	$44,611	$44,131	$42,839	$49,359	$47,948	$47,433
	-9.5%	-1.1%	-4.0%	15.2%	11.93%	10.72%
Total Receipts*	$132,745	$135,038	$133,177	$141,687	$140,942	$140,405
	-0.4%	1.7%	0.3%	6.4%	5.83%	5.43%
General Fund Budget Gaps						
FY 2014	n/a	n/a	n/a	($1,352)	$0	$0
FY 2015	n/a	n/a	n/a	($3,979)	($2,093)	($2,014)
FY 2016	n/a	n/a	n/a	($5,201)	($3,563)	($2,856)
FY 2017	n/a	n/a	n/a	($5,663)	($4,161)	($2,920)
General Fund Reserves						
Stabilization/ Rainy Day Reserve Funds	$1,787	$1,306	$1,306	$1,306	$1,306	$1,306
All Other Reserves/Balances	$1,306	$168	$304	$85	$335	$403
Total	$481	$1,474	$1,610	$1,391	$1,641	$1,709
State Workforce FTEs	119,579	119,728	119,756	n/a	119,601	120,468
(Subject to Direct Executive Control)						

[1] FY 2013 estimates, as updated with the FY 2014 Executive Budget, as amended.

[2] Before proposals/actions to eliminate the projected budget gap. The annual percentage change calculations in the FY 2014 "Before Actions" column have been updated for FY 2013 year-end results.

[3] The annual percentage change calculations in the FY 2014 "Executive Amended" column have been updated for FY 2013 year-end results.

* Includes Federal disaster aid for Superstorm Sandy, estimated at $577 million in FY 2013 and $5.1 billion in FY 2014, and additional Federal aid under the Affordable Care Act, estimated at approximately $600 million in FY 2014. Excluding disbursements for these purposes, All Funds disbursements are expected to total $134.9 billion in FY 2014, an increase of 1.75 percent. Also note that All Governmental Funds disbursements may exceed total receipts in a given fiscal year as the State draws down other available resources held in its various governmental fund balances.

GENERAL FUND CASH-BASIS FINANCIAL PLAN

SUMMARY OF PRELIMINARY UNAUDITED RESULTS FOR FY 2013 (ENDED MARCH 31, 2013)

General Fund receipts, including transfers from other funds, totaled $58.78 billion. Disbursements, including transfers to other funds, totaled $58.96 billion. The State ended FY 2013 with a General Fund balance of $1.61 billion, a decrease of $177 million from FY 2012 results, which reflects the difference between receipts and disbursements. The change in the General Fund balance from FY 2012 results reflects the planned use of balances set aside for: (a) the costs of labor settlements reached in FY 2013 that covered prior contract periods, and (b) disbursements from Community Projects Fund re-appropriations, offset by an increase in the undesignated fund balance.

Receipts for FY 2013 fell $281 million below projections reflected in the February 2013 AIS Update. Tax receipts exceeded planned levels by $251 million, with stronger than anticipated collections for business taxes ($214 million) and personal income taxes ($82 million) offset in part by lower receipts from sales and use taxes ($15 million) and other taxes ($30 million). Miscellaneous receipts and non-tax transfers were $532 million below planned levels. This was due in part to the timing of transfers from other funds to the General Fund, and to lower than expected miscellaneous receipts collections for certain fines and fees. All planned tax refunds were made according to schedule.

General Fund disbursements, including transfers to other funds, were $417 million lower than estimated in the February 2013 AIS Update. Disbursements for disaster assistance related to recent natural disasters, were approximately $100 million below estimated levels in FY 2013. These costs are now expected to be incurred by the General Fund in FY 2014. In addition, disbursements fell below planned levels in a number of areas, including, but not limited to, Mental Hygiene ($98 million), OCFS ($57 million), and the Judiciary ($36 million). Before the end of FY 2013, the State pre-paid from General Fund resources approximately $203 million in certain debt service not due until FY 2014.

The General Fund closing balance of $1.61 billion in FY 2013 was $136 million higher than estimated in the February 2013 AIS Update. The balance consisted of $1.47 billion in statutory reserves, $77 million reserved for labor settlements covering prior contract periods, $13 million reserved for debt management, and $100 million in an undesignated fund balance. The Enacted Budget assumes that an undesignated balance of $100 million at the close of FY 2013 will be used in FY 2014 to cover the timing of certain costs related to disaster assistance that were budgeted in FY 2013, but are now expected to be charged to the General Fund in FY 2014. See the description of FY 2013 in the "Prior Fiscal Years" section herein for more information.

OVERVIEW OF FY 2014 (ENDING MARCH 31, 2014)

In developing the Executive Budget proposal for FY 2014, DOB estimated that, if no corrective actions were taken, the State faced a projected General Fund budget gap of $1.35 billion for FY 2014. The General Fund budget gaps in future years were projected at $4.0 billion in FY 2015, $5.2 billion in FY 2016, and $5.7 billion in FY 2017. Budget gaps represent the difference between: (a) the projected General Fund disbursements, including transfers to other funds, needed to maintain anticipated service levels and specific commitments, and (b) the expected level of resources to pay for them. The General Fund gap estimates were based on a number of assumptions and projections developed by the DOB in consultation with other State agencies.

On January 22, 2013, the Governor submitted his Executive Budget proposal for FY 2014, and made amendments thereto through February 21, 2013, as permitted by law. On February 25, 2013, DOB issued the Executive Budget Financial Plan, as amended, which included projections for FY 2013 through FY 2017 that reflected the estimated impact of the Governor's Executive Budget proposal. The Governor's Executive Budget proposed measures (the “gap-closing plan”) that, if enacted without modification, were expected to be sufficient to eliminate the General Fund budget gap of $1.35 billion in FY 2014, and to reduce the future projected budget gaps to $2.1 billion in FY 2015, $3.6 billion in FY 2016, and $4.2 billion in FY 2017.

On March 28, 2013, the Legislature completed final action on the budget for FY 2014, which began on April 1, 2013. Consistent with past practice, the Legislature enacted the annual debt service appropriations in advance of the other appropriations (the debt service appropriations were passed on March 20, 2013). On April 10, 2013, the Governor completed his review of all budget bills, including the veto of certain line-item appropriations, none of which had a material impact on the Financial Plan.

DOB estimates that the Enacted Budget for FY 2014 is balanced in the General Fund on a cash basis, eliminating the gap in FY 2014 and reducing future projected budget gaps to $2.0 billion in FY 2015 and $2.9 billion in both FY 2016 and FY 2017. The following table summarizes the General Fund Enacted Budget for FY 2014, and compares it to FY 2013 results. See "Financial Plan Overview — Explanation of the FY 2014 Enacted Budget Gap-Closing Plan" for a detailed summary of the General Fund gap-closing plan for FY 2014, and “Financial Plan Overview — Risks and Uncertainties Related to the State Financial Plan” for a discussion of risks that have the potential to affect the Financial Plan.

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FINANCIAL PLAN OVERVIEW

GENERAL FUND FINANCIAL PLAN
CASH BASIS
ANNUAL CHANGE
(millions of dollars)

	FY 2013	FY 2014	Annual Change	
	Results	**Enacted**	**Dollar**	**Percent**
Opening Fund Balance	1,787	1,610	(177)	-9.9%
Receipts:				
Taxes:				
Personal Income Tax	26,884	28,488	1,604	6.0%
User Taxes and Fees[1]	9,112	6,548	(2,564)	-28.1%
Business Taxes	6,253	6,375	122	2.0%
Other Taxes	1,034	1,069	35	3.4%
Miscellaneous Receipts	3,504	3,096	(408)	-11.6%
Federal Receipts	62	2	(60)	-96.8%
Transfers from Other Funds:				
PIT in Excess of Revenue Bond Debt Service	8,328	8,840	512	6.1%
Sales Tax in Excess of LGAC/Sales Tax Revenue Bond Debt Service[2]	2,416	5,440	3,024	125.2%
Real Estate Taxes in Excess of CW/CA Debt Service	541	532	(9)	-1.7%
All Other Transfers	649	866	217	33.4%
Total Receipts	58,783	61,256	2,473	4.2%
Disbursements:				
Local Assistance Grants	39,760	40,258	498	1.3%
Departmental Operations:[3]				
Personal Service	6,130	5,681	(449)	-7.3%
Non-Personal Service	1,726	1,883	157	9.1%
General State Charges	4,550	4,953	403	8.9%
Transfers to Other Funds:				
Debt Service	1,647	1,328	(319)	-19.4%
Capital Projects	916	1,227	311	34.0%
State Share Medicaid[4]	2,846	1,813	(1,033)	-36.3%
SUNY Operations[5]	340	971	631	185.6%
Other Purposes[6]	1,045	3,043	1,998	191.2%
Total Disbursements	58,960	61,157	2,197	3.7%
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(177)	99	276	155.9%
Closing Fund Balance	1,610	1,709	99	6.1%
Statutory Reserves:				
Tax Stabilization Reserve Fund	1,131	1,131	0	
Rainy Day Reserve Fund	175	175	0	
Contingency Reserve Fund	21	21	0	
Community Projects Fund	93	68	(25)	
Reserved For:				
Prior-Year Labor Agreements (2007-2011)	77	51	(26)	
Debt Management	13	263	250	
Undesignated Fund Balance	100	0	(100)	

Source: NYS DOB.

[1,2] The large decrease in the line labeled "User Taxes and Fees" and the large increase in the line labeled "Sales Tax in Excess of LGAC/Sales Tax Revenue Bond Debt Service" reflects in part the impact of legislation enacted with the FY 2014 Enacted Budget that creates a new sales tax revenue bond program. Pursuant to the legislation, the pledged receipts must first be deposited into the new Sales Tax Revenue Bond Tax Fund, an account within the General Debt Service Fund that will provide for the payment of Sales Tax Revenue bonds, and then transferred to the General Fund after payment of debt service.

[3,5] Effective with the academic year that began on July 2012, the State changed the process through which SUNY receives the State share of its operating support from direct General Fund spending to General Fund transfers.

[4,6] The annual decrease in "State Share Medicaid" and the annual increase in "Other Transfers" reflects in part changes in the accounting of State support for Mental Hygiene services due to reductions in Federal reimbursement rates, effective April 1, 2014.

RECEIPTS

General Fund receipts, including transfers from other funds, are expected to total $61.3 billion in FY 2014, an annual increase of $2.5 billion (4.2 percent). Tax collections, including transfers of tax receipts to the General Fund after payment of debt service, are expected to total $57.3 billion, an increase of $2.7 billion (5.0 percent).

General Fund personal income tax receipts, including transfers after payment of debt service on State PIT revenue bonds, are expected to increase by $2.1 billion (6 percent) from FY 2013. This primarily reflects increases in withholding and extension payments attributable to the 2012 tax year, partially offset by an expected increase in total taxpayer refunds and a decline in 2013 estimated payments.

General Fund user taxes and fees receipts for FY 2014, including transfers after the set aside of pledged receipts for debt service on New York Local Government Assistance Corporation (LGAC) and any Sales Tax Revenue Bonds, are estimated to total $12 billion in FY 2014, an increase of $460 million (4 percent) from FY 2013. In the chart on the previous page, the large decrease in the line labeled "User Taxes and Fees" and the large increase in the line labeled "Sales Tax in Excess of LGAC/Sales Tax Revenue Bond Debt Service" reflects in part the impact of legislation enacted with the FY 2014 Enacted Budget that creates a new Sales Tax Revenue Bond Program secured with dedicated revenues consisting of one cent of the State's four cent sales and use tax. Pursuant to the legislation, the pledged receipts must first be deposited into the new Sales Tax Revenue Bond Tax Fund, a sub-fund within the General Debt Service Fund that will provide for the payment of debt service on Sales Tax Revenue Bonds, and the balance to be transferred to the General Fund.

General Fund business tax receipts are estimated at $6.4 billion in FY 2014, an increase of $122 million (2 percent) from FY 2013 results. The estimate reflects growth in all business taxes except the corporate utilities tax and bank tax. Growth in corporate franchise, insurance, and petroleum business tax receipts reflect a continuation of patterns seen in FY 2013. Corporation and utilities tax receipts are expected to decline in FY 2014, and the extraordinary growth in bank tax receipts in FY 2013 is not expected to continue in FY 2014.

Other tax receipts in the General Fund are expected to total approximately $1.1 billion in FY 2014, an increase of $35 million (3.4 percent) from FY 2013. This mainly reflects an increase in expected estate tax receipts, offset in part by a decline in real estate transfer tax receipts. The estate tax increase is the result of an expected return in FY 2014 to a number of large estate payments consistent with historical experience. Real estate transfer tax receipts are expected to decline in FY 2014 following the acceleration of receipts from FY 2014 into FY 2013.

General Fund miscellaneous receipts are estimated at $3.1 billion in FY 2014, a decrease of $408 million. The decrease largely reflects a one-time payment in FY 2013 from a settlement between the Department of Financial Services (DFS) and Standard Chartered Bank, and lower motor vehicle fee receipts due to the cyclical nature of eight-year license renewals, offset by an expected deposit of $250 million from the State Insurance Fund (SIF) reserve release in connection with Workers' Compensation law changes enacted in the FY 2014 budget.

Non-tax transfers to the General Fund are expected to total $866 million, an increase of $217 million (33 percent) largely due to changes in accounting of certain receipts and greater resources from available fund balances.

General Fund receipts are affected by the deposit of dedicated taxes in other funds for debt service and other purposes, the transfer of balances between funds of the State, and other factors. For a more comprehensive discussion of the State's projections for tax receipts, miscellaneous receipts, and transfers, see “State Financial Plan Projections Fiscal Years 2014 through 2017” herein.

DISBURSEMENTS

General Fund disbursements, including transfers to other funds, are expected to total $61.2 billion in FY 2014, an increase of $2.2 billion (3.7 percent) from FY 2013 results. Local assistance grants are expected to total $40.3 billion, an annual increase of $498 million (1.3 percent). Included within local assistance grants, General Fund disbursements are expected to increase by $180 million for School Aid and $116 million for Medicaid.[3] All other local assistance grants, which include, among other things, payments for a range of social services, public health, education, and general purpose aid programs, are expected to increase by $200 million.

State operations disbursements in the General Fund are expected to total $7.6 billion in FY 2014, an annual decrease of $292 million (3.7 percent). Personal service costs are expected to decrease by $449 million, mainly reflecting one-time retroactive payments in FY 2013 made in connection with labor agreements covering prior contract periods. Non-personal service costs are expected to increase by $157 million in FY 2014, in large part due to the timing of certain costs related to disaster assistance.

General State charges are expected to total $5.0 billion, an annual increase of $403 million (8.9 percent). This mainly reflects an increase in the State's annual pension contribution of $412 million, driven by an increase to the State’s pension contribution rate and an increase in the level of payments associated with prior year pension amortization. The State expects to continue to amortize pension costs in excess of the amortization thresholds established in law. In FY 2014, costs in excess of 12.5 percent of payroll for the Employees Retirement System (ERS) and 20.5 percent for the Police and Fire Retirement System (PFRS) are expected to be amortized.

General Fund transfers to other funds are expected to total $8.4 billion in FY 2014, a $1.6 billion increase from FY 2013. This increase is partially attributable to the accounting of SUNY operating support as a transfer rather than a direct State Operating expense in the General Fund, and a reduction in Federal aid for Mental Hygiene services, which results in higher State-share costs.

General Fund disbursements are affected by the level of financing sources available in other funds, transfers of balances between funds of the State, and other factors that may change from year to year. For a more comprehensive discussion of the State's disbursements projections by major activity, see “State Financial Plan Projections Fiscal Years 2014 through 2017” herein.

CLOSING BALANCE

DOB projects that the State will end FY 2014 with a General Fund cash balance of $1.7 billion, an increase of $99 million from FY 2013 results. Balances in the State’s principal "rainy day" reserve funds, the Tax Stabilization Reserve Fund and the Rainy Day Reserve Fund, are expected to remain unchanged in FY 2014. The combined balance of the two funds is equal to approximately 2.1 percent of estimated General Fund disbursements in FY 2014. The Community Projects Fund, which finances discretionary

[3] DOH Medicaid disbursements only. Medicaid-related expenses for Mental Hygiene are shown as a transfer from the General Fund on the line labeled “State Share Medicaid”.

grants allocated by the Legislature and Governor, is expected to decrease by $25 million in FY 2014, reflecting disbursements from existing re-appropriations.

The Financial Plan continues to identify money in the General Fund balance to cover the costs of potential retroactive labor settlements with unions that have not agreed to terms for prior contract periods. The amount identified is calculated based on the "pattern" settlement for FY 2008 through FY 2011 that was agreed to by the State's largest unions. In FY 2014, DOB estimates the reserve will be reduced by $26 million to fund the FY 2014 costs of a labor settlement reached with NYSCOPBA in FY 2013 for prior contract periods. The remaining reserve will be reduced as labor agreements for prior periods are reached with other unions.

The Enacted Budget reserves $263 million for debt management purposes in FY 2014, an increase of $250 million from FY 2013 results. The increase is expected to be funded with certain reserves released by the SIF pursuant to Workers' Compensation Law changes enacted with the FY 2014 budget.

The Financial Plan assumes that the undesignated balance of $100 million at the close of FY 2013 will be used in its entirety in FY 2014 to cover the timing of certain costs related to disaster assistance that were expected in FY 2013, but are now expected to be incurred by the General Fund in FY 2014.

PROJECTED GENERAL FUND BUDGET GAPS

The General Fund budget gaps for future years are now projected at approximately $2.0 billion in FY 2015 and $2.9 billion in both FY 2016 and FY 2017. The following table summarizes the projected General Fund receipts and disbursements for FY 2015, FY 2016, and FY 2017. The projections reflect the expected impact of the FY 2014 Enacted Budget gap-closing plan.

GENERAL FUND FINANCIAL PLAN
CASH BASIS
FY 2015 through FY 2017
(millions of dollars)

	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Receipts:			
Taxes:			
Personal Income Tax	29,423	31,541	33,619
User Taxes and Fees	6,814	7,094	7,275
Business Taxes	5,854	6,349	6,579
Other Taxes	1,144	1,159	1,169
Miscellaneous Receipts	3,551	2,682	2,653
Federal Receipts	0	0	0
Transfers from Other Funds:			
PIT in Excess of Revenue Bond Debt Service	9,124	9,572	10,066
Sales Tax in Excess of LGAC/Sales Tax Revenue Bond Debt Service	5,602	5,784	5,881
Real Estate Taxes in Excess of CW/CA Debt Service	608	683	739
All Other Transfers	764	719	722
Total Receipts	62,884	65,583	68,703
Disbursements:			
Local Assistance Grants	42,598	45,056	47,276
Departmental Operations:			
Personal Service	5,850	6,111	6,127
Non-personal Service	1,968	2,005	2,086
General State Charges	5,328	5,604	5,873
Transfers to Other Funds:			
Debt Service	1,483	1,452	1,345
Capital Projects	1,384	1,400	1,799
State Share Medicaid	1,338	1,311	1,279
SUNY Operations	971	971	971
Other Purposes	4,003	4,548	4,853
Total Disbursements	64,923	68,458	71,609
Reserve (Uses)/Deposits:			
Community Projects Fund	(35)	(33)	0
Prior-Year Labor Agreements (2007-2011)	10	14	14
Debt Management	0	0	0
Undesignated Fund Balance	0	0	0
Change in Reserves	(25)	(19)	14
Excess (Deficiency) of Receipts Over Disbursements and Reserves	(2,014)	(2,856)	(2,920)

Source: NYS DOB.

EXPLANATION OF THE FY 2014 ENACTED BUDGET GAP-CLOSING PLAN

The table below itemizes the FY 2014 Enacted Budget gap-closing plan and for FY 2015 through FY 2017.

GENERAL FUND BUDGETARY BASIS SURPLUS/(GAP) PROJECTIONS
SUMMARY OF ENACTED BUDGET GAP-CLOSING PLAN
(millions of dollars)

	FY 2014	FY 2015	FY 2016	FY 2017
CURRENT SERVICES GAP ESTIMATES (BEFORE ACTIONS)[1]	**(1,352)**	**(3,979)**	**(5,201)**	**(5,663)**
SPENDING CONTROL	**1,351**	**838**	**730**	**931**
Agency Operations	**325**	**313**	**317**	**313**
Executive Agencies	95	158	165	177
Independent Officials/University System	62	29	28	14
Fringe Benefits/Fixed Costs	168	126	124	122
Local Assistance	**676**	**442**	**445**	**594**
Health Care	110	98	92	114
Social Services/Housing	92	203	182	196
Human Services COLA/Trends (All Agencies)	71	85	88	95
Education	429	20	79	218
School Aid	*402*	*7*	*51*	*190*
All Other	*27*	*13*	*28*	*28*
All Other Local Assistance	(26)	36	4	(29)
Debt Management	**350**	**83**	**(32)**	**24**
INITIATIVES/INVESTMENTS	**(699)**	**(757)**	**(886)**	**(1,122)**
Joint Legislative Additions[2]	(376)	(440)	(522)	(553)
Executive Budget Investments	(178)	(159)	(98)	(98)
Thruway Authority	(84)	(86)	(87)	(89)
Capital Commitment Plan (Debt Service Impact)	(5)	(25)	(87)	(277)
All Other	(56)	(47)	(92)	(105)
FEDERAL REVENUE REDUCTION PLAN	**0**	**(65)**	**(43)**	**282**
OPWDD Federal Rate Change[3]	(1,100)	(1,000)	(650)	(325)
State Savings Plan	500	480	272	272
Federal Resources	600	455	335	335
REVENUES/EXTENDERS	**389**	**723**	**2,080**	**2,139**
18-a Utility Assessment	255	472	396	358
Limit on High Income Charitable Contribution	70	140	140	70
PIT Extension	0	500	1,993	2,445
Middle Class Family Tax Credit	0	(410)	(410)	(410)
Extend and Reform Film Credit	0	0	0	(165)
Job Growth Package	0	(65)	(115)	(196)
All Other	64	86	76	37
OTHER CHANGES	**311**	**1,226**	**464**	**513**
Workers' Compensation Reform/SIF Reserve Release	250	1,000	250	250
Debt Management Set-Aside	(250)	0	0	0
Receipts Forecast Revisions (since Jan. 2013)	130	242	226	270
Undesignated Fund Balance (Timing for Disaster Assistance)	100	0	0	0
All Other	81	(16)	(12)	(7)
ENACTED BUDGET SURPLUS/(GAPS)	**0**	**(2,014)**	**(2,856)**	**(2,920)**

[1] All forecast revisions made since the release of the Executive Budget in January 2013 are accounted for in the appropriate categories of the gap-closing plan (e.g., spending reestimates in the category entitled "Spending Control").

[2] Restorations to Executive Budget proposals are reflected in the "Spending Control" and "Revenues/Extenders" categories.

[3] The current services gap estimates (i.e., the projected receipts and disbursements, prior to the actions and reestimates reflected in the Enacted Budget) had assumed the phase-down of Federal rates for State-Operated disability services beginning in FY 2016.

FINANCIAL PLAN OVERVIEW

The FY 2014 Enacted Budget gap-closing plan provides recurring savings and other actions over the Financial Plan period, reducing the General Fund budget gaps by a projected $2.0 billion in FY 2015, $2.3 billion in FY 2016, and $2.7 billion in FY 2017. The FY 2015 General Fund budget gap equals approximately 3.2 percent of projected General Fund receipts for FY 2015. In total, the combined General Fund budget gap estimates for FY 2014 through FY 2017 is approximately $7.8 billion. By comparison, the budget gap closed in FY 2012 alone was estimated at $10 billion.

During negotiations, the Governor and Legislature agreed to approximately $553 million in gross spending restorations and additions to the Executive Budget. Restorations, which are costs from the rejection of certain savings proposals contained in the Executive Budget, totaled approximately $177 million. The impact of the restorations are accounted for in "spending control". The largest restorations were in the areas of mental hygiene, health care, and education. Additions, which represent distinct new spending added to the Executive Budget by the Legislature, totaled approximately $376 million. The most significant additions were for School Aid and other education programs. The Governor and Legislature also reached agreement on the reprogramming of certain spending initiatives proposed in the Executive Budget.

Resources were identified to fund the restorations and additions, and to provide for a balanced budget in FY 2014. These include forecast revisions to receipts and disbursements, based on updated economic data, receipts collections, and year-end operating results for FY 2013. In addition, $500 million from the SIF reserve release related to Workers' Compensation Law changes has been redirected from PAYGO capital in FY 2014, as had been proposed in the Executive Budget, to reduce the budget gap in FY 2015. The total reserve release used to reduce the FY 2015 budget gap now totals $1.0 billion.

SPENDING CONTROL

AGENCY OPERATIONS

Agency Operations include salaries, wages, fringe benefits, and non-personal service costs (i.e., supplies, utilities). Reductions from the FY 2014 current-services forecast for agency operating costs contribute $325 million to the General Fund gap-closing plan for FY 2014.

- **Executive Agencies:** Continued workforce management, annualization of savings from closures of facilities, elimination of excess capacity, and efforts to right-size State government are expected to result in lower personal service and fringe benefits costs. The size of the Executive State workforce is projected to remain relatively constant at approximately 120,468 Full-Time Equivalents (FTEs). Additional savings are expected through operational efficiencies as agencies continue to redesign operations to improve service delivery, reduce costs, and eliminate duplicative functions.

- **Independent Officials/University Systems:** The budgets for the Legislature, Judiciary, State Comptroller, and the Department of Law do not reflect an annual increase in FY 2014 (compared to the FY 2013 estimates contained in the FY 2014 Executive Budget).

- **Fringe Benefits/Fixed Costs:** Savings for employee/retiree health care have been achieved through a lower than anticipated 2013 rate renewal increase for the Empire Plan. In addition, savings are expected by making monthly payments (rather than a single payment in March 2014) to the State's pension system to realize annual interest savings. The earlier payments during the year are expected to be possible due to the State's improved liquidity position.

LOCAL ASSISTANCE

Local assistance spending includes financial aid to local governments and non-profit organizations, as well as entitlement payments to individuals. Reductions from the FY 2014 current-services forecast for local assistance include both targeted actions and additional savings from the continuation of prior-year cost containment actions, which together contribute $676 million to the General Fund gap-closing plan. The most significant gap-closing actions in local assistance include:

- **Healthcare:** The Enacted Budget reduces disbursements for various public health programs by 5 percent, transfers funding for other public health programs between HCRA and the General Fund, reduces costs of the Excess Medical Malpractice program, and improves program administration. In addition, savings are realized from re-estimates to FY 2014 disbursement levels.

- **Social Services/Housing:** The Enacted Budget authorizes the use of supplemental Federal Temporary Assistance to Needy Families (TANF) funding for child care, which will provide General Fund savings in FY 2014. In addition, resources from the State of New York Mortgage Agency’s (SONYMA's) excess Mortgage Insurance Fund (MIF) reserves will be used to support the Neighborhood and Rural Preservation Programs and the Rural Rental Assistance program in FY 2014 and FY 2015.

- **Human Services Cost-of-Living Adjustments (COLA)/Trends:** The Enacted Budget eliminates the automatic 1.4 percent human services “cost-of-living” increase for FY 2014, and maintains existing rates for mental hygiene programs, including various residential and day programs for individuals with developmental disabilities, and other health and human services programs. In addition, savings are realized from re-estimates to FY 2014 disbursement levels based on FY 2013 operating results.

- **Education:** Savings in FY 2014 are realized by the prepayment in March 2013 of School Aid otherwise payable in the first quarter of FY 2014 (the timing has no impact on a school year basis). Financial Plan savings are also realized by the recalculation of future School Aid growth under the statutory cap to reflect DOB’s updated personal income forecast, among other things. In addition, certain school districts were not in compliance with the Annual Professional Performance Review by the January 17, 2013 deadline, and, as a result, they were not eligible for planned increases for the 2012-13 school year.

- **Other Local Programs:** Savings are expected to be achieved across multiple functions and program areas. Actions include delays to certain plans associated with mental health bed development, and the establishment of fraud protection mechanisms related to the STAR program. In addition, projected disbursements for several programs have been revised downward based on FY 2013 results.

DEBT MANAGEMENT

Savings have been realized by the pre-payment, in FY 2013, of debt service due in FY 2014. In addition, savings are expected from, among other things, refunding existing debt at lower interest rates.

INVESTMENTS/INITIATIVES

- **Joint Legislative Additions:** During negotiations, the Executive and Legislature agreed to approximately $553 million in gross spending restorations and additions to the Executive Budget proposal for FY 2014. Restorations, which are costs from the rejection of certain Executive Budget savings proposals totaled approximately $177 million. The largest restorations were in the areas of mental hygiene, health care, and education. Additions, which represent distinct new spending added to the Executive Budget proposal by the Legislature, totaled approximately $376 million. The most significant additions were for School Aid and other education programs.

- **Executive Budget Investments:** As part of budget negotiations, the Executive and Legislature reached agreement on the reprogramming of certain spending initiatives proposed in the Executive Budget. The largest of these were in the areas of education and health care.

- **Thruway Authority:** The personnel and fringe benefit costs for a unit of the New York State Police that handles traffic enforcement for the Thruway Authority, as well as certain operating costs of the Authority, will be financed from general revenues of the State. The State's assumption of these costs, which were previously financed by revenues generated from Thruway toll collections, will help the Thruway Authority maintain fiscal stability without an immediate toll increase.

- **Capital Commitment Plan:** Consistent with the long-term planning goals of New York Works, the DOB has for the first time formulated 10-year capital commitment and disbursement projections for State agencies. The total commitment and disbursement levels permissible over the 10-year capital planning horizon reflect, among other things, projected capacity under the State's debt limit, anticipated levels of Federal aid, and the timing of capital activity based on known needs and historical patterns. The Financial Plan reflects the estimated debt service costs from the capital plan.

- **All Other:** Other investments and initiatives include, among other things, an accelerated Payment in Lieu of Taxes (PILOT) payment to the City of Albany, the promotion of tourism and economic development opportunities in conjunction with Super Bowl XLVIII, and the advance of Tribal State Compact revenues to the City of Salamanca.

FEDERAL REVENUE REDUCTION PLAN

The Enacted Budget addresses reductions in Federal Medicaid revenue related to reimbursement for State-operated developmental disability services. (See "Financial Plan Overview — Risks and Uncertainties Related to the State Financial Plan" herein.) Savings in the future years of the Financial Plan depend on approval by the Federal government of specific aid. The following table: (a) summarizes the specific actions that are reflected in the Financial Plan for FY 2014 to address the decline in Federal funding, and (b) illustrates the impact of those actions on State Operating Funds.

FEDERAL REVENUE REDUCTION PLAN SUMMARY
SUMMARY OF ACTIONS
(millions of dollars)

	FY 2014
OPWDD Federal Rate Reduction	**(1,100)**
State Actions	**500**
OPWDD Savings Actions	90
Other State Actions	30
Global Medicaid Spending Cap - Underspending in FY 2013	200
MRT Investment Delays/Accelerated Reforms	180
Other Resources	**600**
Federal Aid for Emergency Medicaid/Other Costs	250
ACA Resources	100
Other Expected Federal Aid	250

IMPACT OF ACTIONS ON STATE OPERATING FUNDS SPENDING

Change in Available SOF Resources Due to Aid Reduction	**(820)**
Change in SOF Disbursements	**(820)**
OPWDD Savings Actions	*(90)*
Transfer of Costs to DOH Medicaid	***(730)***
Global Cap Underspending	(200)
MRT Investment Delays/Reform Acceleration	(180)
State MA Costs Financed with Eligible Federal Resources	(350)

REVENUES/EXTENDERS

- **18-a Utility Assessment:** The Temporary Utility Assessment on electric, gas, water and steam utilities is extended and phased out over three and one-half years beginning in FY 2015. The rate of 2 percent for public utilities will be lowered to 1.75 percent in FY 2016, 1.5 percent in FY 2017 and 0 percent in FY 2018. The rate of 1 percent for LIPA will decrease to 0.75 percent, 0.5 percent and 0 percent over the same timeframe.

- **High Income Charitable Contribution Deduction Limitation:** The Enacted Budget extends for three years, starting with tax year 2013, the existing limitation on charitable contribution deductions for New York State and New York City taxpayers with adjusted gross income over $10 million.

- **Warrantless Wage Garnishment:** The Enacted Budget allows Department of Taxation and Finance (DTF) to garnish wages of delinquent taxpayers without filing a warrant with the Department of State (DOS) or County Clerks. The warrant requirement is replaced with a faster public notification requirement. Warrants offer no additional protection for delinquent taxpayers and requiring counties to receive the warrants from DTF represents an unfunded mandate. Wages will only be garnished if a taxpayer fails to negotiate a repayment agreement with DTF.

- **Delinquent Taxpayers' Driver's Licenses:** The Enacted Budget creates a new program to aid in the enforcement of past-due tax liabilities by suspending, with certain exceptions, the New York State driver's licenses of taxpayers who owe taxes in excess of $10,000. A "past-due tax liability" refers to any tax liability that has become fixed and final such that the taxpayer no longer has any right to administrative or judicial review. The program will be modeled after the State's successful use of license suspensions to compel legally owed child support payments.

- **New York Film Production Tax Credit:** The Enacted Budget extends the Empire State film production tax credit totaling $420 million per year for an additional five years. Restrictions on the post-production portion of the credit will be reduced and additional reporting will be required to document the effectiveness of the credit in creating jobs. In 2015 through 2019, film and post production projects are eligible for an additional 10 percent credit for wages and salaries (excluding writers, directors, music directors, producers and performers) paid as part of projects undertaken in certain upstate New York counties.

- **Tax Modernization Provisions:** The tax modernization provisions enacted in 2011, and extended last year, are extended again until December 31, 2016. These provisions, including mandatory e-filing and e-payment for preparers and taxpayers, sales tax payment requirements, and segregated accounts for non-complying vendors, would have otherwise expired at the outset of the tax year 2013 filing season on December 31, 2013.

- **Tax Reductions:** The Enacted Budget includes several new tax reductions. These include a refundable $350 credit in each of tax years 2014-2016 to taxpayers with dependents under the age of 17, zero or positive tax liability, and income between $40,000 and $300,000; a refundable tax credit for tax years 2014-2018 for a portion of the minimum wage paid to students age 16-19; a phased in manufacturing tax rate reduction of 9.2 percent in tax year 2014, 12.3 percent in 2015, 15.4 percent in 2016 and 2017, and 25 percent effective tax year 2018; a refundable tax credit for hiring veterans; and a four year refundable tax credit capped at $6 million per year for tax years 2014 through 2017 for hiring unemployed, low-income, or at-risk youth in qualifying areas.

- **PIT Brackets and Rates with Indexing:** The Enacted Budget extends the December 2011 PIT reform program for three additional tax years, 2015-2017.

- **Historic Commercial Properties Rehabilitation Tax Credit:** This law change provides assurance to developers who are rehabilitating historic commercial property, or are considering doing so, by extending the existing $5 million per project tax credit for five years (2015-2019) and makes the credit refundable beginning in tax year 2015.

- **Historic Homes Rehabilitation Credit:** The Enacted Budget extends for five years the maximum credit amount of $50,000 (scheduled to revert to $25,000), and the refundability of the credit for persons with incomes under $60,000 (scheduled to revert to nonrefundable).

OTHER

- **Workers' Compensation Legislation:** The Workers' Compensation Board (WCB) assesses its administrative and special fund costs to the industry which includes carriers, the State agency for the State Insurance Fund (SIF), and the self-insurers including municipal self-insurers. Historically, SIF's share of the various assessments was based on their share of the total paid indemnity reported. As a result, prior to 2013 legislative changes, accounting standards required SIF to accrue and fund a long term assessment liability on its financial statements. Based upon a review of SIF's financial statements, it had a WCB assessment liability in excess of $2 billion. Legislation passed in 2013 includes a complete redesign of the assessment process to an employer-based assessment that will require carriers to collect the necessary amounts from the employers and remit amounts directly to the WCB. As a result of this legislation, SIF's assessments will not be based on the long-term indemnity. Therefore, accounting standards no longer require SIF to accrue a long term assessment liability. Additionally, the legislation states: "Effective immediately, notwithstanding any law to the contrary, pursuant to the provisions of this chapter, the assessment reserves held by the state insurance fund for the payment of future assessments are no longer required and all funds and investments held by the state insurance fund related to the assessment reserves shall be transferred to the chair of the workers' compensation board as soon as possible." The legislation goes on to describe how the funds will be incrementally transferred from the WCB to the State's General Fund from April 1, 2013 to April 1, 2016. As a result of the legislation, SIF is expected to release approximately $2 billion in reserves that would no longer be required to fund future liabilities under the assessment and accounting changes provided for in the law. The Financial Plan assumes $250 million of released reserves will be used in FY 2014 for debt management purposes, and $1.5 billion will be used to reduce budget gaps in future years ($1 billion in FY 2015 and $250 million in both FY 2018 and FY 2019). The remaining amounts of reserves being released are expected to be used to stabilize SIF premiums for a period of time.

- **Debt Management Set-Aside:** The Enacted Budget sets aside an additional $250 million for debt management purposes, which is expected to be financed with $250 million from the release of SIF reserves.

- **Tax Receipts Forecast Revisions:** This reflects the net impact of changes to the tax receipts forecast since the release of the original Executive Budget submission in January 2013. It includes adjustments made in the amended Executive Budget Financial Plan and as part of the consensus revenue forecasting process undertaken with the Legislature in March 2013.

- **Undesignated Fund Balance:** The Financial Plan assumes that the undesignated balance of $100 million at the close of FY 2013 will be used in FY 2014 to cover the timing of certain costs related to disaster assistance that were budgeted in FY 2013, but are now expected to be charged to the General Fund in FY 2014.

RISKS AND UNCERTAINTIES RELATED TO THE STATE FINANCIAL PLAN

GENERAL

The Enacted Budget Financial Plan is subject to many complex economic, social, financial, and political risks and uncertainties, many of which are outside the ability of the State to control. DOB believes that the projections of receipts and disbursements in the Enacted Budget Financial Plan are based on reasonable assumptions, but there can be no assurance that actual results will not differ materially and adversely from these projections. In certain fiscal years, actual receipts collections have fallen substantially below the levels forecast in the Enacted Budget Financial Plan.

The Enacted Budget Financial Plan is based on numerous assumptions, including the condition of the State and national economies and the concomitant receipt of economically sensitive tax receipts in the amounts projected. Other uncertainties and risks concerning the economic and receipts forecasts include the impact of national and international events, such as ongoing instability in the Euro-zone; changes in consumer confidence, oil supplies and oil prices; Federal statutory and regulatory changes concerning financial sector activities; changes concerning financial sector bonus payouts, as well as any future legislation governing the structure of compensation; shifts in monetary policy affecting interest rates and the financial markets; financial and real estate market developments on bonus income and capital gains realizations; and the levels of household debt on consumer spending and State tax collections.

Among other factors, the Enacted Budget Financial Plan is subject to various other uncertainties and contingencies relating to the extent, if any, to which wage increases for State employees exceed projected annual wage costs; changes in the size of the State's workforce; the realization of the projected rate of return for pension fund assets and current assumptions with respect to wages for State employees affecting the State's required pension fund contributions; the willingness and ability of the Federal government to provide the aid contemplated by the Enacted Budget Financial Plan; the ability of the State to implement cost reduction initiatives, including reductions in State agency operations, and the success with which the State controls expenditures; and the ability of the State and its public authorities to market securities successfully in the public credit markets. Some of these specific issues are described in more detail herein. The projections and assumptions contained in the Financial Plan are subject to revisions which may reflect substantial adverse changes resulting from the occurrence of one or more uncertainties. No assurance can be given that these estimates and projections, which depend in part upon actions the State expects to be taken but which are not within the State's control, will be realized.

BUDGET RISKS AND UNCERTAINTIES

There can be no assurance that the State's General Fund budget gaps will not increase materially from current projections. If such events were to occur, the State would be required to take additional gap-closing actions. These may include, but are not limited to, additional reductions in State agency operations; delays or reductions in payments to local governments or other recipients of State aid; delays in or suspension of capital maintenance and construction; extraordinary financing of operating expenses; or other measures. In some cases, the ability of the State to implement such actions requires the approval of the Legislature and cannot be implemented solely by the action of the Governor.

The Financial Plan projections assume that School Aid and Medicaid disbursements will be limited to the growth in NYS personal income and the ten-year average growth in the Medicaid component of Consumer Price Index (CPI), respectively, however, the Enacted Budget authorizes spending for School Aid to increase in excess of the growth in personal income for SY 2014.

State law grants the Executive certain powers to achieve the Medicaid savings assumed in the Financial Plan. However, there can be no assurance that these powers will be sufficient to limit the rate of annual growth in DOH State Funds Medicaid spending to the levels estimated in the Enacted Budget. In addition, savings are dependent upon timely Federal approvals, revenue performance in the State's HCRA fund (which finances approximately one-third of the DOH State-share costs of Medicaid), and the participation of health care industry stakeholders.

The forecast contains specific transaction risks and other uncertainties including, but not limited to, the receipt of certain payments from public authorities; the receipt of miscellaneous revenues at the levels expected in the Financial Plan, including payments pursuant to the Tribal State Compact that have failed to materialize in prior years; and the achievement of cost-saving measures including, but not limited to, the transfer of available fund balances to the General Fund at the levels currently projected. Such risks and uncertainties, if they were to materialize, could have an adverse impact on the Financial Plan in the current year or future years.

FEDERAL ISSUES

The State receives a substantial amount of Federal aid for health care, education, transportation, and other governmental purposes. Any reduction in Federal funding levels could have a materially adverse impact on the State's Financial Plan. In addition, the Enacted Budget may be adversely affected by other actions taken by the Federal government, including audits, disallowances, and changes to Federal participation rates or other Medicaid rules. Issues of particular concern are described below.

FEDERAL REIMBURSEMENT FOR STATE MENTAL HYGIENE SERVICES

The Federal government lowered Medicaid developmental disability center payment rates, effective April 1, 2013, which will reduce Federal funding to the State by approximately $1.1 billion beginning in FY 2014. The Enacted Budget includes a plan to address the loss in Federal aid, including $90 million in OPWDD savings associated with reduced administrative costs, enhanced audit recoveries and improved program efficiencies. The plan is subject to implementation risks and is dependent, in part, on the approval of the Federal government. As described below, the Federal Centers for Medicare and Medicaid Services (CMS) may seek to retroactively recover Federal funds regarding this matter.

AUDIT DISALLOWANCE

In addition to the reductions in rates that commenced on April 1, 2013, on February 8, 2013, the U.S. Department of Health & Human Services Office of the Inspector General, at the direction of the Federal CMS, began a review to determine the allowability of Medicaid costs for services provided in prior years to the Medicaid population in New York State-Operated Intermediate Care Facilities for the Developmentally Disabled (ICF/DD). The initial review period includes claims for services provided during the period April l, 2010 through March 31, 2011. As a result of this review, CMS may seek to recover Federal funds for any payments that it determines to have been in excess of Federal requirements. The State has prospectively resolved CMS concerns regarding its payments to ICF/DDs with a State plan change effective April 1, 2013, and continues to have discussions with CMS to resolve these concerns related to the April 1, 2010 through March 31, 2011 period. As noted above, adverse action by the Federal government relative to the allowability of Medicaid costs or services in years prior to FY 2014 is expected to result in a reduction in Federal aid of an estimated $1.1 billion annually. A comparable amount of Federal aid is at risk for any prior period that may be pursued by CMS. Matters of this type are sometimes resolved with a prospective solution (as already commenced by the State), and the State is not aware of any similar attempts by the Federal government to retroactively recover Federal aid of this magnitude that was paid pursuant to an approved State plan. The State continues to seek CMS approval to proceed with the development of a sustainable system of service funding and delivery for individuals with developmental disabilities. However, there can be no assurance that Federal action in this matter will not result in materially adverse changes to the Enacted Budget Financial Plan.

BUDGET CONTROL ACT

The Federal Budget Control Act (BCA) of 2011 imposed annual caps on Federal discretionary spending over a ten-year period and mandated an additional $1.2 trillion in deficit reduction, which, if not enacted, would be achieved through the sequestration of funds in Federal Fiscal Year (FFY) 2013 and lowered discretionary spending caps in the following years. As the required deficit reduction was not achieved by the March 1, 2013 deadline, an across-the-board 5 percent reduction in FFY 2013 funding for Federal nondefense discretionary programs was implemented. If Congress does not act to otherwise achieve the BCA deficit reduction requirements, DOB estimates that New York State and local governments could lose approximately $5 billion in Federal funding over nine years, mostly from reductions in "pass-through" aid to individuals, school districts, not-for-profit providers, and other beneficiaries.

HEALTH INSURANCE COMPANY CONVERSIONS

State law permits a health insurance company to convert its organizational status from a not-for-profit to a for-profit corporation (a "health care conversion"), subject to a number of terms, conditions, and approvals. Under State law, the State is entitled to proceeds from a health care conversion and such proceeds must be used for health care related expenses. The Enacted Budget counts on conversion proceeds of $175 million in FY 2014, and $300 million annually in FY 2015, FY 2016, and FY 2017. In recent years, the Financial Plan has counted on similar amounts from conversions, which have not been realized. It is expected that any proceeds received will be deposited into the HCRA account. If estimated proceeds from health care conversions are not realized on the timetable or at the levels assumed in the Enacted Budget, the State may be required to take other actions, such as reducing planned spending in HCRA, or financing additional health care expenses in the General Fund, or both.

STATUS OF CURRENT LABOR NEGOTIATIONS (CURRENT CONTRACT PERIOD)

The State has labor contracts with its two largest employee unions, CSEA and PEF, as well as NYSPBA (representing the APSU bargaining unit, formerly ALES), NYSCOPBA, Council 82, and UUP. The State has labor contracts with approximately 90 percent of unionized State employees. Generally, the contracts provide for no across-the-board salary increases for FY 2012 through FY 2014, increases to employee health insurance contributions, and a temporary reduction in employee compensation through a deficit reduction program (DRP). Employees will receive a 2 percent salary increase in both FY 2015 and FY 2016; and, at the end of their contract term, the value of FY 2013 deficit reduction adjustments. The PEF and NYSPBA contracts generally mirror the provisions for the other unions, but cover a four-year period, whereas the others cover a five-year period. PEF and NYSPBA-represented employees will receive a 2 percent salary increase in FY 2015. PEF-represented employees will be repaid all DRP adjustments at the end of their contract in lieu of the $1,000 lump sum payment. Employees represented by the UUP ratified their agreement with the State on June 4, 2013. The agreement contains no general salary increases until 2014 and 2015 when there will be 2 percent general salary increases awarded in each year, payments to be awarded by the Chancellor, and performance incentive lump sum payment awarded by campus presidents. UUP-represented employees will also have a DRP. Employees in the unions that have reached settlements with the State received contingent layoff protection through FY 2013 and continued protection for the remaining term of the agreements. Reductions in force due to management decisions to close or restructure facilities authorized by legislation, SAGE Commission determinations, or material or unanticipated changes in the State's fiscal circumstances are not covered by this protection.

LABOR SETTLEMENTS FOR PRIOR CONTRACT PERIODS

The Enacted Budget continues to identify a portion of the General Fund balance to cover the costs of a pattern settlement with unions that have not agreed to contracts for prior contract periods. The amount is calculated based on the general salary increases agreed to by the State’s largest unions for the same period. There can be no assurance that actual settlements related to prior periods will not exceed the amounts reserved. In addition, the State’s ability to fund the amounts reserved in FY 2014 and beyond depends on the achievement of balanced budgets in those years. The Enacted Budget does not include reserves for settlements covering the current contract period (i.e., starting in FY 2012).

CURRENT CASH-FLOW PROJECTIONS

The State authorizes the General Fund to borrow resources temporarily from available funds in STIP for up to four months, or to the end of the fiscal year, whichever period is shorter. The amount of resources that can be borrowed by the General Fund is limited to the available balances in STIP, as determined by the State Comptroller. Available balances include money in the State’s governmental funds and a relatively small amount of other moneys belonging to the State. Several accounts in Debt Service Funds and Capital Projects Funds that are part of All Governmental Funds are excluded from the balances deemed available in STIP. These excluded funds consist of bond proceeds and money obligated for debt service payments.

DOB expects that the State will have sufficient liquidity to make payments as they become due throughout FY 2014, but that the General Fund may, from time to time on a daily basis, need to borrow resources temporarily from other funds in STIP. As noted above, the State continues to reserve money on a quarterly basis for debt service payments that are financed with General Fund resources. Money to pay debt service on bonds secured by dedicated receipts, including PIT bonds, continues to be set aside as required by law and bond covenants. The table below provides an estimate of month-end balances for FY 2014.

ACTUAL AND PROJECTED MONTH-END CASH BALANCES
FY 2014
(millions of dollars)

	General Fund	Other Funds	All Funds
April (Results)	6,379	3,175	9,554
May (Results)	3,744	3,765	7,509
June (Projected)	3,918	2,512	6,430
July (Projected)	3,920	2,795	6,715
August (Projected)	3,293	3,664	6,957
September (Projected)	5,005	1,471	6,476
October (Projected)	4,219	2,219	6,438
November (Projected)	2,817	2,153	4,970
December (Projected)	4,166	634	4,800
January (Projected)	6,061	2,646	8,707
February (Projected)	6,125	2,612	8,737
March (Projected)	1,709	2,307	4,016

PENSION AMORTIZATION

Under legislation enacted in August 2010, the State and local governments may amortize (defer paying) a portion of their annual pension costs beginning in FY 2011. Amortization temporarily reduces the pension costs that must be paid by public employers in a given fiscal year, but results in higher costs overall when repaid with interest. The legislation enacted a formula to set amortization thresholds for each year. The amortization thresholds may increase or decrease by up to one percentage point annually. Pension contribution costs in excess of the amortization thresholds, which, in FY 2014 will be 12.5 percent of payroll for the Employees Retirement System (ERS) and 20.5 percent for the Police and Fire Retirement System (PFRS), may be amortized.

The Enacted Budget forecast assumes that the State will continue to amortize a portion of its pension costs, pursuant to the FY 2011 legislation. The State's minimum ERS pension contribution rate, as a percentage of payroll, was 9.5 percent in FY 2011, 10.5 percent in FY 2012, and 11.5 percent in FY 2013. DOB projects the rate to be 12.5 percent in FY 2014, 13.5 percent in FY 2015, 14.5 percent in FY 2016, and 15.5 percent in FY 2017. The FY 2018 amortization threshold is projected by DOB to equal the normal contribution rate of 15.6 percent of payroll. Therefore, no amortization of ERS costs will be applicable for FY 2018 and beyond.

The State's minimum PFRS pension contribution rate was 17.5 percent in FY 2011, 18.5 percent in FY 2012 and 19.5 percent in FY 2013. DOB projects the rate to be 20.5 percent in FY 2014, 21.5 percent in FY 2015, 22.5 percent in FY 2016, and 23.5 percent in FY 2017. The PFRS amortization threshold is also projected to equal the normal contribution rate of 23.7 percent by FY 2018. . Therefore, no amortization of ERS costs will be applicable for FY 2018 and beyond. These projected contribution rates, however, are a function of projected market returns and future actuarial assumptions with the next quinquennial study to take place in 2015 and are subject to change.

The authorizing legislation also permits amortization in all future years if the actuarial contribution rate is greater than the amortization thresholds. In addition, the State is required to begin repayment of the amounts amortized beginning in the fiscal year immediately following the amortizations. Repayment of the amortized amounts is required to be made over a period of not more than ten years at an interest rate to be determined by the State Comptroller annually for amounts amortized in that year and with the rate fixed for the entire term of that amortization.

In March of 2013, the State made pension payments to NYSLRS that totaled $1.181 billion for FY 2013, and amortized $674 million. In addition, the State's Office of Court Administration (OCA) made its pension payment of $189 million, and amortized $104 million. The $778 million in total deferred payments will be repaid with interest over the next ten years, beginning in FY 2014.

For amounts amortized in FY 2011, FY 2012, and FY 2013, the State Comptroller set interest rates of 5 percent, 3.75 percent and 3 percent, respectively. The Enacted Budget forecast assumes that both the State and OCA will elect to amortize pension costs in future years, consistent with the provisions of the authorizing legislation, and repay such amounts at an interest cost assumed by DOB to be 3 percent (per annum) over ten years from the date of each deferred payment, consistent with the interest rate charged on the FY 2013 amortized amounts.

The following table, which summarizes pension contributions and projections for future fiscal years, reflects the "Normal Costs" of pension contributions as the amount the State would contribute to fund pensions before amortization, along with actual "New Amortized Amounts" in prior years and assumed "New Amortized Amounts" in upcoming years. The repayment costs (principal and interest) associated with these amortizations are reflected as the "Amortization Payment." Consistent with these amortization assumptions, Part TT of Chapter 57 of the Laws of 2010 requires that: (a) the State make additional contributions in upcoming fiscal years, above the actuarially required contribution, and (b) once all outstanding amortizations are paid off, additional contributions be set aside as reserves for rate increases, to be invested by the State Comptroller and used to offset future rate increases.

As noted above, DOB's most recent pension contribution rate forecast assumes that the normal contribution rate will equal the amortization threshold in FY 2018. Therefore, the State will not have the option to amortize any of its pension costs in 2018, or in the immediately succeeding fiscal years. Projections in the following table are based on certain DOB assumptions about actuarial factors on investment earnings and benefits to be paid, and while DOB believes such assumptions to be reasonable, actual results may vary from the projections provided in the following table, and such variances could be substantial.

**EMPLOYEE RETIREMENT SYSTEM AND POLICE AND FIRE RETIREMENT SYSTEM[1]
PENSION CONTRIBUTIONS AND OUTYEAR PROJECTIONS
(millions of dollars)**

Fiscal Year	Normal Costs[2]	New Amortized Amounts	Amortization Payment	Total
2011 Actual	1,552.8	(249.6)	0.0	1,303.2
2012 Actual	2,041.7	(562.9)	32.3	1,511.1
2013 Actual	2,084.3	(778.5)	100.9	1,406.7
2014 Projected	2,481.6	(858.0)	192.1	1,815.7
2015 Projected	2,509.9	(744.0)	292.7	2,058.6
2016 Projected	2,103.4	(262.7)	379.9	2,220.6
2017 Projected	1,883.4	(44.6)	410.7	2,249.5
2018 Projected	1,891.2	0.0	416.0	2,307.2
2019 Projected	1,904.1	0.0	416.0	2,320.1
2020 Projected	1,941.1	0.0	416.0	2,357.1
2021 Projected	1,967.0	0.0	416.0	2,383.0
2022 Projected	1,980.7	0.0	383.6	2,364.3
2023 Projected	1,968.1	0.0	315.1	2,283.2
2024 Projected	1,942.0	0.0	223.8	2,165.8
2025 Projected	1,913.3	0.0	123.2	2,036.5
2026 Projected	1,870.1	0.0	36.0	1,906.1

Source: NYS DOB.

[1] Pension contribution values do not include pension costs related to the Optional Retirement Program and Teachers' Retirement System for SUNY and SED, whereas the projected pension disbursements in the Financial Plan tables presented in this AIS include such pension disbursements.

[2] Includes payments from amortization prior to FY 2011. Such prior amortization payments will end in FY 2017.

OTHER POST-EMPLOYMENT BENEFITS (OPEB)

State employees become eligible for post-employment benefits (health insurance) if they reach retirement while working for the State, are enrolled in New York State Health Insurance Program (NYSHIP) (or are enrolled in the State's opt-out program) at the time they have reached retirement, and have at least ten years of NYSHIP benefits eligible service. The cost of providing post-retirement health insurance is shared between the State and the retired employee. Contributions are established by law and may be amended by the Legislature. The State pays its share of costs on a PAYGO basis as required by law.

In accordance with Governmental Accounting Standards Board (GASB) Statement 45, the State must perform an actuarial valuation every two years for purposes of calculating OPEB liabilities. As disclosed in Note 13 of the State's Basic Financial Statements for FY 2012, the Annual Required Contribution (ARC) represents the annual level of funding that, if set aside on an ongoing basis, is projected to cover normal costs each year and to amortize any unfunded liabilities of the plan over a period not to exceed 30 years. Amounts required but not actually set aside to pay for these benefits are accumulated, with interest, as part of the net OPEB obligation, after adjusting for amounts previously required.

As reported in the State's Basic Financial Statements for FY 2012, an actuarial valuation of OPEB liabilities was performed as of April 1, 2010. The valuation calculated the unfunded actuarial accrued liability as of April 1, 2010 at $72.1 billion ($59.7 billion for the State and $12.4 billion for SUNY), determined using the Frozen Entry Age actuarial cost method, and is amortized over an open period of 30 years using the level percentage of projected payroll amortization method.

The annual OPEB cost for FY 2012 totaled $3.9 billion ($3.1 billion for the State and $0.8 billion for SUNY) under the Frozen Entry Age actuarial cost method, allocating costs on a level basis over earnings. This was $2.5 billion ($1.9 billion for the State and $0.6 billion for SUNY) above the payments for retiree costs made by the State in FY 2012. This difference between the State's PAYGO costs and the actuarially determined required annual contribution under GASB Statement 45 reduced the State's net asset condition at the end of FY 2012 by $2.5 billion.

An updated actuarial valuation of OPEB liabilities was also performed as of April 1, 2012. The unfunded actuarial accrued liability for FY 2013 is $66.5 billion ($54.3 billion for the State and $12.2 billion for SUNY). The annual OPEB cost totaled $3.4 billion ($2.6 billion for the State and $0.8 billion for SUNY). The unfunded actuarial accrued liability and annual OPEB cost for the State detailed in this paragraph are unaudited. Audited amounts will ultimately be reflected in the Basic Financial Statements for the State and SUNY for FY 2013.

GASB does not require the additional costs to be funded on the State's budgetary (cash) basis, and no funding is assumed for this purpose in the State Financial Plan. The State continues to finance these costs, along with all other employee health care expenses, on a PAYGO basis.

There is no provision in the current Financial Plan to pre-fund OPEB liabilities. If such liabilities were pre-funded, the additional cost above the PAYGO amounts would be lowered. The State's Health Insurance Council, which consists of Governor's Office of Employee Relations (GOER), Civil Service and DOB, will continue to review this matter and seek input from the State Comptroller, the legislative fiscal committees and other outside parties. However, it is not expected that the State will alter its planned funding practices in light of existing fiscal conditions.

LITIGATION

Litigation against the State may include potential challenges to the constitutionality of various actions. The State may also be affected by adverse decisions that are the result of various lawsuits. Such adverse decisions may not meet the materiality threshold to warrant individual description but, in the aggregate, could still adversely affect the State Financial Plan. For more information on litigation affecting the State, see the section entitled "Litigation and Arbitration" later in this AIS.

UPDATE ON STORM RECOVERY

In August 2011, Hurricane Irene disrupted power and caused extensive flooding to various New York State counties, and was soon followed by the September 2011 Tropical Storm Lee which caused flooding in additional New York State counties and, in some cases, exacerbated the damage caused by Hurricane Irene two weeks earlier. Little more than one year later, on October 29, 2012, Superstorm Sandy struck the East Coast, causing widespread infrastructure damage and economic losses to the greater New York region. The frequency and intensity of these storms presents economic and financial risks to the State. Major disaster response and recovery activities have been ongoing. In January 2013, the Federal government approved approximately $60 billion in Federal disaster aid for general recovery, rebuilding and mitigation activity nationwide, of which New York anticipates receiving $30 billion. The State expects to receive $5.1 billion in extraordinary Federal assistance during FY 2014 specifically for Superstorm Sandy expenses. There can be neither the assurance that all anticipated Federal disaster aid described above will be provided to the State and its affected entities, nor that such Federal disaster aid will be provided on the expected schedule.

CLIMATE CHANGE ADAPTATION

Climate change is expected to cause long-term threats to physical and biological systems. Potential hazards and risks related to climate change for the State include, among other things, rising sea levels, more severe coastal flooding and erosion hazards, and more intense storms. Storms in recent years, including Superstorm Sandy, Hurricane Irene, and Tropical Storm Lee, have demonstrated vulnerabilities in the State's infrastructure, including mass transit systems, power transmission and distribution systems, and other critical lifelines, to extreme weather events, including coastal flooding caused by storm surges. Significant long-term planning and investment by the Federal government, State, and municipalities is expected to be needed to adapt existing infrastructure to the risks posed by climate change.

FINANCIAL CONDITION OF NEW YORK STATE LOCALITIES

The fiscal demands on the State may be affected by the fiscal conditions of New York City and potentially other localities, which rely in part on State aid to balance their budgets and meet their cash requirements. Certain localities outside New York City, including cities, and counties, have experienced financial problems and have requested and received additional State assistance during the last several State fiscal years. For more information, see the section entitled "Authorities and Localities" later in this AIS.

BOND MARKET

Implementation of the Enacted Budget is dependent on the State's ability to market its bonds successfully. The State finances much of its capital spending in the first instance from the General Fund or STIP, which it then reimburses with proceeds from the sale of bonds. If the State cannot sell bonds at the levels (or on the timetable) expected in the capital plan, it can adversely affect the State’s overall cash position and capital funding plan. The success of projected public sales will, among other things, be subject to prevailing market conditions. Future developments in the financial markets generally, as well as future developments concerning the State and public discussion of such developments, may affect the market for outstanding State-supported and State-related debt.

CAPITAL COMMITMENT PLAN AND DEBT REFORM ACT LIMIT

The New York Works Task Force was formed in FY 2013 to assist in the coordination of long-term capital planning among State agencies and public authorities. Consistent with the long-term planning goals of New York Works, the DOB has for the first time formulated 10-year capital commitment and disbursement projections for State agencies. The total commitment and disbursement levels permissible over the 10-year capital planning horizon reflect, among other things, projected capacity under the State's debt limit, anticipated levels of Federal aid, and the timing of capital activity based on known needs and historical patterns.

The Debt Reform Act of 2000 restricts the issuance of State-supported debt to capital purposes only and limits such debt to a maximum term of 30 years. The Act limits the amount of new State-supported debt to 4 percent of State personal income and new State-supported debt service costs to 5 percent of All Funds receipts. The restrictions apply to all new State-supported debt issued since April 1, 2000. The cap on new State-supported debt outstanding began at 0.75 percent of personal income in FY 2001 and was fully phased-in at 4 percent of personal income during FY 2011, while the cap on new State-supported debt service costs began at 0.75 percent of All Funds receipts in FY 2001 and will increase until it is fully phased in at 5 percent during FY 2014. For FY 2012, the last year for which a calculation has been completed, the State was in compliance with the statutory caps based on calendar year 2011 personal income and FY 2012 debt outstanding. The FY 2013 calculation is expected to be completed in October 2013.

Current projections estimate that debt outstanding and debt service will continue to remain below the limits imposed by the Act. Based on the most recent personal income and debt outstanding forecasts, the available room under the debt outstanding cap is expected to decline from $3.6 billion in FY 2013 to $560 million in FY 2016. This includes the estimated impact of the bond-financed portion of increased capital commitment levels included in the 10-year capital planning projections and debt outstanding and debt service caps continue to include the existing SUNY Dormitory Facilities lease revenue bonds, which are backed by a general obligation pledge of SUNY. Going forward, bonds issued under the newly created SUNY Dormitory Facilities Revenue credit will not be included in the State’s calculation of debt caps. Capital spending priorities and debt financing practices may be adjusted from time to time to preserve available debt capacity and stay within the statutory limits, as events warrant.

DEBT OUTSTANDING SUBJECT TO CAP (millions of dollars)								TOTAL STATE-SUPPORTED DEBT (millions of dollars)	
Year	Personal Income	Cap %	Cap $	Debt Outstanding Since April 1, 2000	Remaining Capacity	Debt as a % of PI	Remaining Capacity	Debt Outstanding Prior to April 1, 2000	Supported Debt Outstanding
FY 2013	1,029,227	4.00%	41,169	37,523	3,647	3.65%	0.35%	15,011	52,534
FY 2014	1,053,199	4.00%	42,128	40,432	1,696	3.84%	0.16%	13,661	54,093
FY 2015	1,113,934	4.00%	44,557	43,639	919	3.92%	0.08%	11,940	55,579
FY 2016	1,176,932	4.00%	47,077	46,517	560	3.95%	0.05%	10,560	57,077
FY 2017	1,241,836	4.00%	49,673	48,902	772	3.94%	0.06%	9,019	57,921
FY 2018	1,308,517	4.00%	52,341	50,657	1,683	3.87%	0.13%	7,503	58,161

DEBT SERVICE SUBJECT TO CAP (millions of dollars)								TOTAL STATE-SUPPORTED DEBT SERVICE (millions of dollars)	
Year	All Funds Receipts	Cap %	Cap $	Debt Service Since April 1, 2000	$ Capacity	DS as a % of Revenue	% Capacity	Debt Service Prior to April 1, 2000	Total State-Debt Service
FY 2013	133,174	4.98%	6,637	3,678	2,959	2.76%	2.22%	2,460	6,138
FY 2014	140,405	5.00%	7,020	3,925	3,095	2.80%	2.20%	1,804	5,729
FY 2015	143,404	5.00%	7,170	4,211	2,960	2.94%	2.06%	1,881	6,091
FY 2016	148,146	5.00%	7,407	4,594	2,813	3.10%	1.90%	1,859	6,453
FY 2017	154,031	5.00%	7,702	4,988	2,713	3.24%	1.76%	1,766	6,754
FY 2018	156,302	5.00%	7,815	5,328	2,487	3.41%	1.59%	1,711	7,039

DEBT FINANCING CHANGES

SALES TAX REVENUE BOND PROGRAM

Legislation enacted with the FY 2014 Enacted Budget creates a new Sales Tax Revenue Bond Program. The legislation creates the Sales Tax Revenue Bond Tax Fund, a sub-fund within the General Debt Service Fund that will provide for the payment of these bonds. The new Sales Tax Revenue Bonds will be secured by the pledge of payments from this fund, which will receive 1 percent of the State's 4 percent sales and use tax receipts. With a limited exception, upon the satisfaction of all of the obligations and liabilities of LGAC, the amount of sales tax receipts directed to this fund will increase to 2 percent. Tax receipts in excess of debt service requirements will be transferred to the State’s General Fund.

DOB expects the first Sales Tax Revenue Bond issue to close in the third quarter of FY 2014 and that the Sales Tax Revenue Bonds will be used interchangeably with PIT bonds to finance most of the State capital needs. Based on current projections and anticipated coverage requirements, the State expects to issue about $1 billion of Sales Tax Revenue Bonds annually.

SUNY DORMITORY FACILITIES REVENUE BOND PROGRAM

Legislation included in the FY 2014 Enacted Budget creates a new bonding program for SUNY Dormitory Facilities. The new bonding program will be supported solely by third party revenues generated by student rents. All rental revenues will flow to the newly created Dormitory Facilities Revenue Fund held by the Commissioner of Taxation and Finance and owned by DASNY for the payment of debt service without an appropriation. Unlike the existing program, the new program will not include a SUNY general obligation pledge, thereby eliminating any recourse to the State. Accordingly, such bonds will not be classified as State-supported debt for purposes of the Debt Reform Act. It is expected that future SUNY Dormitory Facilities capital needs will be funded through the new credit. Under this legislation, the existing SUNY Dormitory Facilities lease revenue bonds and associated debt service will continue to be counted as State-supported debt until they are refunded into the new program or are paid off at maturity.

SECURED HOSPITAL PROGRAM

Under the Secured Hospital Program, the State entered into service contracts to enable certain financially distressed not-for-profit hospitals to have tax-exempt debt issued on their behalf to pay for the cost of upgrading their primary health care facilities. In the event of shortfalls in revenues to pay debt service on the Secured Hospital bonds (which include hospital payments made under loan agreements between DASNY and the hospitals and certain reserve funds held by the applicable trustees for the bonds) the service contracts obligate the State to pay debt service, subject to annual appropriations by the Legislature, on bonds issued by the New York State Medical Care Facilities Financing Agency (MCFFA) and by the Dormitory Authority of the State of New York (DASNY) through the Secured Hospital Program. . As of March 31, 2013, there was approximately $421 million of bonds outstanding for this program.

The financial condition of hospitals in the State's Secured Hospital Program continues to deteriorate. Of the six remaining hospitals in the program, two are experiencing significant operating losses that have impaired their ability to remain current on their loan agreements with DASNY. In relation to the Secured Hospital Program, the State plans to pay debt service costs of $13 million in FY 2014, approximately $30 million annually for FY 2015 through FY 2017, and $17 million in FY 2018. These amounts are based on the actual experience to date of the participants in the program, and would cover the debt service costs for two hospitals that currently are not meeting the terms of their legal agreements with DASNY, as well as the debt service costs of a third hospital that is now closed. The State has estimated additional exposure of up to $44 million annually, if all hospitals in the program failed to meet the terms of their agreement with DASNY and if available reserve funds were depleted.

SUNY DOWNSTATE HOSPITAL

To address the deteriorating financial condition of SUNY Downstate Hospital, legislation included in the FY 2014 Enacted Budget required the Chancellor of SUNY to submit to the Governor and the Legislature a sustainability plan for the Downstate Hospital on or before June 1, 2013, and upon approval by both the Commissioner of Health and the Director of Budget, for the Chancellor of SUNY to initiate implementation of such plan by June 15, 2013. Specifically, the legislation required the sustainability plan to: 1) set forth recommendations necessary to achieve financial stability for Downstate Hospital, and 2) preserve the academic mission of Downstate Hospital's medical school. In accordance with this legislation, the Chancellor of SUNY submitted a sustainability plan for Downstate Hospital on May 31, 2013, and supplemented the plan with changes in a letter dated June 13, 2013. The supplemented plan was approved by both the Commissioner of Health and the Director of the Budget on June 13, 2013. As part of the approved sustainability plan, State financial assistance will be made available based on the implementation of specific initiatives necessary to achieve the financial milestones included in the sustainability plan**.**

2013 LEGISLATIVE SESSION

The State's 2013 legislative session is expected to end on June 20, 2013. Impacts to the State's financial plan from end-of-session legislative activity are not expected to result in material and adverse differences to the estimates for the current fiscal year contained in this AIS. However, certain tax law changes under consideration related to the creation of "tax-free zones", if enacted, would likely reduce anticipated revenue growth starting in FY 2015. The potential loss in tax receipts in future years will depend on the final provisions and implementation of the legislation. DOB expects to update its multi-year projections of receipts and disbursements with the first quarterly update to the AIS to reflect the fiscal impact, if any, of all legislation enacted in the remainder of the session.

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STATE FINANCIAL PLAN PROJECTIONS
FISCAL YEARS 2014 THROUGH 2017

INTRODUCTION

This section presents the State's updated multi-year Financial Plan projections for receipts and disbursements, reflecting the impact of the FY 2014 Enacted Budget actions. The section includes preliminary FY 2013 results and projections for FY 2014 through FY 2017, with an emphasis on the FY 2014 projections.

The State's cash-basis budgeting system, complex fund structure, and practice of earmarking certain tax receipts for specific purposes complicates the discussion of the State's receipts and disbursement projections. Therefore, to minimize the distortions caused by these factors and, equally important, to highlight relevant aspects of the projections, DOB has adopted the following approaches in summarizing the projections:

- **Receipts:** The detailed discussion of tax receipts covers projections for both the General Fund and State Funds (including capital projects). The latter perspective reflects overall estimated tax receipts before their diversion among various funds and accounts, including tax receipts dedicated to capital projects funds (which fall outside of the General Fund and State Operating Funds accounting perspectives). DOB believes this presentation provides a clearer picture of projected receipts, trends and forecast assumptions, by factoring out the distorting effects of earmarking certain tax receipts.

- **Disbursements:** Over 40 percent of projected State-financed spending for operating purposes is accounted for outside of the General Fund and is primarily concentrated in the areas of health care, School Aid, higher education, transportation and mental hygiene. To provide a clearer picture of spending commitments, the multi-year projections and growth rates are presented, where appropriate, on both a General Fund and State Operating Funds basis.

In evaluating the State's multi-year operating forecast, it should be noted that the reliability of the estimates and projections as a predictor of the State's future financial position is likely to diminish the further removed such estimates and projections are from the date of this AIS. Accordingly, in terms of the outyear projections, the first outyear of the FY 2014 budget, FY 2015, is the most relevant from a planning perspective.

SUMMARY

DOB estimates that the Enacted Budget provides for a balanced General Fund Financial Plan in FY 2014 and leaves projected budget gaps that total approximately $2.0 billion in FY 2015, $2.9 billion in FY 2016, and $2.9 billion in FY 2017. The net operating shortfalls in State Operating Funds is projected at $2.0 billion in FY 2015, $2.7 billion in FY 2016 and $2.6 billion in FY 2017.

The annual budget gaps projected for the General Fund and State Operating Funds in future years are similar because the General Fund is the financing source of last resort for many State programs. Budget gaps in other funds are typically financed by the General Fund.

STATE FINANCIAL PLAN PROJECTIONS FISCAL YEARS 2014 THROUGH 2017

The following tables present the multi-year projections for the General Fund and State Operating Funds, as well as reconciliation between the State Operating Funds projections and the General Fund budget gaps. The tables are followed by a summary of the multi-year receipts and disbursements forecasts.

GENERAL FUND PROJECTIONS

GENERAL FUND PROJECTIONS
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Receipts					
Taxes (After Debt Service)	54,568	57,292	58,569	62,182	65,328
Miscellaneous Receipts/Federal Grants	3,566	3,098	3,551	2,682	2,653
Other Transfers	649	866	764	719	722
Total Receipts	**58,783**	**61,256**	**62,884**	**65,583**	**68,703**
Disbursements					
Local Assistance Grants	39,760	40,258	42,598	45,056	47,276
School Aid	17,110	17,290	18,573	19,390	20,519
Medicaid	11,109	11,225	11,391	12,136	12,631
All Other	11,541	11,743	12,634	13,530	14,126
State Operations	7,856	7,564	7,818	8,116	8,213
Personal Service	6,130	5,681	5,850	6,111	6,127
Non-Personal Service	1,726	1,883	1,968	2,005	2,086
General State Charges	4,550	4,953	5,328	5,604	5,873
Transfers to Other Funds	6,794	8,382	9,179	9,682	10,247
Debt Service	1,647	1,328	1,483	1,452	1,345
Capital Projects	916	1,227	1,384	1,400	1,799
Mental Hygiene State Share Medicaid	2,846	1,813	1,338	1,311	1,279
SUNY Operations	340	971	971	971	971
All Other	1,045	3,043	4,003	4,548	4,853
Total Disbursements	**58,960**	**61,157**	**64,923**	**68,458**	**71,609**
Change in Reserves	**(177)**	**99**	**(25)**	**(19)**	**14**
Prior-Year Labor Agreements (2007-11)	(206)	(26)	10	14	14
Community Projects Fund	(9)	(25)	(35)	(33)	0
Debt Management	0	250	0	0	0
Undesignated Fund Balance	38	(100)	0	0	0
Budget Surplus/(Gap) Projections	**0**	**0**	**(2,014)**	**(2,856)**	**(2,920)**

STATE OPERATING FUNDS PROJECTIONS

STATE OPERATING FUNDS PROJECTIONS
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Receipts					
Taxes	64,932	67,951	69,765	74,014	77,722
Miscellaneous Receipts/Federal Grants	20,142	19,299	20,329	19,437	19,576
Total Receipts	**85,074**	**87,250**	**90,094**	**93,451**	**97,298**
Disbursements					
Local Assistance Grants	58,578	59,564	62,218	64,871	67,288
School Aid	20,163	20,471	21,692	22,514	23,641
STAR	3,286	3,419	3,602	3,704	3,805
Other Education Aid	1,927	2,032	2,091	2,197	2,328
Higher Education	2,629	2,825	2,911	2,994	3,066
Medicaid[1]	15,879	16,230	16,780	17,591	18,248
Public Health/Aging	2,040	2,222	1,997	1,989	1,960
Mental Hygiene	3,602	2,833	3,450	3,967	4,173
Social Services	3,031	2,996	3,050	3,146	3,242
Transportation	4,303	4,745	4,831	4,910	4,995
Local Government Assistance	754	764	769	782	794
All Other	964	1,027	1,045	1,077	1,036
State Operations	17,683	17,824	18,246	18,846	19,155
Personal Service	12,403	12,357	12,637	13,071	13,204
Non-Personal Service	5,280	5,467	5,609	5,775	5,951
General State Charges	6,437	7,089	7,531	7,952	8,285
Pension Contribution	1,601	2,013	2,256	2,418	2,446
Health Insurance (Active Employees)	1,720	1,824	1,945	2,060	2,232
Health Insurance (Retired Employees)	1,409	1,491	1,531	1,651	1,788
All Other	1,707	1,761	1,799	1,823	1,819
Debt Service	6,138	5,743	6,123	6,482	6,783
Capital Projects	8	5	5	5	5
Total Disbursements	**88,844**	**90,225**	**94,123**	**98,156**	**101,516**
Net Other Financing Sources/(Uses)	4,283	2,885	2,080	2,028	1,601
Net Operating Surplus/(Deficit)	**513**	**(90)**	**(1,949)**	**(2,677)**	**(2,617)**
Reconciliation to General Fund Gap:					
Designated Fund Balances:	(513)	90	(65)	(179)	(303)
General Fund	177	(99)	25	19	(14)
Special Revenue Funds	(737)	248	(96)	(205)	(268)
Debt Service Funds	47	(59)	6	7	(21)
General Fund Budget Gap	**0**	**0**	**(2,014)**	**(2,856)**	**(2,920)**

[1] This value does not include HCRA Indigent Care payments to SUNY institutions, which have been reclassified as transfers for reporting purposes.

RECEIPTS

Financial Plan receipts comprise a variety of taxes, fees, and charges for State-provided services, Federal grants, and other miscellaneous receipts. The receipts estimates and projections have been prepared by DOB on a multi-year basis with the assistance of the Department of Taxation and Finance and other agencies responsible for the collection of State receipts. Where noted, certain tables in the following section display General Fund tax receipts that exclude amounts transferred to the General Fund in excess of amounts needed for certain debt service obligations (e.g., personal income tax receipts in excess of the amount transferred for debt service on revenue bonds). For a detailed description of revenue sources, see “Exhibit D - Principal State Taxes and Fees” herein.

OVERVIEW OF THE RECEIPTS FORECAST

- New York’s economic recovery continued in FY 2013, with all major tax groups registering gains compared with the prior year. Personal income tax payments grew stronger during the final quarter of the fiscal year, mainly as the result of anticipated Federal tax law changes. Sales tax receipts increased by one percent (despite the full return of the clothing exemption), business tax receipts registered another large annual gain, and other tax receipts benefitted from real estate gains taken in advance of Federal tax law changes which took effect in 2013. Continuing economic growth is expected to yield a fourth consecutive year of growth in receipts during FY 2014.

- After climbing 7.7 percent in FY 2012, base receipts adjusted for tax law changes grew by 5.8 percent in FY 2013 and are expected to increase by 4.6 percent in FY 2014.

- Corporate profits are expected to record a fifth consecutive year of growth in calendar year 2013, albeit at a slower rate when compared to the growth rates of recent years.

- After accounting for law changes, consumer and business spending on taxable goods and services rose for the third consecutive year in FY 2013, growing 3.2 percent, and is estimated to rise 3.1 percent in FY 2014.

- Personal income tax liability growth is expected to slow in tax year 2013. Capital gains, dividend payouts, and wage shifting taken in advance of Federal tax rate hikes artificially inflated tax year 2012 liability growth. These liability components are expected to grow more slowly, or even decline in tax year 2013.

- Significant risks or uncertainties, such as budget disputes at the Federal level or an energy price shock or a natural disaster, could impact economic growth, and therefore receipts growth, in FY 2014.

All Funds receipts are projected to total $140.4 billion, an increase of $7.2 billion (5.4 percent) from FY 2013 results. The table below summarizes the receipts projections for FY 2014 and FY 2015.

TOTAL RECEIPTS
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Annual $ Change	Annual % Change	FY 2015 Projected	Annual $ Change	Annual % Change
General Fund	**58,783**	**61,256**	**2,473**	**4.2%**	**62,884**	**1,628**	**2.7%**
Taxes	43,283	42,480	(803)	-1.9%	43,235	755	1.8%
Miscellaneous Receipts	3,504	3,096	(408)	-11.6%	3,551	455	14.7%
Federal Grants	62	2	(60)	-96.8%	0	(2)	-100.0%
Transfers	11,934	15,678	3,744	31.4%	16,098	420	2.7%
State Funds	**90,304**	**92,866**	**2,562**	**2.8%**	**96,035**	**3,169**	**3.4%**
Taxes	66,302	69,351	3,049	4.6%	71,194	1,843	2.7%
Miscellaneous Receipts	23,838	23,435	(403)	-1.7%	24,763	1,328	5.7%
Federal Grants	164	80	(84)	-51.2%	78	(2)	-2.5%
All Funds	**133,177**	**140,405**	**7,228**	**5.4%**	**143,405**	**3,000**	**2.1%**
Taxes	66,302	69,351	3,049	4.6%	71,194	1,843	2.7%
Miscellaneous Receipts	24,036	23,621	(415)	-1.7%	24,949	1,328	5.6%
Federal Grants	42,839	47,433	4,594	10.7%	47,262	(171)	-0.4%

This change in taxes and transfers reflects an Enacted Budget accounting change that will first deposit 25 percent of sales tax receipts that were formerly directed to the General Fund into the new Sales Tax Revenue Bond Fund. The balance will be transferred to the General Fund after the payment of debt service.

Base growth of 4.6 percent in tax receipts is estimated for FY 2014, after adjusting for law changes, and is projected to be 4.8 percent in FY 2015. These projected increases in overall base growth in tax receipts are dependent on many factors:

- Continued growth in a broad range of economic activities;
- Improving profitability and moderate wage growth;
- Recovery in the real estate market, particularly the residential market; and
- Increases in consumer spending as a result of wage and employment gains.

PERSONAL INCOME TAX

PERSONAL INCOME TAX
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
General Fund[1]	**26,884**	**28,488**	**6.0%**	**29,423**	**3.3%**	**31,541**	**7.2%**	**33,619**	**6.6%**
Gross Collections	47,443	50,421	6.3%	52,637	4.4%	56,208	6.8%	59,553	6.0%
Refunds[2]	(7,216)	(7,878)	9.2%	(8,603)	9.2%	(9,215)	7.1%	(9,654)	4.8%
STAR	(3,286)	(3,419)	4.0%	(3,602)	5.4%	(3,704)	2.8%	(3,805)	2.7%
RBTF	(10,057)	(10,636)	5.8%	(11,009)	3.5%	(11,748)	6.7%	(12,475)	6.2%
State Funds	**40,227**	**42,543**	**5.8%**	**44,034**	**3.5%**	**46,993**	**6.7%**	**49,899**	**6.2%**
Gross Collections	47,443	50,421	6.3%	52,637	4.4%	56,208	6.8%	59,553	6.0%
Refunds[2]	(7,216)	(7,878)	9.2%	(8,603)	9.2%	(9,215)	7.1%	(9,654)	4.8%

[1] Excludes Transfers.

[2] FY 2013 results reflect DOB inclusion of the State-City offset in the "Refunds" category.

State Funds PIT receipts for FY 2014 are projected to be $42.5 billion, an increase of $2.3 billion (5.8 percent) from FY 2013. This primarily reflects increases in withholding and extension payments attributable to the 2012 tax year, partially offset by an increase in total refunds and a decline in 2013 estimated payments.

General Fund income tax receipts are net of deposits to the STAR Fund, which provides property tax relief, and the RBTF, which supports debt service payments on State Personal Income Tax Revenue Bonds. General Fund income tax receipts for FY 2014 of $28.5 billion are expected to increase by $1.6 billion (6 percent) from the prior year, mainly reflecting the increase in All Funds receipts noted above. RBTF deposits are projected to be $10.6 billion and the STAR transfer is projected to be $3.4 billion.

State Funds income tax receipts for FY 2015 of $44 billion are projected to increase $1.5 billion (3.5 percent) from the prior year. This primarily reflects increases of $2.3 billion (7.1 percent) in withholding and $1.4 billion (16.4 percent) in estimated payments related to tax year 2014, partially offset by a decline of $1.6 billion (30.5 percent) in extension payments related to tax year 2013 and a $725 million (9.2 percent) increase in total refunds.

General Fund income tax receipts for FY 2015 of $29.4 billion are projected to increase by $935 million (3.3 percent) from the prior year. RBTF deposits are projected to be $11 billion, and the STAR transfer is projected to be $3.6 billion.

State Funds income tax receipts of $47 billion in FY 2016 are projected to increase $3 billion (6.7 percent) from the prior year. Gross receipts are projected to increase 6.8 percent and reflect withholding that is projected to grow by $2.3 billion (6.6 percent) and estimated payments related to tax year 2015 that are projected to grow by $820 million (8.1 percent). The aforementioned three-year extension of the December 2011 income tax reform contributes $893 million to the projected withholding increase and $1.1 billion to the projected increase in estimated payments. Payments from extensions for tax year 2014 are projected to increase by $278 million (7.8 percent) and final returns are expected to increase $100 million (4.6 percent). Delinquencies are projected to increase $40 million (3.2 percent) from the prior year. Total refunds are projected to increase by $612 million (7.1 percent) from the prior year.

General Fund income tax receipts for FY 2016 of $31.5 billion are projected to increase by $2.1 billion (7.2 percent) from the prior year.

State Funds income tax receipts are projected to increase by $2.9 billion (6.2 percent) in FY 2017 to reach $49.9 billion, while General Fund receipts are projected to be $33.6 billion.

USER TAXES AND FEES

USER TAXES AND FEES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
General Fund[1]	**9,112**	**6,548**	**-28.1%**	**6,814**	**4.1%**	**7,094**	**4.1%**	**7,275**	**2.6%**
Sales Tax	8,423	5,866	-30.4%	6,133	4.6%	6,415	4.6%	6,599	2.9%
Cigarette and Tobacco Taxes	443	431	-2.7%	425	-1.4%	418	-1.6%	410	-1.9%
Alcoholic Beverage Taxes	246	251	2.0%	256	2.0%	261	2.0%	266	1.9%
State Funds	**14,615**	**15,116**	**3.4%**	**15,689**	**3.8%**	**16,275**	**3.7%**	**16,640**	**2.2%**
Sales Tax	11,989	12,530	4.5%	13,101	4.6%	13,695	4.5%	14,085	2.8%
Cigarette and Tobacco Taxes	1,551	1,491	-3.9%	1,466	-1.7%	1,436	-2.0%	1,405	-2.2%
Motor Fuel Tax	492	500	1.6%	504	0.8%	507	0.6%	510	0.6%
Highway Use Tax	145	140	-3.4%	143	2.1%	151	5.6%	149	-1.3%
Alcoholic Beverage Taxes	246	251	2.0%	256	2.0%	261	2.0%	266	1.9%
Taxicab Surcharge	83	90	8.4%	100	11.1%	101	1.0%	101	0.0%
Auto Rental Tax	109	114	4.6%	119	4.4%	124	4.2%	124	0.0%

[1] Excludes Transfers.

State Funds user taxes and fees receipts for FY 2014 are estimated to be $15.1 billion, an increase of $501 million (3.4 percent) from FY 2013. Sales tax receipts are expected to increase by $541 million (4.5 percent) from the prior year as the result of base growth (i.e., absent law changes) of 3.1 percent (due in part to strong vehicle sales) and the impact of new enforcement initiatives. Cigarette and tobacco collections are estimated to decline by $60 million (3.9 percent), primarily reflecting trend declines and a continuation of reductions in tax stamp sales, particularly in NYC.

General Fund user taxes and fees receipts for FY 2014 are estimated to total $6.5 billion in FY 2014, a decrease of nearly $2.6 billion (28.1 percent) from FY 2013. This decrease reflects an Enacted Budget accounting change that will first deposit 25 percent of sales tax receipts that were formerly directed to the General Fund into the new Sales Tax Revenue Bond Fund. The balance will be transferred to the General Fund after the payment of debt service. Absent this redistribution, General Fund sales tax receipts are estimated to increase by $378 million (4.5 percent) from the prior year. Also, there is an estimated decline in cigarette and tobacco collections of $12 million (2.7 percent) from FY 2013.

State Funds user taxes and fee receipts for FY 2015 are projected to be $15.7 billion, an increase of $573 million (3.8 percent) from FY 2014. The increase in sales tax receipts of $571 million (4.6 percent) reflects sales tax base growth of 4.4 percent due to expected increased consumer activity based on strong projected disposable income growth. Cigarette and tobacco tax receipts are projected to decline by $25 million (1.7 percent).

General Fund user taxes and fees receipts are projected to total $6.8 billion in FY 2015, an increase of $266 million (4.1 percent) from FY 2014. This increase largely reflects the projected increase in State Funds sales tax receipts discussed above.

State Funds user taxes and fees are projected to be $16.3 billion in FY 2016 and $16.6 billion in FY 2017, representing increases of $586 million (3.7 percent) and $365 million (2.2 percent), respectively, from the prior year. These increases represent base growth in sales tax receipts, offset slightly by trend declines in cigarette tax collections.

BUSINESS TAXES

BUSINESS TAXES
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
General Fund	**6,253**	**6,375**	**2.0%**	**5,854**	**-8.2%**	**6,349**	**8.5%**	**6,579**	**3.6%**
Corporate Franchise Tax	2,624	2,934	11.8%	2,237	-23.8%	2,595	16.0%	2,721	4.9%
Corporation and Utilities Tax	686	603	-12.1%	646	7.1%	662	2.5%	678	2.4%
Insurance Tax	1,346	1,418	5.3%	1,468	3.5%	1,523	3.7%	1,540	1.1%
Bank Tax	1,597	1,420	-11.1%	1,503	5.8%	1,569	4.4%	1,640	4.5%
State Funds	**8,465**	**8,638**	**2.0%**	**8,195**	**-5.1%**	**8,750**	**6.8%**	**9,046**	**3.4%**
Corporate Franchise Tax	3,009	3,379	12.3%	2,704	-20.0%	3,085	14.1%	3,234	4.8%
Corporation and Utilities Tax	895	788	-12.0%	833	5.7%	854	2.5%	881	3.2%
Insurance Tax	1,509	1,587	5.2%	1,644	3.6%	1,706	3.8%	1,730	1.4%
Bank Tax	1,912	1,694	-11.4%	1,789	5.6%	1,870	4.5%	1,956	4.6%
Petroleum Business Tax	1,140	1,190	4.4%	1,225	2.9%	1,235	0.8%	1,245	0.8%

State Funds business tax receipts for FY 2014 are estimated at $8.6 billion, an increase of $173 million (2 percent) from the prior year. The estimate reflects growth across all taxes except the corporate utilities tax and bank tax. Growth in corporate franchise, insurance, and petroleum business tax receipts reflect a continuation of growth seen in FY 2013. Corporation and utilities tax receipts are expected to decline in FY 2014, and the extraordinary FY 2013 growth in bank tax receipts is not expected to continue in FY 2014.

General Fund business tax receipts for FY 2014 of $6.4 billion are estimated to increase by $122 million (2 percent) from FY 2013 results. Business tax receipts deposited to the General Fund reflect the All Funds trends discussed above.

State Funds business tax receipts for FY 2015 of $8.2 billion are projected to decrease $443 million (5.1 percent) from the prior year. This decrease primarily reflects the first year of the repayment of deferred tax credits to taxpayers. Excluding this payback, FY 2015 receipts would show virtually no change from FY 2014.

General Fund business tax receipts for FY 2015 of $5.9 billion are projected to decrease $521 million (8.2 percent) from the prior year for the reasons cited above.

State Funds business tax receipts for FY 2016 and FY 2017 reflect projected trends in corporate profits, taxable insurance premiums, electric utility consumption and prices, the consumption of taxable telecommunications services, and automobile fuel consumption and fuel prices. State Funds business tax receipts are projected to increase to $8.8 billion (6.8 percent) in FY 2016, and increase to $9 billion (3.4 percent) in FY 2017. General Fund business tax receipts are expected to increase to $6.3 billion (8.5 percent) in FY 2016 and increase to $6.6 billion (3.6 percent) in FY 2017.

OTHER TAXES

OTHER TAXES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
General Fund[1]	**1,034**	**1,069**	**3.4%**	**1,144**	**7.0%**	**1,159**	**1.3%**	**1,169**	**0.9%**
Estate Tax	1,014	1,050	3.6%	1,125	7.1%	1,140	1.3%	1,150	0.9%
Gift Tax	1	0	N/A	0	N/A	0	N/A	0	N/A
Pari-Mutuel Taxes	18	18	0.0%	18	0.0%	18	0.0%	18	0.0%
All Other Taxes	1	1	0.0%	1	0.0%	1	0.0%	1	0.0%
State Funds	**1,790**	**1,809**	**1.1%**	**1,954**	**8.0%**	**2,044**	**4.6%**	**2,109**	**3.2%**
Estate Tax	1,014	1,050	**3.6%**	1,125	7.1%	1,140	1.3%	1,150	0.9%
Gift Tax	1	0	N/A	0	N/A	0	N/A	0	N/A
Real Estate Transfer Tax	756	740	-2.1%	810	9.5%	885	9.3%	940	6.2%
Pari-Mutuel Taxes	18	18	0.0%	18	0.0%	18	0.0%	18	0.0%
All Other Taxes	1	1	0.0%	1	0.0%	1	0.0%	1	0.0%

[1] Excludes Transfers.

State Funds other tax receipts for FY 2014 are estimated to be $1.8 billion, an increase of $19 million (1.1 percent) from FY 2013. This mainly reflects an increase of $36 million (3.6 percent) in estate tax receipts, partially offset by a decline of $16 million (2.1 percent) in real estate transfer tax receipts. The estate tax increase is the result of an expected return in FY 2014 to a number of super-large estate payments (payments of over $25 million) consistent with long-term trends. The FY 2014 real estate transfer tax estimate reflects the spin-up of money from FY 2013 into FY 2014 caused by the uncertainty surrounding the fiscal cliff negotiations, which more than offsets improvements in FY 2014 market pricing.

General Fund other tax receipts are expected to be nearly $1.1 billion in FY 2014, an increase of $35 million (3.4 percent) from FY 2013. This reflects the change in estate tax receipts mentioned above.

State Funds other tax receipts for FY 2015 are projected to be just under $2 billion, an increase of $145 million (8 percent) from FY 2014. This reflects strong projected growth in both the real estate transfer and estate taxes.

General Fund other tax receipts are expected to total more than $1.1 billion in FY 2015. This reflects an increase of $75 million (7.1 percent) in estate tax receipts from the prior year due to a projected increase in household net worth.

The FY 2016 State Funds receipts projection for other taxes is over $2 billion, an increase of $90 million (4.6 percent) from FY 2015. Growth in the estate tax is projected to follow forecast increases in household net worth. Receipts from the real estate transfer tax are also projected to increase, reflecting continuing growth in the residential and commercial real estate markets.

The FY 2017 State Funds receipts projection for other taxes is $2.1 billion, an increase of $65 million (3.2 percent) from FY 2016. Moderate growth is projected in estate tax collections, following forecast increases in household net worth. Real estate transfer tax collections are projected to grow as a result of increases in the value of real property transfers.

General Fund other tax receipts for FY 2016 are projected to grow by $15 million (1.3 percent) entirely due to the modest growth in the estate tax noted above. General Fund other tax receipts for FY 2017 are projected to increase by $10 million (0.9 percent), also due to the small estate tax growth noted above.

MISCELLANEOUS RECEIPTS AND FEDERAL GRANTS

MISCELLANEOUS RECEIPTS AND FEDERAL GRANTS
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
General Fund	**3,566**	**3,098**	**-13.1%**	**3,551**	**14.6%**	**2,682**	**-24.5%**	**2,653**	**-1.1%**
Miscellaneous Receipts	3,504	3,096	-11.6%	3,551	14.7%	2,682	-24.5%	2,653	-1.1%
Federal Grants	62	2	-96.8%	0	-100.0%	0	N/A	0	N/A
State Funds	**24,002**	**23,515**	**-2.0%**	**24,841**	**5.6%**	**24,332**	**-2.0%**	**23,780**	**-2.3%**
Miscellaneous Receipts	23,838	23,435	-1.7%	24,763	5.7%	24,254	-2.1%	23,702	-2.3%
Federal Grants	164	80	-51.2%	78	-2.5%	78	0.0%	78	0.0%
All Funds	**66,875**	**71,054**	**6.2%**	**72,211**	**1.6%**	**72,682**	**0.7%**	**74,853**	**3.0%**
Miscellaneous Receipts	24,036	23,621	-1.7%	24,949	5.6%	24,440	-2.0%	23,888	-2.3%
Federal Grants	42,839	47,433	10.7%	47,262	-0.4%	48,242	2.1%	50,965	5.6%

All Funds miscellaneous receipts include moneys received from HCRA financing sources, SUNY tuition and patient income, lottery receipts for education, assessments on regulated industries, and a variety of fees and licenses. All Funds miscellaneous receipts are projected to total $23.6 billion in FY 2014, a decrease of $415 million from FY 2013. The General Fund component of the All Funds miscellaneous receipts represent $3.1 billion in FY 2014, a decrease of $408 million from FY 2013 results, largely due to the one-time receipt during FY 2013 of $340 million as part of a settlement between DFS and Standard Chartered Bank, and lower motor vehicle fee receipts due to the cyclical nature of eight-year license renewals. Significant changes outside of the General Fund include projected increases in HCRA, SUNY income, and growth in bond proceeds funding for several capital improvement projects, offset by a decline in debt service receipts that is largely associated with the restructuring of the SUNY Dormitory bonding program which removes associated receipts from the State's All Governmental Funds budget.

Federal grants help pay for State spending on Medicaid, temporary and disability assistance, mental hygiene, School Aid, public health, and other activities. Annual changes to Federal grants generally correspond to changes in Federally-reimbursed spending. Accordingly, DOB typically plans for Federal reimbursement to be received in the State fiscal year in which spending occurs, but timing sometimes varies. All Funds Federal grants are projected to total $47.4 billion in FY 2014, an increase of $4.6 billion from FY 2013, driven primarily by additional Federal funding for disaster assistance costs, as well as the annual impact of increased Federal spending associated with the ACA.

All Funds miscellaneous receipts are projected to increase by $1.3 billion in FY 2015, the General Fund component of which is $455 million and primarily reflects new resources from the planned transfer of $500 million from the SIF release related to Workers' Compensation changes. Other projected State fund increases to miscellaneous receipts include bond proceeds for capital projects, HCRA, debt service, and SUNY income from tuition revenues.

All Funds Federal grants are projected to decrease by $171 million in FY 2015, driven primarily by the timing of Federal disaster assistance costs, the majority of which is expected to be disbursed during FY 2014.

All Funds miscellaneous receipts decrease by $509 million in FY 2016, driven by the decline in General Fund resources transferred from SIF, partially offset by a projected increase in miscellaneous receipts from bond proceeds available to fund capital improvement projects. All Funds miscellaneous receipts decrease by $552 million in FY 2017, driven by a projected decrease in miscellaneous receipts for capital projects, partially offset by increases in SUNY income and HCRA revenue collections.

Annual Federal grants growth of $980 million in FY 2016 and $2.7 billion in FY 2017 is primarily due to growth in Medicaid spending, reflecting the continued impact of spending associated with the ACA.

DISBURSEMENTS

General Fund disbursements in FY 2014 are estimated to total $61.2 billion, an increase of $2.2 billion (3.7 percent) over preliminary FY 2013 results. State Operating Funds disbursements for FY 2014 are estimated to total $90.2 billion, an increase of $1.4 billion (1.6 percent) over preliminary FY 2013 results.

The multi-year disbursements projections take into account agency staffing levels, program caseloads, funding formulas contained in State and Federal law, inflation and other factors. Factors that affect spending estimates vary by program. For example, public assistance spending is based primarily on anticipated caseloads that are estimated by analyzing historical trends and projected economic conditions. Projections account for the timing of payments, since not all of the amounts appropriated in the Budget are disbursed in the same fiscal year. Consistent with past years, the aggregate spending projections (i.e., the sum of all projected spending by individual agencies) in Special Revenue Funds have been adjusted downward in all fiscal years based on typical spending patterns and the observed variance between estimated and actual results over time.

Total disbursements in FY 2014 are estimated at $61.2 billion in the General Fund and $90.2 billion in State Operating Funds. Over the multi-year Financial Plan, State Operating Funds spending projections assume Medicaid and School Aid will grow at their statutorily-indexed rates. The projections do not reflect any potential impact of automatic Federal spending reductions that were triggered on March 1, 2013, most of which is “pass-through” aid.

Medicaid, education, pension costs, employee and retiree health benefits, and debt service are significant drivers of annual spending growth.

LOCAL ASSISTANCE GRANTS

Local Assistance spending includes payments to local governments, school districts, health care providers, and other entities, as well as financial assistance to, or on behalf of, individuals, families and not-for-profit organizations. State-funded local assistance spending is estimated at $59.6 billion in FY 2014 and accounts for over 65 percent of total State Operating Funds spending. Education and health care spending account for three-quarters of local assistance spending.

Selected assumptions used by DOB in preparing the spending projections for the State's major programs and activities are summarized in the following tables.

FORECAST FOR SELECTED PROGRAM MEASURES AFFECTING OPERATING ACTIVITIES

		Forecast			
	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Medicaid					
Medicaid Caseload	4,812,715	5,176,084	6,110,639	6,169,418	6,198,080
- Family Health Plus Caseload	446,259	467,246	0	0	0
- Child Health Plus Caseload	344,000	356,000	368,000	380,000	392,000
State Takeover of County/NYC Costs	$1,613	$1,690	$1,665	$1,800	$2,168
- Family Health Plus	$477	$528	$219	$0	$0
- Medicaid	$1,136	$1,162	$1,446	$1,800	$2,168
Education					
School Aid (School Year)	$20,236	$21,228	$21,950	$22,784	$24,037
Education Growth	3.0	4.9	3.4	3.8	5.5
Higher Education					
Public Higher Education Enrollment (FTEs)	567,473	566,707	565,941	565,078	564,880
Tuition Assistance Program Recipients	309,921	310,065	310,065	310,065	310,065
Public Assistance Caseloads					
Family Assistance Program	256,566	249,528	243,345	238,262	233,706
Safety Net Program - Families	122,368	118,706	115,450	112,747	110,279
Safety Net Program - Singles	187,254	185,777	184,815	184,361	184,385
Mental Hygiene					
Total Mental Hygiene Community Beds	90,394	92,977	97,514	100,245	102,239
- OMH Community Beds	38,778	40,707	44,644	46,778	48,222
- OPWDD Community Beds	39,536	40,091	40,621	41,121	41,621
- OASAS Community Beds	12,080	12,179	12,249	12,346	12,396
Prison Population (Corrections)	54,617	54,300	54,000	53,800	53,700

Note: Dollar amounts in table are in millions. FY 2013 results are preliminary and are subject to revision.

EDUCATION

SCHOOL AID

School Aid helps support elementary and secondary education for New York pupils enrolled in 676 major school districts throughout the State. State funding is provided to districts based on statutory aid formulas and through reimbursement of categorical expenses. State funding for schools assists districts in meeting locally defined needs, supports the construction of school facilities, and finances school transportation for nearly three million students statewide.

SCHOOL YEAR (JULY 1 -JUNE 30)

School Aid will increase by $992 million in 2013-14 school year, a 4.9 percent increase from 2012-13 school year[4]. In addition, $75 million of competitive grant funding is provided for several key initiatives recommended by the *New* NY Education Reform Commission in its Preliminary Report to the Governor, including pre-kindergarten and extended learning, bringing the total annual education aid increase to $1.067 billion. The Enacted Budget also includes a new two-year appropriation that continues Education Law provisions to tie future School Aid increases to the rate of growth in New York State personal income.

Projected School Aid funding is a function of both a personal income growth index used to determine allowable growth, and future legislation to allocate the allowable increases. Current law prescribes allowable growth to include spending for new competitive grant programs to reward school districts that demonstrate significant student performance improvements or undertake long-term structural changes to reduce costs and improve efficiency. Allowable growth also includes increases in expense-based aid programs (e.g., Building Aid, Transportation Aid) under existing statutory provisions. Any remaining allowable growth is allocated pursuant to a chapter of law for purposes including, but not limited to, additional spending for competitive grants, increases in Foundation Aid, or restoration of the Gap Elimination Adjustment.

Based on updated estimates of personal income growth, School Aid is projected to increase by an additional $722 million in school year (SY) 2015 and $834 million in SY 2016. School Aid is projected to reach an annual total of $24.0 billion in SY 2017.

SCHOOL AID AND *NEW* NY EDUCATION REFORM INITIATIVES - SCHOOL YEAR BASIS (JULY 1 - JUNE 30)
(millions of dollars)

	SY 2013	SY 2014	Change	SY 2015	Change	SY 2016	Change	SY 2017	Change
School Aid	$20,236	$21,228	$992	$21,950	$722	$22,784	$834	$24,037	$1,253
			4.9%		3.4%		3.8%		5.5%
New NY Education Reform Initiatives	$0	$75	$75	$75	$0	$75	$0	$75	$0
Total	**$20,236**	**$21,303**	**$1,067**	**$22,025**	**$722**	**$22,859**	**$834**	**$24,112**	**$1,253**
			5.3%		**3.4%**		**3.8%**		**5.5%**

[4] This amount reflects the annual increase in formula-based aids in the computer runs produced by the Department of Education in support of the Enacted Budget, plus the annual increase in categorical and other aids, including competitive Performance Improvement and Management Efficiency grants.

STATE FISCAL YEAR

The State finances School Aid and New NY Education Reform Initiatives from General Fund receipts and from Lottery Fund receipts, including VLTs, which are accounted for and disbursed from a dedicated account. Because the State fiscal year begins on April 1, the State typically pays approximately 70 percent of the annual school year commitment during the State fiscal year in which it is enacted, and pays the remaining 30 percent in the first three months of the following State fiscal year.

The table below summarizes the multi-year projected funding levels on a State fiscal year basis.

SCHOOL AID AND EDUCATION REFORM AID - STATE FISCAL YEAR BASIS
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**20,163**	**20,471**	**1.5%**	**21,692**	**6.0%**	**22,514**	**3.8%**	**23,641**	**5.0%**
General Fund Local Assistance	17,110	17,289	1.0%	18,573	7.4%	19,390	4.4%	20,519	5.8%
General Fund Lottery Aid Guarantee	0	10	N/A	0	N/A	0	0.0%	0	0.0%
Core Lottery Aid	2,217	2,230	0.6%	2,225	-0.2%	2,227	0.1%	2,225	-0.1%
VLT Lottery Aid	857	881	2.8%	894	1.5%	897	0.3%	897	0.0%
VLT Aid Balance Roll	(21)	21	N/A	0	N/A	0	0.0%	0	0.0%
Other Lottery Fund Resources	0	40	N/A	0	N/A	0	0.0%	0	0.0%

State spending for School Aid and New NY Education Reform Initiatives is projected to total $20.5 billion in FY 2014. In future years, receipts available to finance this category of aid from core lottery sales are projected to remain stable, while VLT receipts are anticipated to increase through FY 2015 as a result of the recent implementation of the VLT facility at the Aqueduct Racetrack. In addition to State aid, school districts receive approximately $3 billion annually in Federal categorical aid.

OTHER EDUCATION AID

In addition to School Aid, the State provides funding and support for various other education-related initiatives. These include: special education services; pre-kindergarten through grade 12 education programs; cultural education; higher and professional education programs; and adult career and continuing education services.

Major programs under the Office of Prekindergarten through Grade 12 address specialized student needs or reimburse school districts for education-related services, including the school breakfast and lunch programs, non-public school aid, and various special education programs. In special education, New York provides a full spectrum of services to over 400,000 students from ages 3 to 21. Higher and professional education programs monitor the quality and availability of postsecondary education programs and regulate the licensing and oversight of 50 professions.

OTHER EDUCATION
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**1,927**	**2,032**	**5.4%**	**2,091**	**2.9%**	**2,197**	**5.1%**	**2,328**	**6.0%**
Special Education	1,352	1,418	4.9%	1,522	7.3%	1,626	6.8%	1,751	7.7%
All Other Education	575	614	6.8%	569	-7.3%	571	0.4%	577	1.1%

Special education growth is primarily driven by an increase in program costs and enrollment for preschool special education and the summer school special education programs. The increase in other education spending for FY 2014 over FY 2013 is driven primarily by one-time costs associated with targeted aid and grants, which are not projected to continue beyond FY 2014.

In order to enhance oversight of the preschool special education program, the FY 2014 Enacted Budget also supports the expansion of State and county audit capabilities and the development of data systems to enhance analysis of available program data.

SCHOOL TAX RELIEF PROGRAM

The STAR program provides school tax relief to taxpayers. The three components of STAR and their approximate shares in FY 2014 are: the basic school property tax exemption for homeowners with income under $500,000 (55 percent), the enhanced school property tax exemption for senior citizen homeowners with income under $79,050 (27 percent), and a flat refundable credit and rate reduction for income-eligible New York City resident personal income taxpayers (18 percent).

SCHOOL TAX RELIEF (STAR)
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**3,286**	**3,419**	**4.0%**	**3,602**	**5.4%**	**3,704**	**2.8%**	**3,805**	**2.7%**
Basic Exemption	1,857	1,896	2.1%	1,997	5.3%	2,052	2.8%	2,106	2.6%
Enhanced (Seniors)	841	912	8.4%	986	8.1%	1,014	2.8%	1,040	2.6%
New York City PIT	588	611	3.9%	619	1.3%	638	3.1%	659	3.3%

The STAR program exempts the first $30,000 of every eligible homeowner's property value from the local school tax levy. Lower-income senior citizens will receive a $63,300 exemption in FY 2014. Spending for the STAR property tax exemption reflects reimbursements made to school districts to offset the reduction in property tax revenues.

The annual increase in a qualifying homeowner's STAR exemption benefit is limited to 2 percent. Homeowners who earn more than $500,000 a year are not eligible for the STAR property tax exemption. New York City personal income taxpayers with annual income over $500,000 have a reduced benefit.

The FY 2014 Enacted Budget establishes a STAR re-registration and anti-fraud program. This program is expected to eliminate waste, fraud and abuse in the STAR exemption by (1) authorizing DTF to require all recipients of a Basic STAR exemption to be registered with the Department, and (2) strengthening the penalties for fraud while tightening the standards and procedures for determining eligibility.

HIGHER EDUCATION

Local assistance for higher education spending includes funding for CUNY, SUNY and HESC. The State provides assistance for CUNY's senior college operations, and works in conjunction with the City of New York to support CUNY's community colleges. The CUNY system is the largest urban public university system in the nation. Funding for SUNY supports 30 community colleges across multiple campuses.

The State also provides a sizeable benefit to SUNY and CUNY through the debt service it pays on bond-financed educational facilities capital projects at the universities. This is not reflected in the annual spending totals for the universities. State debt service payments for capital projects at SUNY and CUNY are expected to total about $1.4 billion in FY 2014.

HESC administers the TAP program that provides awards to income-eligible students. It also provides centralized processing for other student financial aid programs, and offers prospective students information and guidance on how to finance a college education. The financial aid programs that the Corporation administers are funded by the State and the Federal government.

Annual growth by CUNY in FY 2014 reflects the net impact of enrollment changes at community colleges, additional fringe benefit costs, and the timing of aid payments across State fiscal years. Growth in HESC reflects the rising cost of higher education tuition and the consequent demand for increased tuition assistance. SUNY local assistance reflects an increase in community college aid, which fully annualizes in the outyears.

HIGHER EDUCATION
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	2,629	2,825	7.5%	2,911	3.0%	2,994	2.9%	3,066	2.4%
City University	**1,220**	**1,345**	**10.2%**	**1,401**	**4.2%**	**1,470**	**4.9%**	**1,548**	**5.3%**
City University	1,026	1,130	10.1%	1,185	4.9%	1,254	5.8%	1,332	6.2%
Community College	194	215	10.8%	216	0.5%	216	0.0%	216	0.0%
Higher Education Services	**947**	**1,004**	**6.0%**	**1,018**	**1.4%**	**1,032**	**1.4%**	**1,026**	**-0.6%**
Tuition Assistance Program	893	948	6.2%	959	1.2%	972	1.4%	966	-0.6%
Aid for Part Time Study	14	12	-14.3%	12	0.0%	12	0.0%	12	0.0%
Scholarships/Awards	40	44	10.0%	47	6.8%	48	2.1%	48	0.0%
State University	**462**	**476**	**3.0%**	**492**	**3.4%**	**492**	**0.0%**	**492**	**0.0%**
State University	457	472	3.3%	485	2.8%	485	0.0%	485	0.0%
Other/Cornell	5	4	-20.0%	7	75.0%	7	0.0%	7	0.0%

Note: State support for SUNY four-year institutions is funded through State operations rather than local assistance.

Growth in spending for higher education over the multi-year Financial Plan period largely reflects aid to New York City for reimbursement of CUNY senior college operating expenses associated with the rising contribution rates for fringe benefits.

HEALTH CARE

Local assistance for health care-related spending includes Medicaid, statewide public health programs and a variety of mental hygiene programs. The DOH works with the local health departments and social services departments, including New York City, to coordinate and administer statewide health insurance programs and activities. The majority of government-financed health care programs are included under DOH, but many programs are supported through multi-agency efforts. The Medicaid program finances inpatient hospital care, outpatient hospital services, clinics, nursing homes, managed care, prescription drugs, home care, FHP (a State-administered program to provide comprehensive health insurance for low-income families which do not meet certain Medicaid-eligibility thresholds), and services provided in a variety of community-based settings (including mental health, substance abuse treatment, developmental disabilities services, school-based services and foster care services). The State share of Medicaid spending is budgeted and expended principally through DOH, but State share Medicaid spending also appears in the Financial Plan estimates for mental hygiene agencies, child welfare programs and DOCCS.

MEDICAID

Medicaid is a means-tested program that finances health care services for low-income individuals and long-term care services for the elderly and disabled, primarily through payments to health care providers. The Medicaid program is financed jointly by the State, the Federal government, and local governments (including New York City). New York State's Medicaid spending is projected to total approximately $55.7 billion in FY 2014, including the local contribution[5].

The Enacted Budget reflects continuation of the Medicaid spending cap enacted in FY 2012, and recommends funding consistent with its provisions. The cap is based on the ten-year average change in the medical component of the CPI. Statutory changes approved with the FY 2012 Enacted Budget to grant the Executive certain administrative powers to help hold Medicaid spending to the capped level were amended through legislation included in the FY 2014 Enacted Budget to provide flexibility to adjust Medicaid projections to meet unanticipated costs resulting from events such as a natural or other type of disaster. The statutory provisions of the Medicaid spending cap have been extended through FY 2015, pursuant to authorization included in the FY 2014 Enacted Budget. The cap itself remains in place, and the Financial Plan assumes that statutory authority will be extended in subsequent years.

Based on updated data, the allowable growth under the cap is 3.9 percent. The FY 2014 Enacted Budget also eliminates the FHP program effective January 1, 2015. The majority of the population receiving health care benefits through FHP will begin receiving more robust health care benefits through the Medicaid program, pursuant to new Medicaid eligibility thresholds and increased Federal payments pursuant to the ACA. The remaining FHP population, those above Medicaid levels, will be eligible for Federal tax credits in the Health Insurance Exchange and the State will pay all additional out-of-pocket costs for these individuals. The proposed transition to the Exchange is expected to provide savings to the State of $59.0 million in FY 2015, and $67.5 million thereafter.

[5] The local contribution to the Medicaid program is not included in the State's Financial Plan. Since January 2006, the State has paid the entire non-Federal share of the FHP program and any annual Medicaid increases above a fixed level for local social services districts. The FY 2013 Enacted Budget amended these statutory indexing provisions by implementing a three-year phased-takeover of the local share of growth above the previous year's enacted levels beginning in April 2013 for Calendar Year 2013, with the State assuming all growth in County Year 2015. This initiative is expected to save local governments nearly $1.2 billion between FY 2013 and FY 2017, as compared to levels assumed under previous statute.

TOTAL STATE-SHARE MEDICAID DISBURSEMENTS[1]
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Department of Health					
DOH State Share	15,900	16,421	16,977	17,805	18,474
Local Assistance	15,879	16,230	16,780	17,591	18,248
State Operations[2]	21	191	197	214	226
Annual $ Change - DOH Only		521	556	828	669
Annual % Change - DOH Only		3.3%	3.4%	4.9%	3.8%
Other State Agencies					
Mental Hygiene	4,758	4,903	5,430	6,019	6,141
Foster Care	89	87	90	94	98
Education	17	0	0	0	0
Corrections	0	12	12	13	13
Total State Share (All Agencies)	**20,764**	**21,423**	**22,509**	**23,931**	**24,726**
Annual $ Change - Total State Share		659	1,086	1,422	795
Annual % Change - Total State Share		3.2%	5.1%	6.3%	3.3%

[1] Medicaid services growth is indexed to the 10-year average of CPI Medical, currently 3.9 percent. Financial Plan spending is adjusted for the inclusion of Medicaid State Operations spending (formerly outside the Medicaid Cap), which is supporting expanded functions pursuant to the phased-in takeover of local administrative responsibilities, and the decision of Monroe County to participate in the Medicaid local cap program, rather than continuing the sales tax intercept option. Finally, the State Share of Medicaid is adjusted for increased Federal Financial Participation beginning in January 2014.

[2] Increased State Operations costs in FY 2014 reflects the transfer of the Office of Health Insurance Programs to Medicaid from Public Health without new spending.

Factors affecting the level of Medicaid spending growth that must be managed within the cap include Medicaid enrollment, costs of provider health care services (particularly in managed care) and levels of utilization. The number of Medicaid recipients, including FHP, is expected to exceed 5.6 million at the end of FY 2014, an increase of 7.3 percent from the FY 2013 caseload of 5.3 million, a result mainly attributable to expanded eligibility pursuant to the ACA. Under the provisions of the ACA, the Federal government is expected to finance a greater share of Medicaid costs, the impact of which is expected to lower future growth in the State share of Medicaid costs beginning in FY 2014.

Total "state share" Medicaid, which includes Medicaid costs of State agencies in addition to DOH, reflects downward spending adjustments of $820 million in FY 2014, $535 million in FY 2015, and $357 million thereafter. This is attributable to the impact of reduced Federal revenue associated with the reimbursement of Medicaid costs at State-operated facilities providing developmental disability services. To compensate for the reduced Federal reimbursement for services provided, the State is undertaking various actions to reduce overall costs while minimizing any impact on service delivery. These actions include shifting a portion of OPWDD Medicaid costs to DOH, the impact of which is expected to be managed on a neutral Financial Plan basis through the implementation of several actions, including comprehensive program reforms consistent with other states to generate Federal reimbursement for services already being provided, and the management of certain MRT investment initiatives. These savings are valued at $730 million in FY 2014, $445 million in FY 2015, and $267 million in each of FYs 2016 and 2017, and are part of the Mental Hygiene Stabilization Fund within the DOH global spending cap.

The FY 2013 Enacted Budget included authorization for the State to take over administration of the Medicaid program, and to cap spending on local Medicaid administration at FY 2012 appropriation levels. The FY 2013 Enacted Budget also provided Medicaid spending relief for all counties and New York City by reducing growth in local Medicaid payments. These changes are expected to provide fiscal and administrative relief to local governments.

As allowed under the FY 2013 Enacted Budget legislation, Monroe County, which had previously authorized a State intercept of sales tax in lieu of payment for its portion of the local share of Medicaid, chose to enter the Medicaid program effective February 1, 2013. Monroe County is expected to benefit in the long-term from entering the local cap program, as future costs associated with its Medicaid growth will be paid for by the State under the phased-in takeover initiative.

The State share of DOH Medicaid spending is comprised of the General Fund, HCRA, provider assessment revenue, and indigent care payments. The chart below provides information on the financing sources for State Medicaid spending.

DEPARTMENT OF HEALTH MEDICAID[1]
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
State Operating Funds	**15,900**	**16,421**	**3.3%**	**16,977**	**3.4%**	**17,805**	**4.9%**	**18,474**	**3.8%**
Total General Fund - Local	11,109	11,225	1.0%	11,391	1.5%	12,136	6.5%	12,631	4.1%
Total General Fund - State Operations	21	191	809.5%	197	3.1%	214	8.6%	226	5.6%
Other State Funds Support	4,770	5,005	4.9%	5,389	7.7%	5,455	1.2%	5,617	3.0%
HCRA Financing	3,214	3,444	7.2%	3,812	10.7%	3,878	1.7%	4,040	4.2%
Indigent Care Support	767	776	1.2%	792	2.1%	792	0.0%	792	0.0%
Provider Assessment Revenue	783	785	0.3%	785	0.0%	785	0.0%	785	0.0%
Other	6	0	-100.0%	0	0.0%	0	0.0%	0	0.0%

[1] Does not include Medicaid spending in other State agencies, transfers, or the local government share of total Medicaid program spending.

The FY 2014 Enacted Budget transfers all administrative costs, including those State resources associated with the local Medicaid takeover program, from the Public Health budget to the Medicaid budget. This change will align operational resources with programmatic responsibilities, and provide the necessary flexibility for meeting emerging needs during the course of the year. Using additional efficiencies gained from the local Medicaid takeover, this change is expected to avoid State General Fund costs of approximately $32 million in FY 2014, $50 million in FY 2015, and $67 million annually thereafter, without placing additional fiscal pressure on the Medicaid Global Cap.

Ongoing MRT efforts have identified a variety of other programmatic efficiencies and re-investments which are expected to improve overall service delivery within the health care industry, but which are not expected to have a significant net financial impact on the State's Medicaid program.

PUBLIC HEALTH/AGING PROGRAMS

Public Health includes the EPIC program that provides prescription drug insurance to low-income seniors, the CHP program that finances health insurance coverage for children of low-income families up to the age of 19, the GPHW program that reimburses local health departments for the cost of providing certain public health services, the EI program that pays for services to infants and toddlers under the age of three with disabilities or developmental delays, and other HCRA and State-supported programs.

SOFA promotes and administers programs and services for New Yorkers 60 years of age and older. The Office primarily oversees community-based services, including but not limited to in-home services and nutrition assistance, provided through a network of county Area Agencies on Aging and local providers.

Many public health programs, such as the EI and GPHW programs, are run by county health departments, which are reimbursed by the State for a share of program costs. The State spending projections do not include the county share of public health funding. In addition, a significant portion of HCRA spending is included under the public health budget.

PUBLIC HEALTH AND AGING
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**2,040**	**2,222**	**8.9%**	**1,997**	**-10.1%**	**1,989**	**-0.4%**	**1,960**	**-1.5%**
Public Health	**1,927**	**2,108**	**9.4%**	**1,877**	**-11.0%**	**1,862**	**-0.8%**	**1,828**	**-1.8%**
Child Health Plus	364	380	4.4%	446	17.4%	378	-15.2%	304	-19.6%
General Public Health Work	247	215	-13.0%	237	10.2%	233	-1.7%	238	2.1%
EPIC	98	170	73.5%	207	21.8%	237	14.5%	258	8.9%
Early Intervention	144	151	4.9%	167	10.6%	171	2.4%	171	0.0%
HCRA Program Account	442	424	-4.1%	429	1.2%	441	2.8%	441	0.0%
F-SHRP	249	384	54.2%	0	-100.0%	0	0.0%	0	0.0%
All Other	383	384	0.3%	391	1.8%	402	2.8%	416	3.5%
Aging	**113**	**114**	**0.9%**	**120**	**5.3%**	**127**	**5.8%**	**132**	**3.9%**

Spending growth in the CHP program through FY 2015 largely reflects costs associated with the expectation of additional caseload growth under the ACA. As CHP enrollment increases, initial costs to the State are expected; however, these costs are expected to decrease beginning in FY 2016 when enhanced Federal participation rates become effective.

Increased State support for the EPIC program, which was authorized in the FY 2013 Enacted Budget to provide coverage of Medicare Part D co-payments and co-insurance for enrollees outside of the existing coverage gap, is also driving a substantial portion of spending growth, as this change took effect on January 1, 2013. Increased spending for expanded EPIC coverage, as well as growth due to the rising costs of prescription drug medication, is expected to be partly financed by additional revenue generated from rebates received from drug manufacturers.

The F-SHRP program is Federal funding provided to the State on a time-limited basis through a Federal waiver under terms and conditions aimed at improving the delivery of health care services. Spending growth in FY 2014 reflects the anticipation of peak utilization prior to the expiration of funding. The program is expected to terminate at the end of FY 2014.

The year-over-year decrease for GPHW in FY 2014 reflects a reestimate of anticipated spending. Other public health programs are being reduced, which is expected to provide savings to the General Fund of approximately $22 million in each year of the Financial Plan.

HCRA

HCRA was established in 1996 to help finance a portion of State health care activities. Extensions and modifications to HCRA have financed new health care programs, including FHP, and provided additional funding for the expansion of existing programs such as CHP. HCRA has also provided additional financing for the health care industry, including investments in worker recruitment and retention, and the HEAL NY program for capital improvements to health care facilities.

HCRA receipts include surcharges and assessments on hospital revenues, a “covered lives” assessment paid by insurance carriers, a portion of cigarette tax revenues, and other revenues dedicated by statute, as well as potential future proceeds from insurance company conversions. Total HCRA revenues are estimated to grow by approximately 3.3 percent on an annual basis during the Financial Plan period.

In addition to FHP, CHP, and HEAL NY, HCRA helps fund Medicaid, EPIC, physician excess medical malpractice insurance, and Indigent Care payments, which provide funding to hospitals serving a disproportionate share of individuals without health insurance.

The FY 2014 Enacted Budget reduces various public health programs and shifts funding for certain programs between HCRA and the General Fund. The shifts are expected to lower spending in HCRA by approximately $145 million in FY 2014 and $175 million thereafter and increase the General Fund spending by the same amount.

HCRA FINANCIAL PLAN FY 2013 THROUGH FY 2017

(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Opening Balance	**3**	**18**	**0**	**0**	**0**
Total Receipts	**5,336**	**5,610**	**5,854**	**5,949**	**6,049**
Surcharges	2,723	2,818	2,871	2,957	3,046
Covered Lives Assessment	1,045	1,045	1,045	1,045	1,045
Cigarette Tax Revenue	1,108	1,060	1,041	1,018	995
Conversion Proceeds	0	175	300	300	300
Hospital Assessments	330	345	444	469	495
NYC Cigarette Tax Transfer/Other	130	167	153	160	168
Total Disbursements	**5,321**	**5,628**	**5,854**	**5,949**	**6,049**
Medicaid Assistance Account	3,219	3,444	3,812	3,878	4,040
Medicaid Costs	*1,840*	*2,145*	*2,724*	*3,229*	3,391
Family Health Plus	*682*	*650*	*439*	*0*	0
Workforce Recruitment & Retention	*157*	*197*	*197*	*197*	197
All Other	*540*	*452*	*452*	*452*	452
HCRA Program Account	459	438	444	460	460
Hospital Indigent Care	777	776	792	792	792
Elderly Pharmaceutical Insurance Coverage	105	183	220	250	271
Child Health Plus	372	386	453	385	312
Public Health Programs	128	29	0	0	0
All Other	261	372	133	184	174
Annual Operating Surplus/(Deficit)	**15**	**(18)**	**0**	**0**	**0**
Closing Balance	**18**	**0**	**0**	**0**	**0**

HCRA is expected to remain in balance over the multi-year projection period. Under the current HCRA appropriation structure, spending reductions will occur if resources are insufficient to meet spending levels. These spending reductions could potentially affect core HCRA programs. The reauthorizations of HCRA in prior years maintained HCRA's balance without the need for automatic spending reductions.

Given the inter-relationship between the General Fund and HCRA, any balances in HCRA are typically eliminated by adjusting the level of Medicaid disbursements that HCRA finances. This reduces costs that otherwise would have been paid for by the General Fund. Conversely, any shortfall in HCRA is expected to be financed by the General Fund.

MENTAL HYGIENE

The Department of Mental Hygiene is comprised of three independent agencies: OPWDD, OMH, and OASAS. Services are administered to adults with serious and persistent mental illness; children with serious emotional disturbances; individuals with developmental disabilities and their families; and persons with chemical dependence. These agencies provide services directly to their patients through State-operated facilities and indirectly through community service providers. The costs associated with providing these services are funded by reimbursement from Medicaid, Medicare, third-party insurance and State funding. Patient care revenues are pledged first to the payment of debt service on outstanding mental hygiene bonds, which are issued to finance improvements to infrastructure at mental hygiene facilities throughout the State, with the remaining revenue used to support State operating costs.

MENTAL HYGIENE
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	3,602	2,833	-21.3%	3,450	21.8%	3,967	15.0%	4,173	5.2%
People with Developmental Disabilities	**2,196**	**1,420**	**-35.3%**	**1,862**	**31.1%**	**2,156**	**15.8%**	**2,220**	**3.0%**
Residential Services	1,551	1,519	-2.1%	1,630	7.3%	1,712	5.0%	1,756	2.6%
Day Programs	560	548	-2.1%	588	7.3%	618	5.1%	635	2.8%
Clinic	22	22	0.0%	23	4.5%	24	4.3%	25	4.2%
Other Local	63	61	-3.2%	66	8.2%	69	4.5%	71	2.9%
Mental Hygiene Stabilization Fund	0	(730)	0.0%	(445)	-39.0%	(267)	-40.0%	(267)	0.0%
Mental Health	**1,094**	**1,097**	**0.3%**	**1,256**	**14.5%**	**1,462**	**16.4%**	**1,590**	**8.8%**
Adult Local Services	913	917	0.4%	1,048	14.3%	1,240	18.3%	1,364	10.0%
Children Local Services	181	180	-0.6%	208	15.6%	222	6.7%	226	1.8%
Alcohol and Substance Abuse	**311**	**315**	**1.3%**	**331**	**5.1%**	**348**	**5.1%**	**362**	**4.0%**
Outpatient/Methadone	134	135	0.7%	142	5.2%	149	4.9%	155	4.0%
Residential	105	106	1.0%	112	5.7%	118	5.4%	123	4.2%
Prevention and Program Support	55	57	3.6%	60	5.3%	63	5.0%	65	3.2%
Crisis	17	17	0.0%	17	0.0%	18	5.9%	19	5.6%
CQCAPD/Justice Center	**1**	**1**	**0.0%**	**1**	**0.0%**	**1**	**0.0%**	**1**	**0.0%**

Legislation enacted in FY 2013 established the Justice Center for the Protection of People with Special Needs, which will have the primary responsibility for tracking, investigating and pursuing serious abuse/neglect complaints at facilities and provider settings operated, certified, or licensed by six State agencies. The activities of CQCAPD will be subsumed by the Justice Center when it becomes operational on June 30, 2013.

Local assistance spending in mental hygiene accounts for nearly half of total mental hygiene spending from State Operating Funds, and is projected to grow by an average rate of 3.7 percent annually. This growth is attributable to increases in the projected State share of Medicaid costs and projected expansion of the various mental hygiene service systems including: increases primarily associated with developing new OPWDD residential and non-residential services and supports; the New York/New York III Supportive Housing agreement; and community beds that are currently under development in the OMH pipeline. Additional outyear spending is assumed in Financial Plan estimates for costs associated with efforts to move individuals in nursing homes and other settings to the least restrictive setting possible, as well as several chemical dependence treatment and prevention initiatives for individuals receiving services through OASAS.

The FY 2014 Enacted Budget achieved lower spending growth by authorizing the elimination of automatic inflationary factors in FY 2014, including the 1.4 percent Human Services COLA and

Medicaid trend adjustment, which provides rate reimbursement adjustments for eligible providers of services to the developmentally disabled, improved program efficiencies, enhanced audit recoveries, reduced administrative costs reimbursed to OPWDD providers, and revised estimates for mental health community bed funding.

OPWDD's Medicaid-related spending estimates have been revised downward in the Enacted Budget by $820 million in FY 2014, $535 million in FY 2015, and $357 million thereafter. These revisions are attributable to the impact of reduced Federal revenue from Medicaid reimbursement at State-operated facilities providing developmental disability services. To compensate for the reduced Federal reimbursement for services provided, the State is undertaking various actions to reduce overall costs in the least disruptive manner possible for service delivery. These actions include shifting a portion of OPWDD Medicaid costs to DOH, the impact of which is expected to be managed on a neutral Financial Plan basis through the implementation of several actions, including comprehensive program reforms consistent with other states to generate Federal reimbursement for services already being provided, and the management of certain MRT investment initiatives. These savings are valued at $730 million in FY 2014, $445 million in FY 2015, and $267 million in each of FY 2016 and FY 2017 and are part of the Mental Hygiene Stabilization Fund within the DOH global spending cap. In addition, $90 million of savings will be achieved by OPWDD through a combination of actions identified in consultation with all relevant parties. These include $50 million in savings from reduced administrative costs, improved efficiencies, and collaborative efforts to utilize lower cost community based supports and services as opposed to more costly settings such as institutions and residential schools. In addition, $40 million in savings will be generated from increased audit recoveries generated by enhanced audit activity by the OMIG related to OPWDD services provided by nonprofit agencies.

SOCIAL SERVICES

OTDA local assistance programs provide cash benefits and supportive services to low-income families. The State's three main programs include Family Assistance, Safety Net Assistance and SSI. The Family Assistance program, which is financed by the Federal government, provides time-limited cash assistance to eligible families. The Safety Net Assistance program, financed by the State and local districts, provides cash assistance for single adults, childless couples, and families that have exhausted their five-year limit on Family Assistance imposed by Federal law. The State SSI Supplementation program provides a supplement to the Federal SSI benefit for the elderly, visually handicapped, and disabled.

TEMPORARY AND DISABILITY ASSISTANCE
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**1,540**	**1,392**	**-9.6%**	**1,290**	**-7.3%**	**1,318**	**2.2%**	**1,328**	**0.8%**
SSI	745	766	2.8%	664	-13.3%	691	4.1%	700	1.3%
Public Assistance Benefits	636	502	-21.1%	502	0.0%	502	0.0%	502	0.0%
Welfare Initiatives	36	19	-47.2%	19	0.0%	19	0.0%	19	0.0%
All Other	123	105	-14.6%	105	0.0%	106	1.0%	107	0.9%

The decline in OTDA spending from FY 2013 is driven primarily by the State's projected costs for public assistance caseload and the fact that there are no longer timing delays for payments. The average public assistance caseload is projected to total 554,011 recipients in FY 2014, a decrease of 2.2 percent from FY 2013 levels. Approximately 249,528 families are expected to receive benefits through the Family Assistance program, a decrease of 2.7 percent from the current year. In the Safety Net program, an average of 118,706 families are expected to be helped in FY 2014, a decrease of 3.0 percent. The caseload for single adults/childless couples supported through the Safety Net program is projected at 185,777, a decrease of 0.8 percent.

OCFS provides funding for foster care, adoption, child protective services, preventive services, delinquency prevention, and child care. OCFS oversees the State's system of family support and child welfare services administered by social services departments and community-based organizations. Specifically, child welfare services, which are financed jointly by the Federal government, the State, and local districts, are structured to encourage local governments to invest in preventive services intended to reduce out-of-home placement of children. In addition, the Child Care Block Grant, which is also financed by a combination of Federal, State and local sources, supports child care subsidies for public assistance and low-income families. The youth facilities program serves youth directed by family or criminal courts to be placed in residential facilities.

CHILDREN AND FAMILY SERVICES
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
Total State Operating Funds	**1,492**	**1,604**	**7.5%**	**1,760**	**9.7%**	**1,828**	**3.9%**	**1,914**	**4.7%**
Child Welfare Service	336	462	37.5%	493	6.7%	526	6.7%	560	6.5%
Foster Care Block Grant	436	436	0.0%	456	4.6%	473	3.7%	491	3.8%
Adoption	152	162	6.6%	164	1.2%	167	1.8%	171	2.4%
Day Care	217	165	-24.0%	249	50.9%	249	0.0%	249	0.0%
Youth Programs	114	152	33.3%	161	5.9%	163	1.2%	163	0.0%
Medicaid	89	87	-2.2%	90	3.4%	94	4.4%	98	4.3%
Committees on Special Education	39	30	-23.1%	33	10.0%	38	15.2%	43	13.2%
Adult Protective/Domestic Violence	34	31	-8.8%	35	12.9%	41	17.1%	48	17.1%
All Other	75	79	5.3%	79	0.0%	77	-2.5%	91	18.2%

OCFS spending growth is driven by increases in claims-based programs; an increase in General Fund spending on Day Care beginning in FY 2015, in order to keep spending on this program constant after a projected decrease in Federal funding; and the continued implementation of the NYC Close to Home Initiative. Growth in Child Welfare Services and Adult Protective/Domestic Violence reflects anticipated growth in local claims and flat Federal funding.

TRANSPORTATION

In FY 2014, the DOT will provide $4.7 billion in local assistance to support statewide mass transit systems. This funding, financed through the collection of dedicated taxes and fees, is provided to mass transit operators throughout the State to support operating costs. The MTA, due to the size and scope of its transit system, receives the majority of the statewide mass transit operating aid. The MTA receives operating support from the Mobility Tax and MTA Aid Trust Fund, authorized in May 2009 to collect regional taxes and fees imposed within the Metropolitan Commuter Transportation District. The State collects these taxes and fees on behalf of, and disburses the entire amount to, the MTA to support the transit system. Legislation enacted in December 2011 eliminates the MTA payroll tax for all elementary and secondary schools as well as for certain small businesses. The State is expected to compensate the MTA annually for the decrease in receipts from this tax reduction.

Total operating aid to the transit systems is expected to increase in FY 2014 by 10.3 percent, reflecting spending adjustments made in conjunction with upward revisions in the receipts forecast.

TRANSPORTATION
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Change	FY 2015 Projected	Change	FY 2016 Projected	Change	FY 2017 Projected	Change
Total State Operating Funds	**4,303**	**4,745**	**10.3%**	**4,831**	**1.8%**	**4,910**	**1.6%**	**4,995**	**1.7%**
Mass Transit Operating Aid:	1,906	2,105	10.4%	2,101	-0.2%	2,101	0.0%	2,101	0.0%
Metro Mass Transit Aid	1,761	1,964	11.5%	1,960	-0.2%	1,960	0.0%	1,960	0.0%
Public Transit Aid	93	89	-4.3%	89	0.0%	89	0.0%	89	0.0%
18-B General Fund Aid	27	27	0.0%	27	0.0%	27	0.0%	27	0.0%
School Fare	25	25	0.0%	25	0.0%	25	0.0%	25	0.0%
Mobility Tax and MTA Aid Trust	1,705	1,909	12.0%	1,986	4.0%	2,061	3.8%	2,143	4.0%
Dedicated Mass Transit	647	686	6.0%	698	1.7%	702	0.6%	706	0.6%
AMTAP	45	45	0.0%	45	0.0%	45	0.0%	45	0.0%
All Other	0	0	0.0%	1	0.0%	1	0.0%	0	0.0%

LOCAL GOVERNMENT ASSISTANCE

Direct aid to local governments includes the AIM program, which was created in FY 2006 to consolidate various unrestricted local aid funding streams; VLT impact aid; and Small Government Assistance and Miscellaneous Financial Assistance. In addition, the State provides incentive grants to local governments. Spending for AIM efficiency incentive grants increases over the multi-year period reflecting the implementation of the Local Government Performance and Efficiency Program enacted in FY 2012 to reward municipal efficiencies and to encourage less duplication among local governments in the delivery of services.

LOCAL GOVERNMENT ASSISTANCE
(millions of dollars)

	FY 2013	FY 2014	Annual %	FY 2015	Annual %	FY 2016	Annual %	FY 2017	Annual %
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**754**	**764**	**1.3%**	**769**	**0.7%**	**782**	**1.7%**	**794**	**1.5%**
AIM:									
Big Four Cities	429	429	0.0%	429	0.0%	429	0.0%	429	0.0%
Other Cities	218	218	0.0%	218	0.0%	218	0.0%	218	0.0%
Towns and Villages	68	68	0.0%	68	0.0%	68	0.0%	68	0.0%
Efficiency Incentives	6	11	83.3%	20	81.8%	35	75.0%	47	34.3%
All Other Local Aid	33	38	15.2%	34	-10.5%	32	-5.9%	32	0.0%

ALL OTHER LOCAL ASSISTANCE SPENDING

Other local assistance programs and activities include criminal justice, economic development, aging, and housing. Spending in these areas is not expected to change materially over the Financial Plan period.

AGENCY OPERATIONS

Agency operating costs include personal service, non-personal service, and GSCs. Personal service includes salaries of State employees of the Executive, Legislative, and Judicial branches, as well as overtime payments and costs for temporary employees. Non-personal service generally accounts for the cost of operating State agencies, including real estate rental, utilities, contractual payments (i.e., consultants, information technology, and professional business services), supplies and materials, equipment, and telephone service. GSCs account for the costs of fringe benefits (e.g., pensions, health insurance) provided to State employees and retirees of the Executive, Legislative and Judicial branches, and certain fixed costs paid by the State. In addition, certain agency operations of Transportation and Motor Vehicles are included in the capital projects fund type and not reflected in the State Operating Funds personal service or non-personal service totals.

Approximately 94 percent of the State workforce is unionized. The largest unions include CSEA, which represents office support staff and administrative personnel, machine operators, skilled trade workers, and therapeutic and custodial care staff; PEF, which represents professional and technical personnel (e.g., attorneys, nurses, accountants, engineers, social workers, and institution teachers); UUP, which represents faculty and non-teaching professional staff within the State University system; and NYSCOPBA, which represents security personnel (correction officers, safety and security officers).

Selected assumptions used in preparing the spending projections for the State's major programs and activities are summarized in the following table.

FORECAST OF SELECTED PROGRAM MEASURES AFFECTING PERSONAL SERVICE AND FRINGE BENEFITS

		Forecast*			
	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Negotiated Base Salary Increases [1]					
CSEA/NYSCOPBA/Council 82/UUP	0	0	2%	2%	TBD
PEF / NYSPBA	0	0	2%	TBD	TBD
State Workforce[2]	119,756	120,468	120,634	120,634	120,634
ERS Pension Contribution Rate[3]					
Before Amortization (Normal/Admin/GLIP)	19.4%	21.7%	21.5%	18.0%	16.3%
After Amortization	11.5%	12.5%	13.5%	14.5%	15.5%
PFRS Pension Contribution Rate[3]					
Before Amortization (Normal/Admin/GLIP)	26.6%	30.1%	30.1%	26.2%	24.2%
After Amortization	19.5%	20.5%	21.5%	22.5%	23.5%
Employee/Retiree Health Insurance Growth Rates	3.1%	5.4%	8.5%	8.5%	8.5%
PS/Fringe as % of Receipts (All Funds Basis)	14.5%	14.3%	14.5%	14.6%	14.4%

[1] Reflects current collective bargaining agreements with settled unions. Does not reflect potential impact of future negotiated workforce agreements.

[2] Reflects workforce that is Subject to Direct Executive Control.

[3] As Percent of Salary.

[*] As Forecasted by DOB.

Growth in agency operating spending is concentrated in agencies that operate large facilities, such as the State University, the mental hygiene agencies, and Corrections and Community Supervision. The main causes of growth include inflationary increases in payroll and operating costs expected for food, medical care and prescription drugs, and energy costs in State facilities, offset by expected savings from enterprise procurement efforts. In most years, there are 26 bi-weekly pay periods. In FY 2016, there is one additional State institutional payroll, which results in higher spending mainly in mental hygiene and corrections. In addition, the State will begin repayment to State employees of certain amounts withheld pursuant to the DRP in FY 2012 and FY 2013 beginning in the last pay period in FY 2015.

Prior-year collective bargaining agreements with NYSCOPBA and Council 82 are reflected in the personal service costs below and include retroactive salary increases already paid in FY 2013 for prior years.

STATE OPERATING FUNDS - AGENCY OPERATIONS[1]

(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Subject to Direct Executive Control	**9,819**	**9,754**	**9,935**	**10,289**	**10,436**
Mental Hygiene	2,914	2,857	2,876	2,991	2,945
Corrections and Community Supervision	2,741	2,558	2,616	2,752	2,707
State Police	601	653	650	664	670
Public Health	526	424	431	418	419
Tax and Finance	372	359	366	372	381
Children and Family Services	302	279	263	260	264
Environmental Conservation	231	232	232	234	237
Financial Services	193	203	205	208	208
Temporary and Disability Assistance	187	186	195	193	197
Parks, Recreation and Historic Preservation	180	174	177	179	180
Disaster Assistance	52	(85)	0	0	0
Workers' Compensation Board	150	153	153	156	158
Lottery/Gaming	124	162	166	167	167
General Services	145	168	141	143	145
Information Technology Services	60	143	156	160	160
All Other	1,041	1,288	1,308	1,392	1,598
University System	**5,552**	**5,669**	**5,777**	**5,916**	**6,054**
State University	5,451	5,581	5,687	5,824	5,960
City University	101	88	90	92	94
Independent Agencies	**297**	**304**	**310**	**319**	**323**
Law	160	165	167	171	173
Audit & Control	137	139	143	148	150
Total, excluding Legislature and Judiciary	**15,668**	**15,727**	**16,022**	**16,524**	**16,813**
Judiciary	1,812	1,878	2,000	2,095	2,111
Legislature	203	219	224	227	231
Statewide Total	**17,683**	**17,824**	**18,246**	**18,846**	**19,155**
Personal Service	12,403	12,357	12,637	13,071	13,204
	3.0%	-0.4%	2.3%	3.4%	1.0%
Non-Personal Service	5,280	5,467	5,609	5,775	5,951
	-2.3%	3.5%	2.6%	3.0%	3.0%

[1] Beginning in FY 2013, the Financial Plan reflects the shift of information technology staff from agencies across the State to ITS as well as the transfer of business services staff to OGS.

GENERAL STATE CHARGES

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, unemployment insurance, and dental and vision benefits. The majority of employee fringe benefit costs are paid centrally from statewide appropriations. However, certain agencies, including the Judiciary and SUNY, directly pay all or a portion of their employees' fringe benefit costs from their respective budgets. Employee fringe benefits paid through GSCs are paid from the General Fund in the first instance, and then partially reimbursed by revenue collected from fringe benefit assessments on Federal funds and other special revenue accounts. The largest General Fund reimbursement comes from the mental hygiene agencies.

GSCs also include certain fixed costs such as State taxes paid to local governments for certain State-owned lands, and payments related to lawsuits against the State and its public officers.

GENERAL STATE CHARGES
(millions of dollars)

	FY 2013	FY 2014		FY 2015		FY 2016		FY 2017	
	Results	Enacted	Change	Projected	Change	Projected	Change	Projected	Change
Total State Operating Funds	**6,437**	**7,089**	**10.1%**	**7,531**	**6.2%**	**7,952**	**5.6%**	**8,285**	**4.2%**
Fringe Benefits	**6,046**	**6,700**	**10.8%**	**7,130**	**6.4%**	**7,552**	**5.9%**	**7,885**	**4.4%**
Health Insurance	3,129	3,315	5.9%	3,476	4.9%	3,711	6.8%	4,020	8.3%
Employee Health Insurance	1,720	1,824	6.0%	1,945	6.6%	2,060	5.9%	2,232	8.3%
Retiree Health Insurance	1,409	1,491	5.8%	1,531	2.7%	1,651	7.8%	1,788	8.3%
Pensions	1,601	2,013	25.7%	2,256	12.1%	2,418	7.2%	2,446	1.2%
Social Security	942	959	1.8%	978	2.0%	997	1.9%	1,015	1.8%
All Other Fringe	374	413	10.4%	420	1.7%	426	1.4%	404	-5.2%
Fixed Costs	**391**	**389**	**-0.5%**	**401**	**3.1%**	**400**	**-0.2%**	**400**	**0.0%**

GSCs are projected to increase at an average annual rate of 6.5 percent over the Financial Plan period. This is due to projected growth in health insurance and pension costs, offset by revenue collected from fringe benefit assessments, particularly from the mental hygiene agencies. The annual growth associated with pensions reflects an increase to the State's pension contribution rate and an increase in the level of payments associated with prior year pension amortization.

TRANSFERS TO OTHER FUNDS (GENERAL FUND BASIS)

General Fund transfers help finance certain capital activities, the State's share of Medicaid costs for State-operated mental hygiene facilities, debt service for bonds that do not have dedicated revenues, and a range of other activities.

GENERAL FUND TRANSFERS TO OTHER FUNDS

(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Total Transfers to Other Funds	**6,794**	**8,382**	**9,179**	**9,682**	**10,247**
Mental Hygiene Medicaid State Share	**2,846**	**1,813**	**1,338**	**1,311**	**1,279**
Debt Service	**1,647**	**1,328**	**1,483**	**1,452**	**1,345**
SUNY University Operations	**340**	**971**	**971**	**971**	**971**
Capital Projects	**916**	**1,227**	**1,384**	**1,400**	**1,799**
Dedicated Highway and Bridge Trust Fund	519	551	592	606	720
All Other Capital	397	676	792	794	1,079
All Other Transfers	**1,045**	**3,043**	**4,003**	**4,548**	**4,853**
Mental Hygiene	0	1,839	2,838	3,400	3,688
Department of Transportation (MTA Tax)	277	332	334	334	334
SUNY - Disproportionate Share	209	228	228	228	228
Judiciary Funds	112	107	108	109	109
SUNY - Hospital Operations	81	67	60	60	60
Banking Services	61	65	65	65	65
Statewide Financial System	48	53	55	55	55
Indigent Legal Services	34	40	40	40	40
Mass Transportation Operating Assistance	38	37	37	37	37
Alcoholic Beverage Control	17	18	20	20	20
Information Technology Services	14	40	14	6	10
Public Transportation Systems	12	12	12	12	12
Correctional Industries	10	10	10	10	10
All Other	132	195	182	172	185

A significant portion of the capital and operating expenses of DOT and DMV are funded from the DHBTF. The Fund receives various dedicated tax and fee revenues, including the petroleum business tax, motor fuel tax, and highway use taxes. The Financial Plan includes transfers from the General Fund that effectively subsidize the expenses of the DHBTF. The subsidy is required because the cumulative expenses of the fund — capital and operating expenses of DOT and DMV, debt service on certain transportation bonds — exceed current and projected revenue deposits and bond proceeds.

General Fund transfers to other funds are expected to total $8.4 billion in FY 2014 — a $1.6 billion increase from FY 2013. This increase is partially attributable to the accounting of SUNY operating support as a transfer rather than a direct State Operations expense in the General Fund, and the reduction in Federal aid for Mental Hygiene service, which results in an increase in State costs.

DEBT SERVICE

The State pays debt service on all outstanding State-supported bonds. These include general obligation bonds, for which the State is constitutionally obligated to pay debt service, as well as bonds issued by certain State public authorities on the State's behalf. Depending on the credit structure, debt service is financed by transfers from the General Fund, dedicated taxes and fees, and other resources, such as patient income revenues. See "Capital Program and Financing Plan" herein for more information.

DEBT SERVICE SPENDING PROJECTIONS
(millions of dollars)

	FY 2013 Results	FY 2014 Enacted	Annual Change	Percent Change
General Fund	**1,647**	**1,328**	**(319)**	**-19.4%**
Other State Support	4,491	4,415	(76)	-1.7%
State Operating Funds	**6,138**	**5,743**	**(395)**	**-6.4%**

Total debt service is projected at $5.7 billion in FY 2014, of which $1.3 billion is paid from the General Fund through transfers, and $4.4 billion from other State funds. The General Fund transfer finances debt service payments on general obligation and service contract bonds. Debt service is paid directly from other State funds for the State's revenue bonds, including PIT bonds, DHBTF bonds, and mental health facilities bonds.

Enacted Budget projections for debt service spending have been revised to reflect a number of factors, including planned bond sales, the prepayment of $203 million of debt service otherwise due during FY 2014, and legislative actions taken in the budget, including enactment of the new sales tax revenue bond credit.

CASH RECEIPTS
ALL GOVERNMENTAL FUNDS
FY 2014 THROUGH FY 2017
(millions of dollars)

	FY 2014 Enacted	FY 2015 Projected	FY 2016 Projected	FY 2017 Projected
Taxes:				
Withholdings	33,166	35,511	37,844	40,098
Estimated Payments	13,838	13,707	14,805	15,752
Final Payments	2,186	2,151	2,251	2,350
Other Payments	1,231	1,268	1,308	1,353
Gross Collections	50,421	52,637	56,208	59,553
State/City Offset	(423)	(248)	(198)	(148)
Refunds	(7,455)	(8,355)	(9,017)	(9,506)
Reported Tax Collections	42,543	44,034	46,993	49,899
STAR (Dedicated Deposits)	0	0	0	0
RBTF (Dedicated Transfers)	0	0	0	0
Personal Income Tax	42,543	44,034	46,993	49,899
Sales and Use Tax	12,530	13,101	13,695	14,085
Cigarette and Tobacco Taxes	1,491	1,466	1,436	1,405
Motor Fuel Tax	500	504	507	510
Alcoholic Beverage Taxes	251	256	261	266
Highway Use Tax	140	143	151	149
Auto Rental Tax	114	119	124	124
Taxicab Surcharge	90	100	101	101
Gross Utility Taxes and Fees	15,116	15,689	16,275	16,640
LGAC/STBF (Dedicated Transfers)	0	0	0	0
User Taxes and Fees	15,116	15,689	16,275	16,640
Corporation Franchise Tax	3,379	2,704	3,085	3,234
Corporation and Utilities Tax	788	833	854	881
Insurance Taxes	1,587	1,644	1,706	1,730
Bank Tax	1,694	1,789	1,870	1,956
Petroleum Business Tax	1,190	1,225	1,235	1,245
Business Taxes	8,638	8,195	8,750	9,046
Estate Tax	1,050	1,125	1,140	1,150
Real Estate Transfer Tax	740	810	885	940
Gift Tax	0	0	0	0
Real Property Gains Tax	0	0	0	0
Pari-Mutuel Taxes	18	18	18	18
Other Taxes	1	1	1	1
Gross Other Taxes	1,809	1,954	2,044	2,109
Real Estate Transfer Tax (Dedicated)	0	0	0	0
Other Taxes	1,809	1,954	2,044	2,109
Payroll Tax	1,245	1,322	1,401	1,483
Total Taxes	69,351	71,194	75,463	79,177
Licenses, Fees, Etc.	681	747	638	644
Abandoned Property	650	655	655	655
Motor Vehicle Fees	1,318	1,318	1,318	1,318
ABC License Fee	56	52	58	54
Reimbursements	232	232	231	232
Investment Income	5	30	30	30
Other Transactions	20,679	21,915	21,510	20,955
Miscellaneous Receipts	23,621	24,949	24,440	23,888
Federal Grants	47,433	47,262	48,242	50,965
Total	140,405	143,405	148,145	154,030

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2014
(millions of dollars)

	General Fund	Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	42,480	8,347	17,124	67,951
Miscellaneous Receipts	3,096	15,656	472	19,224
Federal Receipts	2	1	72	75
Total Receipts	45,578	24,004	17,668	87,250
Disbursements:				
Local Assistance Grants	40,258	19,306	0	59,564
Departmental Operations:				
Personal Service	5,681	6,676	0	12,357
Non-Personal Service	1,883	3,544	40	5,467
General State Charges	4,953	2,136	0	7,089
Debt Service	0	0	5,743	5,743
Capital Projects	0	5	0	5
Total Disbursements	52,775	31,667	5,783	90,225
Other Financing Sources (Uses):				
Transfers from Other Funds	15,678	7,601	4,890	28,169
Transfers to Other Funds	(8,382)	(186)	(16,716)	(25,284)
Bond and Note Proceeds	0	0	0	0
Net Other Financing Sources (Uses)	7,296	7,415	(11,826)	2,885
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	99	(248)	59	(90)
Designated General Fund Reserves:				
Community Projects Fund	(25)			
Prior-Year Labor Agreements (2007-2011)	(26)			
Debt Management	250			
Undesignated Fund Balance	(100)			
Increase (Decrease) in Reserves	99			
Net General Fund Deficit	0			

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2015
(millions of dollars)

	General Fund	Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	43,235	8,697	17,833	69,765
Miscellaneous Receipts	3,551	16,061	644	20,256
Federal Receipts	0	1	72	73
Total Receipts	46,786	24,759	18,549	90,094
Disbursements:				
Local Assistance Grants	42,598	19,620	0	62,218
Departmental Operations:				
Personal Service	5,850	6,787	0	12,637
Non-Personal Service	1,968	3,601	40	5,609
General State Charges	5,328	2,203	0	7,531
Debt Service	0	0	6,123	6,123
Capital Projects	0	5	0	5
Total Disbursements	55,744	32,216	6,163	94,123
Other Financing Sources (Uses):				
Transfers from Other Funds	16,098	7,874	4,605	28,577
Transfers to Other Funds	(9,179)	(321)	(16,997)	(26,497)
Bond and Note Proceeds	0	0	0	0
Net Other Financing Sources (Uses)	6,919	7,553	(12,392)	2,080
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,039)	96	(6)	(1,949)
Designated General Fund Reserves:				
Community Projects Fund	(35)			
Prior-Year Labor Agreements (2007-2011)	10			
Increase (Decrease) in Reserves	(25)			
Net General Fund Deficit	(2,014)			

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2016
(millions of dollars)

	General Fund	Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	46,143	8,941	18,930	74,014
Miscellaneous Receipts	2,682	16,196	486	19,364
Federal Receipts	0	1	72	73
Total Receipts	48,825	25,138	19,488	93,451
Disbursements:				
Local Assistance Grants	45,056	19,815	0	64,871
Departmental Operations:				
Personal Service	6,111	6,960	0	13,071
Non-Personal Service	2,005	3,730	40	5,775
General State Charges	5,604	2,348	0	7,952
Debt Service	0	0	6,482	6,482
Capital Projects	0	5	0	5
Total Disbursements	58,776	32,858	6,522	98,156
Other Financing Sources (Uses):				
Transfers from Other Funds	16,758	8,203	4,534	29,495
Transfers to Other Funds	(9,682)	(278)	(17,507)	(27,467)
Bond and Note Proceeds	0	0	0	0
Net Other Financing Sources (Uses)	7,076	7,925	(12,973)	2,028
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,875)	205	(7)	(2,677)
Designated General Fund Reserves:				
Community Projects Fund	(33)			
Prior-Year Labor Agreements (2007-2011)	14			
Increase (Decrease) in Reserves	(19)			
Net General Fund Deficit	(2,856)			

Source: NYS DOB.

CASH FINANCIAL PLAN
STATE OPERATING FUNDS BUDGET
FY 2017
(millions of dollars)

	General Fund	Special Revenue Funds	Debt Service Funds	State Operating Funds Total
Receipts:				
Taxes	48,642	9,185	19,895	77,722
Miscellaneous Receipts	2,653	16,401	449	19,503
Federal Receipts	0	1	72	73
Total Receipts	51,295	25,587	20,416	97,298
Disbursements:				
Local Assistance Grants	47,276	20,012	0	67,288
Departmental Operations:				
Personal Service	6,127	7,077	0	13,204
Non-Personal Service	2,086	3,825	40	5,951
General State Charges	5,873	2,412	0	8,285
Debt Service	0	0	6,783	6,783
Capital Projects	0	5	0	5
Total Disbursements	61,362	33,331	6,823	101,516
Other Financing Sources (Uses):				
Transfers from Other Funds	17,408	8,294	4,403	30,105
Transfers to Other Funds	(10,247)	(282)	(17,975)	(28,504)
Bond and Note Proceeds	0	0	0	0
Net Other Financing Sources (Uses)	7,161	8,012	(13,572)	1,601
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,906)	268	21	(2,617)
Designated General Fund Reserves:				
Prior-Year Labor Agreements (2007-2011)	14			
Increase (Decrease) in Reserves	14			
Net General Fund Deficit	(2,920)			

Source: NYS DOB.

STATE FINANCIAL PLAN PROJECTIONS FISCAL YEARS 2014 THROUGH 2017

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2014
(millions of dollars)

		Special	Capital	Debt	All
	General	Revenue	Projects	Service	Funds
	Fund	Funds	Funds	Funds	Total
Receipts:					
Taxes	42,480	8,347	1,400	17,124	69,351
Miscellaneous Receipts	3,096	15,842	4,211	472	23,621
Federal Receipts	2	45,138	2,221	72	47,433
Total Receipts	45,578	69,327	7,832	17,668	140,405
Disbursements:					
Local Assistance Grants	40,258	59,582	2,104	0	101,944
Departmental Operations:					
Personal Service	5,681	7,329	0	0	13,010
Non-Personal Service	1,883	4,615	0	40	6,538
General State Charges	4,953	2,454	0	0	7,407
Debt Service	0	0	0	5,743	5,743
Capital Projects	0	5	5,892	0	5,897
Total Disbursements	52,775	73,985	7,996	5,783	140,539
Other Financing Sources (Uses):					
Transfers from Other Funds	15,678	7,602	1,557	4,890	29,727
Transfers to Other Funds	(8,382)	(3,191)	(1,505)	(16,716)	(29,794)
Bond and Note Proceeds	0	0	338	0	338
Net Other Financing Sources (Uses)	7,296	4,411	390	(11,826)	271
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	99	(247)	226	59	137
Designated General Fund Reserves:					
Community Projects Fund	(25)				
Prior-Year Labor Agreements (2007-2011)	(26)				
Debt Management	250				
Undesignated Fund Balance	(100)				
Increase (Decrease) in Reserves	99				
Net General Fund Deficit	0				

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2015
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	43,235	8,697	1,429	17,833	71,194
Miscellaneous Receipts	3,551	16,247	4,507	644	24,949
Federal Receipts	0	45,162	2,028	72	47,262
Total Receipts	46,786	70,106	7,964	18,549	143,405
Disbursements:					
Local Assistance Grants	42,598	60,969	1,716	0	105,283
Departmental Operations:					
Personal Service	5,850	7,433	0	0	13,283
Non-Personal Service	1,968	4,570	0	40	6,578
General State Charges	5,328	2,521	0	0	7,849
Debt Service	0	0	0	6,123	6,123
Capital Projects	0	5	6,429	0	6,434
Total Disbursements	55,744	75,498	8,145	6,163	145,550
Other Financing Sources (Uses):					
Transfers from Other Funds	16,098	7,875	1,447	4,605	30,025
Transfers to Other Funds	(9,179)	(2,387)	(1,509)	(16,997)	(30,072)
Bond and Note Proceeds	0	0	306	0	306
Net Other Financing Sources (Uses)	6,919	5,488	244	(12,392)	259
Excess (Deficiency) of Receipts and Other	(2,039)	96	63	(6)	(1,886)
Designated General Fund Reserves:					
Community Projects Fund	(35)				
Prior-Year Labor Agreements (2007-2011)	10				
Increase (Decrease) in Reserves	(25)				
Net General Fund Deficit	(2,014)				

Source: NYS DOB.

STATE FINANCIAL PLAN PROJECTIONS FISCAL YEARS 2014 THROUGH 2017

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2016
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	46,143	8,941	1,449	18,930	75,463
Miscellaneous Receipts	2,682	16,382	4,890	486	24,440
Federal Receipts	0	46,510	1,660	72	48,242
Total Receipts	48,825	71,833	7,999	19,488	148,145
Disbursements:					
Local Assistance Grants	45,056	62,517	1,405	0	108,978
Departmental Operations:					
Personal Service	6,111	7,638	0	0	13,749
Non-Personal Service	2,005	4,675	0	40	6,720
General State Charges	5,604	2,681	0	0	8,285
Debt Service	0	0	0	6,482	6,482
Capital Projects	0	5	6,626	0	6,631
Total Disbursements	58,776	77,516	8,031	6,522	150,845
Other Financing Sources (Uses):					
Transfers from Other Funds	16,758	8,204	1,463	4,534	30,959
Transfers to Other Funds	(9,682)	(2,316)	(1,513)	(17,507)	(31,018)
Bond and Note Proceeds	0	0	120	0	120
Net Other Financing Sources (Uses)	7,076	5,888	70	(12,973)	61
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,875)	205	38	(7)	(2,639)
Designated General Fund Reserves:					
Community Projects Fund	(33)				
Prior-Year Labor Agreements (2007-2011)	14				
Increase (Decrease) in Reserves	(19)				
Net General Fund Deficit	(2,856)				

Source: NYS DOB.

CASH FINANCIAL PLAN
ALL GOVERNMENTAL FUNDS
FY 2017
(millions of dollars)

	General Fund	Special Revenue Funds	Capital Projects Funds	Debt Service Funds	All Funds Total
Receipts:					
Taxes	48,642	9,185	1,455	19,895	79,177
Miscellaneous Receipts	2,653	16,587	4,199	449	23,888
Federal Receipts	0	49,276	1,617	72	50,965
Total Receipts	51,295	75,048	7,271	20,416	154,030
Disbursements:					
Local Assistance Grants	47,276	65,654	1,137	0	114,067
Departmental Operations:					
Personal Service	6,127	7,764	0	0	13,891
Non-Personal Service	2,086	4,685	0	40	6,811
General State Charges	5,873	2,750	0	0	8,623
Debt Service	0	0	0	6,783	6,783
Capital Projects	0	5	6,593	0	6,598
Total Disbursements	61,362	80,858	7,730	6,823	156,773
Other Financing Sources (Uses):					
Transfers from Other Funds	17,408	8,295	1,862	4,403	31,968
Transfers to Other Funds	(10,247)	(2,216)	(1,595)	(17,975)	(32,033)
Bond and Note Proceeds	0	0	65	0	65
Net Other Financing Sources (Uses)	7,161	6,079	332	(13,572)	0
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Uses	(2,906)	269	(127)	21	(2,743)
Designated General Fund Reserves:					
Prior-Year Labor Agreements (2007-2011)	14				
Increase (Decrease) in Reserves	14				
Net General Fund Deficit	(2,920)				

Source: NYS DOB.

CASHFLOW
GENERAL FUND
FY 2014
(dollars in millions)

	2013									2014			
	April Results	May Results	June Projected	July Projected	August Projected	September Projected	October Projected	November Projected	December Projected	January Projected	February Projected	March Projected	Total
OPENING BALANCE	1,610	6,379	3,744	3,918	3,920	3,293	5,005	4,219	2,817	4,166	6,061	6,125	1,610
RECEIPTS:													
Personal Income Tax	4,993	1,790	2,477	1,961	1,731	2,796	1,869	1,248	2,919	3,065	2,006	1,633	28,488
User Taxes and Fees	540	431	628	506	496	657	492	483	662	582	460	611	6,548
Business Taxes	355	109	1,001	149	55	1,158	132	113	1,198	142	89	1,874	6,375
Other Taxes	91	111	90	89	90	90	89	89	89	89	89	63	1,069
Total Taxes	5,979	2,441	4,196	2,705	2,372	4,701	2,582	1,933	4,868	3,878	2,644	4,181	42,480
Abandoned Property	0	0	45	15	15	70	5	130	25	25	70	250	650
ABC License Fee	6	6	4	4	5	5	4	4	5	4	5	4	56
Investment Income	0	0	1	1	1	0	0	1	0	0	0	1	5
Licenses, Fees, etc.	41	82	75	45	40	85	45	40	80	55	45	48	681
Motor vehicle fees	28	(24)	0	0	0	0	0	0	0	0	13	9	26
Reimbursements	8	1	35	5	5	45	15	15	35	15	20	33	232
Other Transactions	39	2	164	43	271	313	39	14	45	35	15	466	1,446
Total Miscellaneous Receipts	122	67	324	113	337	518	108	204	190	134	168	811	3,096
Federal Grants	0	0	0	0	0	0	0	0	0	0	0	2	2
PIT in Excess of Revenue Bond Debt Service	1,664	421	967	443	221	1,116	393	183	1,047	1,069	368	948	8,840
Tax in Excess of LGAC/Sales Tax Debt Service	377	318	738	438	382	594	425	424	595	509	204	436	5,440
Real Estate Taxes in Excess of CW/CA Debt Service	41	57	49	47	50	53	51	36	38	39	37	34	532
All Other	34	59	5	10	0	46	34	0	29	40	71	538	866
Total Transfers from Other Funds	2,116	855	1,759	938	653	1,809	903	643	1,709	1,657	680	1,956	15,678
TOTAL RECEIPTS	8,217	3,363	6,279	3,756	3,362	7,028	3,593	2,780	6,767	5,669	3,492	6,950	61,256
DISBURSEMENTS:													
School Aid	188	2,489	1,950	70	550	1,470	685	1,200	1,620	280	495	6,293	17,290
Higher Education	19	8	760	9	364	181	355	33	221	55	347	440	2,792
All Other Education	23	261	65	159	111	278	72	33	230	106	180	501	2,019
Medicaid - DOH	973	1,253	914	1,080	1,157	874	882	1,041	893	806	813	539	11,225
Public Health	23	46	50	32	107	82	42	46	61	46	42	143	720
Mental Hygiene	2	0	233	1	1	245	147	1	235	101	121	254	1,341
Children and Families	62	58	229	72	72	231	78	78	125	189	73	333	1,600
Temporary & Disability Assistance	151	105	105	137	105	137	105	105	105	105	41	191	1,392
Transportation	0	23	1	0	24	0	0	24	15	0	10	1	98
Unrestricted Aid	0	11	388	5	0	96	7	1	188	0	0	68	764
All Other	9	19	219	57	36	46	(6)	27	40	197	210	163	1,017
Total Local Assistance Grants	1,450	4,273	4,914	1,622	2,527	3,640	2,367	2,589	3,733	1,885	2,332	8,926	40,258
Personal Service	447	525	433	575	433	430	504	427	553	431	427	496	5,681
Non-Personal Service	116	154	125	144	153	151	145	153	117	127	120	378	1,883
Total State Operations	563	679	558	719	586	581	649	580	670	558	547	874	7,564
General State Charges	443	603	133	571	540	195	512	538	49	662	286	421	4,953
Debt Service	567	(187)	(33)	392	(4)	(102)	476	0	(22)	385	(18)	(126)	1,328
Capital Projects	66	111	84	77	84	123	45	55	84	84	84	330	1,227
State Share Medicaid	40	226	141	167	159	168	159	172	165	164	176	76	1,813
SUNY Operations	210	210	210	182	0	0	0	160	0	0	0	(1)	971
Other Purposes	109	83	98	24	97	711	171	88	739	36	21	866	3,043
Total Transfers to Other Funds	992	443	500	842	336	900	851	475	966	669	263	1,145	8,382
TOTAL DISBURSEMENTS	3,448	5,998	6,105	3,754	3,989	5,316	4,379	4,182	5,418	3,774	3,428	11,366	61,157
Excess/(Deficiency) of Receipts over Disbursements	4,769	(2,635)	174	2	(627)	1,712	(786)	(1,402)	1,349	1,895	64	(4,416)	99
CLOSING BALANCE	6,379	3,744	3,918	3,920	3,293	5,005	4,219	2,817	4,166	6,061	6,125	1,709	1,709

Source: NYS DOB

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

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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 is introduced or proposed (i) without modification or addition (except for particularized procedural or technical requirements), and (ii) not in conjunction with any other legislative proposal.

(F) If a Settling State (i) enacts the Model Statute without any modification or addition (except for particularized state procedural or technical requirements) and not in conjunction with any other legislative or regulatory proposal, (ii) uses its best efforts to keep the Model Statute in full force and effect by, among other things, defending the Model Statute fully in any litigation brought in state or federal court within such Settling State (including litigating all available appeals that may affect the effectiveness of the Model Statute), and (iii) otherwise complies with subsection (2)(B), but a court of competent jurisdiction nevertheless invalidates or renders unenforceable the Model Statute with respect to such Settling State, and but for such ruling the Settling State would have been exempt from an NPM Adjustment under subsection (2)(B), then the NPM Adjustment (including reallocations pursuant to subsections (2)(C) and (2)(D)) shall still apply to such Settling State's Allocated Payments but in any individual year shall not exceed 65% of the amount of such Allocated Payments.

(G) In the event a Settling State proposes and/or enacts a statute, regulation, law and/or rule (applicable everywhere the Settling State has authority to legislate) that is not the Model Statute and asserts that such statute, regulation, law and/or rule is a Qualifying Statute, the Firm shall be jointly retained by the Settling States and the Original Participating Manufacturers for the purpose of determining whether or not such statute, regulation, law and/or rule constitutes a Qualifying Statute. The Firm shall make the foregoing determination within 90 days of a written request to it from the relevant Settling State (copies of which request the Settling State shall also provide to all Participating Manufacturers and the Independent Auditor), and the Firm shall promptly thereafter provide written notice of such determination to the relevant Settling State, NAAG, all Participating Manufacturers and the Independent Auditor. The determination of the Firm with respect to this issue shall be conclusive and binding upon all parties, and shall be final and non-appealable; provided, however, (i) that such determination shall be of no force and effect with respect to a proposed statute, regulation, law and/or rule that is thereafter enacted with any modification or addition; and (ii) that the Settling State in which the Qualifying Statute was enacted and any Participating Manufacturer may at any time request that the Firm reconsider its determination as to this issue in light of subsequent events (including, without limitation, subsequent judicial review, interpretation, modification and/or disapproval of a Settling State's Qualifying Statute, and the manner and/or the effect of enforcement of such Qualifying Statute). The Original Participating Manufacturers shall severally pay their Relative Market Shares of the reasonable fees and expenses of the Firm. Only the Participating Manufacturers and Settling States, and their respective counsel, shall be entitled to communicate with the Firm with respect to the Firm's activities pursuant to this subsection (2)(G).

(H) Except as provided in subsection (2)(F), in the event a Qualifying Statute is enacted within a Settling State and is thereafter invalidated or declared unenforceable by a court of competent jurisdiction, otherwise rendered not in full force and effect, or, upon reconsideration by the Firm pursuant to subsection (2)(G) determined not to constitute a Qualifying Statute, then such Settling State's Allocated Payments shall be fully subject to an NPM Adjustment unless and until the requirements of subsection (2)(B) have been once again satisfied.

(3) Allocation of NPM Adjustment among Original Participating Manufacturers. The portion of the total amount of the NPM Adjustment to which the Original Participating Manufacturers are entitled in any year that can be applied in such year consistent with subsection IX(d)(2) (the "Available NPM Adjustment") shall be allocated among them as provided in this subsection IX(d)(3).

(A) The "Base NPM Adjustment" shall be determined for each Original Participating Manufacturer in such year as follows:

(i) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied exceed or are equal to their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal 0 (zero).

(ii) For those Original Participating Manufacturers whose Relative Market Shares in the year immediately preceding the year in which the NPM Adjustment in question is applied are less than their respective 1997 Relative Market Shares, the Base NPM Adjustment shall equal the result of (x) the difference between such Original Participating Manufacturer's Relative Market Share in such preceding year and its 1997 Relative Market Share multiplied by both (y) the number of individual Cigarettes (expressed in thousands of units) shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such preceding year (determined in accordance with subsection II(mm)) and (z) $20 per each thousand units of Cigarettes (as this number is adjusted pursuant to subsection IX(d)(3)(C) below).

(iii) For those Original Participating Manufacturers whose Base NPM Adjustment, if calculated pursuant to subsection (ii) above, would exceed $300 million (as this number is adjusted pursuant to subsection IX(d)(3)(C) below), the Base NPM Adjustment shall equal $300 million (or such adjusted number, as provided in subsection IX(d)(3)(C) below).

(B) The share of the Available NPM Adjustment each Original Participating Manufacturer is entitled to shall be calculated as follows:

(i) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year is less than or equal to the sum of the Base NPM Adjustments of all Original Participating

Manufacturers in such year, then such Available NPM Adjustment shall be allocated among those Original Participating Manufacturers whose Base NPM Adjustment is not equal to 0 (zero) pro rata in proportion to their respective Base NPM Adjustments.

(ii) If the Available NPM Adjustment the Original Participating Manufacturers are entitled to in any year exceeds the sum of the Base NPM Adjustments of all Original Participating Manufacturers in such year, then (x) the difference between such Available NPM Adjustment and such sum of the Base NPM Adjustments shall be allocated among the Original Participating Manufacturers pro rata in proportion to their Relative Market Shares (the applicable Relative Market Shares to be those in the year immediately preceding such year), and (y) each Original Participating Manufacturer's share of such Available NPM Adjustment shall equal the sum of *(1)* its Base NPM Adjustment for such year, and *(2)* the amount allocated to such Original Participating Manufacturer pursuant to clause (x).

(iii) If an Original Participating Manufacturer's share of the Available NPM Adjustment calculated pursuant to subsection IX(d)(3)(B)(i) or IX(d)(3)(B)(ii) exceeds such Original Participating Manufacturer's payment amount to which such NPM Adjustment applies (as such payment amount has been determined pursuant to step B of clause "Seventh" of subsection IX(j)), then *(1)* such Original Participating Manufacturer's share of the Available NPM Adjustment shall equal such payment amount, and *(2)* such excess shall be reallocated among the other Original Participating Manufacturers pro rata in proportion to their Relative Market Shares.

(C) Adjustments:

(i) For calculations made pursuant to this subsection IX(d)(3) (if any) with respect to payments due in the year 2000, the number used in subsection IX(d)(3)(A)(ii)(z) shall be $20 and the number used in subsection IX(d)(3)(A)(iii) shall be $300 million. Each year thereafter, both these numbers shall be adjusted upward or downward by multiplying each of them by the quotient produced by dividing (x) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such year, by (y) the average revenue per Cigarette of all the Original Participating Manufacturers in the year immediately preceding such immediately preceding year.

(ii) For purposes of this subsection, the average revenue per Cigarette of all the Original Participating Manufacturers in any year shall equal (x) the aggregate revenues of all the Original Participating Manufacturers from sales of Cigarettes in the fifty United States, the District of Columbia and Puerto Rico after Federal excise taxes and after payments pursuant to this Agreement and the tobacco litigation Settlement Agreements with the States of Florida, Mississippi, Minnesota and Texas (as such revenues are reported to the United States Securities and Exchange Commission ("SEC") for such year (either independently by the Original Participating Manufacturer or as part of consolidated financial statements reported to the SEC by an Affiliate of the Original Participating Manufacturers) or, in the case of an Original Participating Manufacturer that does not report income to the SEC, as reported in financial statements prepared in accordance with United States generally accepted accounting principles and audited by a nationally recognized accounting firm), divided by (y) the aggregate number of the individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by all the Original Participating Manufacturers in such year (determined in accordance with subsection II(mm)).

(D) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied both (x) the Relative Market Share of Lorillard Tobacco Company (or of its successor) ("Lorillard") was less than or equal to 20.0000000%, and (y) the number of individual Cigarettes shipped in or to the United States, the District of Columbia and Puerto Rico by Lorillard (determined in accordance with subsection II(mm)) (for purposes of this subsection (D), "Volume") was less than or equal to 70 billion, Lorillard's and Philip Morris Incorporated's (or its successor's) ("Philip Morris") shares of the Available NPM Adjustment calculated pursuant to subsections (3)(A)-(C) above shall be further reallocated between Lorillard and Philip Morris as follows (this subsection (3)(D) shall not apply in the year in which either of the two conditions specified in this sentence is not satisfied):

(i) Notwithstanding subsections (A)-(C) of this subsection (d)(3), but subject to further adjustment pursuant to subsections (D)(ii) and (D)(iii) below, Lorillard's share of the Available NPM Adjustment shall equal its Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding the year in which such NPM Adjustment is applied). The dollar amount of the difference between the share of the Available NPM Adjustment Lorillard is entitled to pursuant to the preceding sentence and the share of the Available NPM Adjustment it would be entitled to in the same year pursuant to subsections (d)(3)(A)-(C) shall be reallocated to Philip Morris and used to decrease or increase, as the case may be, Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C).

(ii) In the event that in the year immediately preceding the year in which the NPM Adjustment in question is applied either (x) Lorillard's Relative Market Share was greater than 15.0000000% (but did not exceed 20.0000000%), or (y) Lorillard's Volume was greater than 50 billion (but did not exceed 70 billion), or both, Lorillard's share of the Available NPM Adjustment calculated pursuant to subsection (d)(3)(D)(i) shall be reduced by a percentage equal to the greater of *(1)* 10.0000000% for each percentage point (or fraction thereof) of excess of such Relative Market Share over 15.0000000% (if any), or (2) 2.5000000% for each billion (or fraction thereof) of excess of such Volume over 50 billion (if any). The dollar amount by which Lorillard's share of the Available NPM Adjustment is reduced in any year pursuant to this subsection (D)(ii) shall be reallocated to Philip Morris and used to increase Philip Morris's share of the Available NPM Adjustment in such year.

In the event that in any year a reallocation of the shares of the Available NPM Adjustment between Lorillard and Philip Morris pursuant to this subsection (d)(3)(D) results in Philip Morris's share of the Available NPM Adjustment in such year exceeding the greater of (x) Philip Morris's Relative Market Share of such Available NPM Adjustment (the applicable Relative Market Share to be that in the year immediately preceding such year), or (y) Philip Morris's share of the Available NPM Adjustment in such year calculated pursuant to subsections (d)(3)(A)-(C), Philip Morris's share of the Available NPM Adjustment in such year shall be reduced to equal the greater of (x) or (y) above. In such instance, the dollar amount by which Philip Morris's share of the Available NPM Adjustment is reduced pursuant to the preceding sentence shall be reallocated to Lorillard and used to increase Lorillard's share of the Available NPM Adjustment in such year.

(iv) In the event that either Philip Morris or Lorillard is treated as a Non-Participating Manufacturer for purposes of this subsection IX(d)(3) pursuant to subsection XVIII(w)(2)(A), this subsection (3)(D) shall not be applied, and the Original Participating Manufacturers' shares of the Available NPM Adjustment shall be determined solely as described in subsections (3)(A)-(C).

(4) NPM Adjustment for Subsequent Participating Manufacturers. Subject to the provisions of subsection IX(i)(3), a Subsequent Participating Manufacturer shall be entitled to an NPM Adjustment with respect to payments due from such Subsequent Participating Manufacturer in any year during which an NPM Adjustment is applicable under subsection (d)(1) above to payments due from the Original Participating Manufacturers. The amount of such NPM Adjustment shall equal the product of (A) the NPM Adjustment Percentage for such year multiplied by (B) the sum of the payments due in the year in question from such Subsequent Participating Manufacturer that correspond to payments due from Original Participating Manufacturers pursuant to subsection IX(c) (as such payment amounts due from such Subsequent Participating Manufacturer have been adjusted and allocated pursuant to clauses "First" through "Fifth" of subsection IX(j)). The NPM Adjustment to payments by each Subsequent Participating Manufacturer shall be allocated and reallocated among the Settling States in a manner consistent with subsection (d)(2) above.

(e) Supplemental Payments. Beginning on April 15, 2004, and on April 15 of each year thereafter in perpetuity, in the event that the sum of the Market Shares of the Participating Manufacturers that were Participating Manufacturers during the entire calendar year immediately preceding the year in which the payment in question would be due (the applicable Market Share to be that for the calendar year immediately preceding the year in which the payment in question would be due) equals or exceeds 99.0500000%, each Original Participating Manufacturer shall severally pay to the Escrow Agent (to be credited to the Subsection IX(e) Account) for the benefit of the Foundation its Relative Market Share of the base amount of $300,000,000, as such payments are modified in accordance with this subsection (e). Such payments shall be utilized by the Foundation to fund the national public education functions of the Foundation described in subsection VI(f)(1), in the manner described in and subject to the provisions of subsections VI(g) and VI(h). The payments made by the Original Participating Manufacturers pursuant to this subsection shall be subject to the Inflation Adjustment, the Volume Adjustment, the Non-Settling States Reduction, and the offset for miscalculated or disputed payments described in subsection XI(i).

(f) Payment Responsibility. The payment obligations of each Participating Manufacturer pursuant to this Agreement shall be the several responsibility only of that Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any Affiliate of such Participating Manufacturer. The payment obligations of a Participating Manufacturer shall not be the obligation or responsibility of any other Participating Manufacturer. Provided, however, that no provision of this Agreement shall waive or excuse liability under any state or federal fraudulent conveyance or fraudulent transfer law. Any Participating Manufacturer whose Market Share (or Relative Market Share) in any given year equals zero shall have no payment obligations under this Agreement in the succeeding year.

(g) Corporate Structures. Due to the particular corporate structures of R.J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("B&W") with respect to their non-domestic tobacco operations, Reynolds and B&W shall be severally liable for their respective shares of each payment due pursuant to this Agreement up to (and their liability hereunder shall not exceed) the full extent of their assets used in and earnings derived from, the manufacture and/or sale in the States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of their other assets or earnings to satisfy such obligations.

(h) Accrual of Interest. Except as expressly provided otherwise in this Agreement, any payment due hereunder and not paid when due (or payments requiring the accrual of interest under subsection XI(d)) shall accrue interest from and including the date such payment is due until (but not including) the date paid at the Prime Rate plus three percentage points.

(i) Payments by Subsequent Participating Manufacturers.

(1) A Subsequent Participating Manufacturer shall have payment obligations under this Agreement only in the event that its Market Share in any calendar year exceeds the greater of *(1)* its 1998 Market Share or *(2)* 125 percent of its 1997 Market Share (subject to the provisions of subsection (i)(4)). In the year following any such calendar year, such Subsequent Participating Manufdcturer 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(h) Account (First), Subsection IX(b) Account (Subsequent), Subsection IX(c)(1) Account and Subsection IX(c)(2) Account, respectively (as such Accounts are defined in the Escrow Agreement), that are at such time held in such Accounts for the benefit of such Settling State, and which are to be transferred to the appropriate State-Specific Account for such Settling State. If neither the Settling State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to make such transfer. If the Settling State in question or any Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (f)(3), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and the undisputed portion to the appropriate State-Specific Account. No amounts may be transferred or credited to a State-Specific Account for the benefit of any State as to which State-Specific Finality has not occurred or as to which this Agreement has terminated.

(4) Payments to Parties other than Particular Settling States.

(A) Promptly following the occurrence of State-Specific Finality in one Settling State, such Settling State and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of State-Specific Finality in at least one Settling State and of the amounts held in the Subsection VI(b) Account, Subsection VI(c) Account (First), and Subsection VIII(c) Account (as such Accounts are defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of State-Specific Finality in one Settling State, by notice delivered to each Notice Party not later than ten Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Accounts to the Foundation or to the Fund specified in subsection VIII(c), as appropriate. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(A), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation or to the Fund specified in subsection VIII(c), as appropriate.

(B) The Independent Auditor shall instruct the Escrow Agent to disburse funds on deposit in the Subsection VIII(b) Account and Subsection IX(e) Account (as such Accounts are defined in the Escrow Agreement) to NAAG or to the Foundation, as appropriate, within 10 Business Days after the date on which such amounts were credited to such Accounts.

(C) Promptly following the occurrence of State-Specific Finality in Settling States having aggregate Allocable Shares equal to at least 80% of the total aggregate Allocable Shares assigned to all States that were Settling States as of the MSA Execution Date, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of such State-Specific Finality and of the amounts held in the Subsection VI(c) Account (Subsequent) (as such Account is defined in the Escrow Agreement), if any. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts or disputes the occurrence of such State-Specific Finality, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in such Account to the Foundation. If any Settling State or Participating Manufacturer disputes such amounts or the occurrence of such State-Specific Finality by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (4)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to the Foundation.

(5) Treatment of Payments Following Termination.

(A) As to amounts held for Settling States. Promptly upon the termination of this Agreement with respect to any Settling State (whether or not as part of the termination of this Agreement as to all Settling States) such State or any Participating Manufacturer shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection IX(b) Account (First), the Subsection IX(b) Account (Subsequent), the Subsection IX(c)(1) Account, the Subsection IX(c)(2) Account, and the State-Specific Account for the benefit of such Settling State. If neither the State in question nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If the State in question or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(A), the Independent Auditor shall promptly instruct the Escrow Agent to transfer the amount disputed to the Disputed Payments Account and the undisputed portion to the Participating Manufacturers (on the basis of their respective contributions of such funds).

(B) As to amounts held for others. If this Agreement is terminated with respect to all of the Settling States, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(b) Account, the Subsection VI(c) Account (First), the Subsection VIII(b) Account, the Subsection VIII(c) Account and the Subsection IX(e) Account. If neither any such State nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Accounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(B), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(C) As to amounts held in the Subsection VI(c) Account (Subsequent). If this Agreement is terminated with respect to Settling States having aggregate Allocable Shares equal to more than 20% of the total aggregate Allocable Shares assigned to those States that were Settling States as of the MSA Execution Date, the Original Participating Manufacturers shall promptly notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of such termination and of the amounts held in the Subsection VI(c) Account (Subsequent) (as defined in the Escrow Agreement). If neither any such State with respect to which this Agreement has terminated nor any Participating Manufacturer disputes such amounts or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the preceding sentence, the Independent Auditor shall promptly instruct the Escrow Agent to transfer such amounts to the Participating Manufacturers (on the basis of their respective contributions of such funds). If any such State or any Participating Manufacturer disputes the amounts held in the Account or the occurrence of such termination by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of the notice described in the second sentence of this subsection (5)(C), the Independent Auditor shall promptly instruct the Escrow Agent to credit the amount disputed to the Disputed Payments Account and transfer the undisputed portion to the Participating Manufacturers (on the basis of their respective contribution of such funds).

(6) Determination of amounts paid or held for the benefit of each individual Settling State. For purposes of subsections (f)(3), (f)(5)(A) and (i)(2), the portion of a payment that is made or held for the benefit of each individual Settling State shall be determined: (A) in the case of a payment credited to the Subsection IX(b) Account (First) or the Subsection IX(b) Account (Subsequent), by allocating the results of clause "Eighth" of subsection IX(j) among those Settling States who were Settling States at the time that the amount of such payment was calculated, pro rata in proportion to their respective Allocable Shares; and (B) in the case of a payment credited to the Subsection IX(c)(1) Account or the Subsection IX(c)(2) Account, by the results of clause "Twelfth" of subsection IX(j) for each individual Settling State. Provided, however, that, solely for purposes of subsection (f)(3), the Settling States may by unanimous agreement agree on a different method of allocation of amounts held in the Accounts identified in this subsection (f)(6).

(g) Payments to be Made Only After Final Approval. Promptly following the occurrence of Final Approval, the Settling States and the Original Participating Manufacturers shall notify the Independent Auditor of such occurrence. The Independent Auditor shall promptly thereafter notify each Notice Party of the occurrence of Final Approval and of the amounts held in the State-Specific Accounts. If neither any of the Settling States nor any of the Participating Manufacturers disputes such amounts, disputes the occurrence of Final Approval or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to disburse the funds held in the State-Specific Accounts to (or as directed by) the respective Settling States. If any Notice Party disputes such amounts or the occurrence of Final Approval, or claims that this Agreement has terminated as to any Settling State for whose benefit the funds are held in a State-Specific Account, by notice delivered to each other Notice Party not later than 10 Business Days after delivery by the Independent Auditor of such notice of Final Approval, the Independent Auditor shall promptly instruct the Escrow Agent to credit the amounts disputed to the Disputed Payments Account and to disburse the undisputed portion to (or as directed by) the respective Settling States.

(h) Applicability to Section XVII Payments. This section XI shall not be applicable to payments made pursuant to section XVII; provided, however, that the Independent Auditor shall be responsible for calculating Relative Market Shares in connection with such payments, and the Independent Auditor shall promptly provide the results of such calculation to any Original Participating Manufacturer or Settling State that requests it do so.

(i) Miscalculated or Disputed Payments.

(1) Underpayments.

(A) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date, and such information shows that any Participating Manufacturer was instructed to make an insufficient payment on such date ("original payment"), the Independent Auditor shall promptly determine the additional payment owed by such Participating Manufacturer and the allocation of such additional payment among the applicable payees. The Independent Auditor shall then reduce such additional payment (up to the full amount of such additional payment) by any adjustments or offsets that were available to the Participating Manufacturer in question against the original payment at the time it was made (and have not since been used) but which such Participating Manufacturer was unable to use against such original payment because such adjustments or offsets were in excess of such original payment (provided that any adjustments or offsets used against such additional payment shall reduce on a dollar-for-dollar basis any remaining carry-forward held by such Participating Manufacturer with respect to such adjustment or offset). The Independent Auditor shall then add interest at the Prime Rate (calculated from the Payment Due Date in question) to the additional payment (as reduced pursuant to the preceding sentence), except that where the additional payment owed by a Participating Manufacturer is the result of an underpayment by such Participating Manufacturer caused by such Participating Manufacturer's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h). The Independent Auditor shall promptly give notice of the additional payment owed by the Participating Manufacturer in question (as reduced and/or increased as described above) to all Notice Parties, showing the new information and all calculations. Upon receipt of such notice, any Participating Manufacturer or Settling State may dispute the Independent Auditor's calculations in the manner described in subsection (d)(3), and the Independent Auditor shall promptly notify each Notice Party of any subsequent revisions to its calculations. Not more than 15 days after receipt of such notice (or, if the Independent Auditor revises its calculations, not more than 15 days after receipt of the revisions), any Participating Manufacturer and any Settling State may dispute the Independent Auditor's calculations in the manner prescribed in subsection (d)(6). Failure to dispute the Independent Auditor's calculations in this manner shall constitute agreement with the Independent Auditor's calculations, subject to the limitations set forth in subsection (d)(6). Payment of the undisputed portion of an additional payment shall be made to the Escrow Agent not more than 20 days after receipt of the notice described in this subsection (A) (or, if the Independent Auditor revises its calculations, not more than 20 days after receipt of the revisions). Failure to pay such portion shall render the Participating Manufacturer liable for interest thereon as provided in subsection IX(h). Payment of the disputed portion shall be governed by subsection (d)(8).

(B) To the extent a dispute as to a prior payment is resolved with finality against a Participating Manufacturer: (i) in the case where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to the applicable payee Account(s); (ii) in the case where the disputed amount has not been paid into the Disputed Payments Account and the dispute was identified prior to the Payment Due Date in question by delivery of a statement pursuant to subsection (d)(6) identifying such dispute, the Independent Auditor shall calculate interest on the disputed amount from the Payment Due Date in question (the applicable interest rate to be that provided in subsection IX(h)) and the allocation of such amount and interest among the applicable payees, and shall provide notice of the amount owed (and the identity of the payor and payees) to all Notice Parties; and (iii) in all other cases, the procedure described in subsection (ii) shall apply, except that the applicable interest rate shall be the Prime Rate.

(2) Overpayments.

(A) If a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid into the Disputed Payments Account pursuant to subsection (d)(8), the Independent Auditor shall instruct the Escrow Agent to transfer such amount to such Participating Manufacturer.

(B) If information becomes available to the Independent Auditor not later than four years after a Payment Due Date showing that a Participating Manufacturer made an overpayment on such date, or if a dispute as to a prior payment is resolved with finality in favor of a Participating Manufacturer where the disputed amount has been paid but not into the Disputed Payments Account, such Participating Manufacturer shall be entitled to a continuing dollar-for-dollar offset as follows:

(i) offsets under this subsection (B) shall be applied only against eligible payments to be made by such Participating Manufacturer after the entitlement to the offset arises. The eligible payments shall be: in the case of offsets arising from payments under subsection IX(b) or IX(c)(1), subsequent payments under any of such subsections; in the case of offsets arising from payments under subsection IX(c)(2), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under subsection IX(c)(1); in the case of offsets arising from payments under subsection IX(e), subsequent payments under such subsection or subsection IX(c); in the case of offsets arising from payments under subsection VI(c), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under any of subsection IX(c)(1), IX(c)(2) or IX(e); in the case of offsets arising from payments under subsection VIII(b), subsequent payments under such subsection or, if no subsequent payments are to be made under such subsection, subsequent payments under either subsection IX(c)(1) or IX(c)(2); in the case of offsets arising from payments under subsection VIII(c), subsequent payments under either subsection IX(c)(1) or IX(c)(2); and, in the case of offsets arising from payments under subsection IX(i), subsequent payments under such subsection (consistent with the provisions of this subsection (B)(i)).

(ii) in the case of offsets to be applied against payments under subsection IX(c), the offset to be applied shall be apportioned among the Settling States pro rata in proportion to their respective shares of such payments, as such respective shares are determined pursuant to step E of clause "Seventh" (in the case of payments due from the Original Participating Manufacturers) or clause "Sixth" (in the case of payments due from the Subsequent Participating Manufacturers) of subsection IX(j) (except where the offset arises from an overpayment applicable solely to a particular Settling State).

(iii) the total amount of the offset to which a Participating Manufacturer shall be entitled shall be the full amount of the overpayment it made, together with interest calculated from the time of the overpayment to the Payment Due Date of the first eligible payment against which the offset may be applied. The applicable interest rate shall be the Prime Rate (except that, where the overpayment is the result of a Settling State's withholding of information as described in subsection (d)(5)(B), the applicable interest rate shall be that described in subsection IX(h)).

(iv) an offset under this subsection (B) shall be applied up to the full amount of the Participating Manufacturer's share (in the case of payments due from Original Participating Manufacturers, determined as described in the first sentence of clause "Seventh" of subsection IX(j) (or, in the case of payments pursuant to subsection IX(c), step D of such clause)) of the eligible payment in question, as such payment has been adjusted and reduced pursuant to clauses "First" through "Sixth" of subsection IX(j), to the extent each such clause is applicable to the payment in question. In the event that the offset to which a Participating Manufacturer is entitled under this subsection (B) would exceed such Participating Manufacturer's share of the eligible payment against which it is being applied (or, in the case where such offset arises from an overpayment applicable solely to a particular Settling State, the portion of such payment that is made for the benefit of such Settling State), the offset shall be the full amount of such Participating Manufacturer's share of such payment and all amounts not offset shall carry forward and be offset against subsequent eligible payments until all such amounts have been offset.

(j) Payments After Applicable Condition. To the extent that a payment is made after the occurrence of all applicable conditions for the disbursement of such payment to the payee(s) in question, the Independent Auditor shall instruct the Escrow Agent to disburse such payment promptly following its deposit.

XII. SETTLING STATES' RELEASE, DISCHARGE AND COVENANT

(a) Release.

(1) Upon the occurrence of State-Specific Finality in a Settling State, such Settling State shall absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Releasing Parties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall or may have.

(2) Notwithstanding the foregoing, this release and discharge shall not apply to any defendant in a lawsuit settled pursuant to this Agreement (other than a Participating Manufacturer) unless and until such defendant releases the Releasing Parties (and delivers to the Attorney General of the applicable Settling State a copy of such release) from any and all Claims of such defendant relating to the prosecution of such lawsuit.

(3) Each Settling State (for itself and for the Releasing Parties) further covenants and agrees that it (and the Releasing Parties) shall not after the occurrence of State-Specific Finality sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

(4) (A) Each Settling State (for itself and for the Releasing Parties) further agrees that, if a Released Claim by a Releasing Party against any person or entity that is not a Released Party (a "non-Released Party") results in or in any way gives rise to a claim-over (on any theory whatever other than a claim based on an express written indemnity agreement) by such non-Released Party against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such non-Released Party the full amount of any judgment or settlement such non-Released Party may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such non-Released Party, obtain from such non-Released Party for the benefit of such Released Party a satisfaction in full of such non-Released Party's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (4)(A) do not fully eliminate any and all liability of any Original Participating Manufacturer (or of any person or entity that is a Released Party by virtue of its relation to any Original Participating Manufacturer) with respect to claims-over (on any theory whatever other than a claim based on an express written indemnity agreement) by any non-Released Party to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such non-Released Party to any Releasing Party arising out of any Released Claim, such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (4) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset and the Litigating Releasing Parties Offset): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of subsection (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of section IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(5) This release and covenant shall not operate to interfere with a Settling State's ability to enforce as against any Participating Manufacturer the provisions of this Agreement, or with the Court's ability to enter the Consent Decree or to maintain continuing jurisdiction to enforce such Consent Decree pursuant to the terms thereof. Provided, however, that neither subsection III(a) or III(r) of this Agreement nor subsection V(A) or V(I) of the Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

(6) The Settling States do not purport to waive or release any claims on behalf of Indian tribes.

(7) The Settling States do not waive or release any criminal liability based on federal, state or local law.

(8) Notwithstanding the foregoing (and the definition of Released Parties), this release and covenant shall not apply to retailers, suppliers or distributors to the extent of any liability arising from the sale or distribution of Tobacco Products of, or the supply of component parts of Tobacco Products to, any non-Released Party.

(A) Each Settling State (for itself and for the Releasing Parties) agrees that, if a claim by a Releasing Party against a retailer, supplier or distributor that would be a Released Claim but for the operation of the preceding sentence results in or in any way gives rise to a claim-over (on any theory whatever) by such retailer, supplier or distributor against any Released Party (and such Released Party gives notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), the Releasing Party: (i) shall reduce or credit against any judgment or settlement such Releasing Party may obtain against such retailer, supplier or distributor the full amount of any judgment or settlement such retailer, supplier or distributor may obtain against the Released Party on such claim-over; and (ii) shall, as part of any settlement with such retailer, supplier or distributor, obtain from such retailer, supplier or distributor for the benefit of such Released Party a satisfaction in full of such retailer's, supplier's or distributor's judgment or settlement against the Released Party.

(B) Each Settling State further agrees that in the event that the provisions of subsection (8)(A) above do not fully eliminate any and all liability of any Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship to an Original Participating Manufacturer) with respect to claims-over (on any theory whatever) by any such retailer, supplier or distributor to recover in whole or in part any liability (whether direct or indirect, or whether by way of settlement (to the extent that such Released Party has given notice to the applicable Settling State within 30 days of the service of such claim-over (or within 30 days after the MSA Execution Date, whichever is later) and prior to entry into any settlement of such claim-over), judgment or otherwise) of such retailer, supplier or distributor to any Releasing Party arising out of any claim that would be a Released Claim but for the operation of the first sentence of this subsection (8), such Original Participating Manufacturer shall receive a continuing dollar-for-dollar offset for any amounts paid by such Original Participating Manufacturer (or by any person or entity that is a Released Party by virtue of its relation to such Original Participating Manufacturer) on any such liability against such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment, up to the full amount of such Original Participating Manufacturer's share of such Allocated Payment each year, until all such amounts paid on such liability have been offset. In the event that the offset under this subsection (8) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the offset for miscalculated or disputed payments, the Federal Tobacco Legislation Offset, the Litigating Releasing Parties Offset and the offset for claims-over under subsection XII(a)(4)(B)): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(C) Each Settling State further agrees that, subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset described in subsection (B) above to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on liability that would give rise to an offset under such subsection if paid by an Original Participating Manufacturer.

(9) Notwithstanding any provision of law, statutory or otherwise, which provides that a general release does not extend to claims which the creditor does not know or suspect to exist in its favor at the time of executing the release, which if known by it must have materially affected its settlement with the debtor, the releases set forth in this section XII release all Released Claims against the Released Parties, whether known or unknown, foreseen or unforeseen, suspected or unsuspected, that the Releasing Parties may have against the Released Parties, and the Releasing Parties understand and acknowledge the significance and consequences of waiver of any such provision and hereby assume full responsibility for any injuries, damages or losses that the Releasing Parties may incur.

(b) Released Claims Against Released Parties. If a Releasing Party (or any person or entity enumerated in subsection II(pp), without regard to the power of the Attorney General to release claims of such person or entity) nonetheless attempts to maintain a Released Claim against a Released Party, such Released Party shall give written notice of such potential claim to the Attorney General of the applicable Settling State within 30 days of receiving notice of such potential claim (or within 30 days after the MSA Execution Date, whichever is later) (unless such potential claim is being maintained by such Settling State). The Released Party may offer the release and covenant as a complete defense. If it is determined at any point in such action that the release of such claim is unenforceable or invalid for any reason (including, but not limited to, lack of authority to release such claim), the following provisions shall apply:

(1) The Released Party shall take all ordinary and reasonable measures to defend the action fully. The Released Party may settle or enter into a stipulated judgment with respect to the action at any time in its sole discretion, but in such event the offset described in subsection (b)(2) or (b)(3) below shall apply only if the Released Party obtains the relevant Attorney General's consent to such settlement or stipulated judgment, which consent shall not be unreasonably withheld. The Released Party shall not be entitled to the offset described in subsection (b)(2) or (b)(3) below if such Released Party failed to take ordinary and reasonable measures to defend the action fully.

(2) The following provisions shall apply where the Released Party is an Original Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with an Original Participating Manufacturer):

(A) In the event of a settlement or stipulated judgment, the settlement or stipulated amount shall give rise to a continuing offset as such amount is actually paid against the full amount of such Original Participating Manufacturer's share (determined as described in step E of clause "Seventh" of subsection IX(j)) of the applicable Settling State's Allocated Payment until such time as the settlement or stipulated amount is fully credited on a dollar-for-dollar basis.

(B) Judgments (other than a default judgment) against a Released Party in such an action shall, upon payment of such judgment, give rise to an immediate and continuing offset against the full amount of such Original Participating Manufacturer's share (determined as described in subsection (A)) of the applicable Settling State's Allocated Payment, until such time as the judgment is fully credited on a dollar-for-dollar basis.

(C) Each Settling State reserves the right to intervene in such an action (unless such action was brought by the Settling State) to the extent authorized by applicable law in order to protect the Settling State's interest under this Agreement. Each Participating Manufacturer agrees not to oppose any such intervention.

(D) In the event that the offset under this subsection (b)(2) with respect to a particular Settling State would in any given year exceed such Original Participating Manufacturer's share of such Settling State's Allocated Payment (as such share had been reduced by adjustment, if any, pursuant to the NPM Adjustment, and has been reduced by offsets, if any, pursuant to the Federal Tobacco Legislation Offset and the offset for miscalculated or disputed payments): (i) the offset to which such Original Participating Manufacturer is entitled under this subsection (2) in such year shall be the full amount of such Original Participating Manufacturer's share of such Allocated Payment; and (ii) all amounts not offset by reason of clause (i) shall carry forward and be offset in the following year(s) until all such amounts have been offset.

(3) The following provisions shall apply where the Released Party is a Subsequent Participating Manufacturer (or any person or entity that is a Released Party by virtue of its relationship with a Subsequent Participating Manufacturer): Subject to the provisions of subsection IX(i)(3), each Subsequent Participating Manufacturer shall be entitled to the offset as described in subsections (2)(A)-(C) above against payments it otherwise would owe under section IX(i) to the extent that it (or any person or entity that is a Released Party by virtue of its relationship with such Subsequent Participating Manufacturer) has paid on a settlement, stipulated judgment or judgment that would give rise to an offset under such subsections if paid by an Original Participating Manufacturer.

XIII. CONSENT DECREES AND DISMISSAL OF CLAIMS

(a) Within 10 days after the MSA Execution Date (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit), each Settling State and each Participating Manufacturer that is a party in any of the lawsuits identified in Exhibit D shall jointly move for a stay of all proceedings in such Settling State's lawsuit with respect to the Participating Manufacturers and all other Released Parties (except any proceeding seeking public disclosure of documents pursuant to subsection IV(b)). Such stay of a Settling State's lawsuit shall be dissolved upon the earlier of the occurrence of State-Specific Finality or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Not later than December 11, 1998 (or, as to any Settling State identified in the Additional States provision of Exhibit D, concurrently with the filing of its lawsuit):

(1) each Settling State that is a party to a lawsuit identified in Exhibit D and each Participating Manufacturer will:

(A) tender this Agreement to the Court in such Settling State for its approval; and

(B) tender to the Court in such Settling State for entry a consent decree conforming to the model consent decree attached hereto as Exhibit L (revisions or changes to such model consent decree shall be limited to the extent required by state procedural requirements to reflect accurately the factual setting of the case in question, but shall not include any substantive revision to the duties or obligations of any Settling State or Participating Manufacturer, except by agreement of all Original Participating Manufacturers); and

(2) each Settling State shall seek entry of an order of dismissal of claims dismissing with prejudice all claims against the Participating Manufacturers and any other Released Party in such Settling State's action identified in Exhibit D. Provided, however, that the Settling State is not required to seek entry of such an order in such Settling State's action against such a Released Party (other than a Participating Manufacturer) unless and until such Released Party has released the Releasing Parties (and delivered to the Attorney General of such Settling State a copy of such release) (which release shall be effective upon the occurrence of State-Specific Finality in such Settling State, and shall recite that in the event this Agreement is terminated with respect to such Settling State pursuant to subsection XVIII(u)(1) the Released Party agrees that the order of dismissal shall be null and void and of no effect) from any and all Claims of such Released Party relating to the prosecution of such action as provided in subsection XII(a)(2).

XIV. PARTICIPATING MANUFACTURERS' DISMISSAL OF RELATED LAWSUITS

(a) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will dismiss without prejudice (and without costs and fees) the lawsuit(s) listed in Exhibit M pending in such Settling State in which the Participating Manufacturer is a plaintiff. Within 10 days after the MSA Execution Date, each Participating Manufacturer and each Settling State that is a party in any of the lawsuits listed in Exhibit M shall jointly move for a stay of all proceedings in such lawsuit. Such stay of a lawsuit against a Settling State shall be dissolved upon the earlier of the occurrence of State-Specific Finality in such Settling State or termination of this Agreement with respect to such Settling State pursuant to subsection XVIII(u)(1).

(b) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against such Settling State and any of such Settling State's officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel relating to or in connection with the lawsuit(s) commenced by the Attorney General of such Settling State identified in Exhibit D.

(c) Upon State-Specific Finality in a Settling State, each Participating Manufacturer will release and discharge any and all monetary Claims against all subdivisions (political or otherwise, including, but not limited to, municipalities, counties, parishes, villages, unincorporated districts and hospital districts) of such Settling State, and any of their officers, employees, agents, administrators, representatives, officials acting in their official capacity, agencies, departments, commissions, divisions and counsel arising out of Claims that have been waived and released with continuing full force and effect pursuant to section XII of this Agreement.

XV. VOLUNTARY ACT OF THE PARTIES

The Settling States and the Participating Manufacturers acknowledge and agree that this Agreement is voluntarily entered into by each Settling State and each Participating Manufacturer as the result of arm's-length negotiations, and each Settling State and each Participating Manufacturer was represented by counsel in deciding to enter into this Agreement. Each Participating Manufacturer further acknowledges that it understands that certain provisions of this Agreement may require it to act or refrain from acting in a manner that could otherwise give rise to state or federal constitutional challenges and that, by voluntarily consenting to this Agreement, it (and the Tobacco-Related Organizations (or any trade associations formed or controlled by any Participating Manufacturer)) waives for purposes of performance of this Agreement any and all claims that the provisions of this Agreement violate the state or federal constitutions. Provided, however, that nothing in the foregoing shall constitute a waiver as to the entry of any court order (or any interpretation thereof) that would operate to limit the exercise of any constitutional right except to the extent of the restrictions, limitations or obligations expressly agreed to in this Agreement or the Consent Decree.

XVI. CONSTRUCTION

(a) No Settling State or Participating Manufacturer shall be considered the drafter of this Agreement or any Consent Decree, or any provision of either, for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter.

(b) Nothing in this Agreement shall be construed as approval by the Settling States of any Participating Manufacturer's business organizations, operations, acts or practices, and no Participating Manufacturer may make any representation to the contrary.

XVII. RECOVERY OF COSTS AND ATTORNEYS' FEES

(a) The Original Participating Manufacturers agree that, with respect to any Settling State in which the Court has approved this Agreement and the Consent Decree, they shall severally reimburse the following "Governmental Entities": (1) the office of the Attorney General of such Settling State; (2) the office of the governmental prosecuting authority for any political subdivision of such Settling State with a lawsuit pending against any Participating Manufacturer as of July 1, 1998 (as identified in Exhibit N) that has released such Settling State and such Participating Manufacturer(s) from any and all Released Claims (a "Litigating Political Subdivision"); and (3) other appropriate agencies of such Settling State and such Litigating Political Subdivision, for reasonable costs and expenses incurred in connection with the litigation or resolution of claims asserted by or against the Participating Manufacturers in the actions set forth in Exhibits D, M and N; provided that such costs and expenses are of the same nature as costs and expenses for which the Original Participating Manufacturers would reimburse their own counsel or agents (but not including costs and expenses relating to lobbying activities).

(b) The Original Participating Manufacturers further agree severally to pay the Governmental Entities in any Settling State in which State-Specific Finality has occurred an amount sufficient to compensate such Governmental Entities for time reasonably expended by attorneys and paralegals employed in such offices in connection with the litigation or resolution of claims asserted against or by the Participating Manufacturers in the actions identified in Exhibits D, M and N (but not including time relating to lobbying activities), such amount to be calculated based upon hourly rates equal to the market rate in such Settling State for private attorneys and paralegals of equivalent experience and seniority.

(c) Such Governmental Entities seeking payment pursuant to subsection (a) and/or (b) shall provide the Original Participating Manufacturers with an appropriately documented statement of all costs, expenses and attorney and paralegal time for which payment is sought, and, solely with respect to payments sought pursuant to subsection (b), shall do so no earlier than the date on which State-Specific Finality occurs in such Settling State. All amounts to be paid pursuant to subsections (a) and (b) shall be subject to reasonable verification if requested by any Original Participating Manufacturer; provided, however, that nothing contained in this subsection (c) shall constitute, cause, or require the performance of any act that would constitute any waiver (in whole or in part) of any attorney-client privilege, work product protection or common interest/joint prosecution privilege. All such amounts to be paid pursuant to subsections (a) and (b) shall be subject to an aggregate cap of $150 million for all Settling States, shall be paid promptly following submission of the appropriate documentation (and the completion of any verification process), shall be paid separately and apart from any other amounts due pursuant to this Agreement, and shall be paid severally by each Original Participating Manufacturer according to its Relative Market Share. All amounts to be paid pursuant to subsection (b) shall be paid to such Governmental Entities in the order in which State-Specific Finality has occurred in such Settling States (subject to the $150 million aggregate cap).

(d) The Original Participating Manufacturers agree that, upon the occurrence of State-Specific Finality in a Settling State, they will severally pay reasonable attorneys' fees to the private outside counsel, if any, retained by such Settling State (and each Litigating Political Subdivision, if any, within such Settling State) in connection with the respective actions identified in Exhibits D, M and N and who are designated in Exhibit S for each Settling State by the relevant Attorney General (and for each Litigating Political Subdivision, as later certified in writing to the Original Participating Manufacturers by the relevant governmental prosecuting authority of each Litigating Political Subdivision) as having been retained by and having represented such Settling State (or such Litigating Political Subdivision), in accordance with the terms described in the Model Fee Payment Agreement attached as Exhibit O.

XVIII. MISCELLANEOUS

(a) Effect of Current or Future Law. If any current or future law includes obligations or prohibitions applying to Tobacco Product Manufacturers related to any of the provisions of this Agreement, each Participating Manufacturer shall comply with this Agreement unless compliance with this Agreement would violate such law.

(b) Limited Most-Favored Nation Provision.

(1) If any Participating Manufacturer enters into any future settlement agreement of other litigation comparable to any of the actions identified in Exhibit D brought by a non-foreign governmental plaintiff other than the federal government ("Future Settlement Agreement"):

' (A) before October 1, 2000, on overall terms more favorable to such governmental plaintiff than the overall terms of this Agreement (after due consideration of relevant differences in population or other appropriate factors), then, unless a majority of the Settling States determines that the overall terms of the Future Settlement Agreement are not more favorable than the overall terms of this Agreement, the overall terms of this Agreement will be revised so that the Settling States will obtain treatment with respect to such Participating Manufacturer at least as relatively favorable as the overall terms provided to any such governmental plaintiff; provided, however, that as to economic terms this Agreement shall not be revised based on any such Future Settlement Agreement if such Future Settlement Agreement is entered into after: (i) the impaneling of the jury (or, in the event of a non-jury trial, the commencement of trial) in such litigation or any severed or bifurcated portion thereof; or (ii) any court order or judicial determination relating to such litigation that (x) grants judgment (in whole or in part) against such Participating Manufacturer; or (y) grants injunctive or other relief that affects the assets or on-going business activities of such Participating Manufacturer in a manner other than as expressly provided for in this Agreement; or

(B) on or after October 1, 2000, on non-economic terms more favorable to such governmental plaintiff than the non-economic terms of this Agreement, and such Future Settlement Agreement includes terms that provide for the implementation of non-economic tobacco-related public health measures different from those contained in this Agreement, then this Agreement shall be revised with respect to such Participating Manufacturer to include terms comparable to such non-economic terms, unless a majority of the Settling States elects against such revision.

(2) If any Settling State resolves by settlement Claims against any Non-Participating Manufacturer after the MSA Execution Date comparable to any Released Claim, and such resolution includes overall terms that are more favorable to such Non-Participating Manufacturer than the terms of this Agreement (including, without limitation, any terms that relate to the marketing or distribution of Tobacco Products and any term that provides for a lower settlement cost on a per pack sold basis), then the overall terms of this Agreement will be revised so that the Original Participating Manufacturers will obtain, with respect to that Settling State, overall terms at least as relatively favorable (taking into account, among other things, all payments previously made by the Original Participating Manufacturers and the timing of any payments) as those obtained by such Non-Participating Manufacturer pursuant to such resolution of Claims. The foregoing shall include but not be limited: (a) to the treatment by any Settling State of a Future Affiliate, as that term is defined in agreements between any of the Settling States and Brooke Group Ltd., Liggett & Myers Inc. and/or Liggett Group, Inc. ("Liggett"), whether or not such Future Affiliate is merged with, or its operations combined with, Liggett or any Affiliate thereof; and (b) to any application of the terms of any such agreement (including any terms subsequently negotiated pursuant to any such agreement) to a brand of Cigarettes (or tobacco-related assets) as a result of the purchase by or sale to Liggett of such brand or assets or as a result of any combination of ownership among Liggett and any entity that manufactures Tobacco Products. Provided, however, that revision of this Agreement pursuant to this subsection (2) shall not be required by virtue of the subsequent entry into this Agreement by a Tobacco Product Manufacturer that has not become a Participating Manufacturer as of the MSA Execution Date. Notwithstanding the provisions of subsection XVIII(j), the provisions of this subsection XVIII(b)(2) may be waived by (and only by) unanimous agreement of the Original Participating Manufacturers.

(3) The parties agree that if any term of this Agreement is revised pursuant to subsection (b)(l) or (b)(2) above and the substance of such term before it was revised was also a term of the Consent Decree, each affected Settling State and each affected Participating Manufacturer shall jointly move the Court to amend the Consent Decree to conform the terms of the Consent Decree to the revised terms of the Agreement.

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

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

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

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

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

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

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

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

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

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

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

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

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

(o) Severability.

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

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

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

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

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

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

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

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

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

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

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

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

(u) Termination.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(ee) Export Packaging. Each Participating Manufacturer shall place a visible indication on each pack of Cigarettes it manufactures for sale outside of the fifty United States and the District of Columbia that distinguishes such pack from packs of Cigarettes it manufactures for sale in the fifty United States and the District of Columbia.

(ff) Actions Within Geographic Boundaries of Settling States. To the extent that any provision of this Agreement expressly prohibits, restricts, or requires any action to be taken "within" any Settling State or the Settling States, the relevant prohibition, restriction, or requirement applies within the geographic boundaries of the applicable Settling State or Settling States, including, but not limited to, Indian country or Indian trust land within such geographic boundaries.

(gg) Notice to Affiliates. Each Participating Manufacturer shall give notice of this Agreement to each of its Affiliates.

IN WITNESS WHEREOF, each Settling State and each Participating Manufacturer, through their fully authorized representatives, have agreed to this Agreement.

[Signatures Intentionally Omitted]

EXHIBIT A
STATE ALLOCATION PERCENTAGES

State	Percentage
Alabama	1.6161308%
Alaska	0.3414187%
Arizona	1.4738845%
Arkansas	0.8280661%
California	12.7639554%
Colorado	1.3708614%
Connecticut	1.8565373%
Delaware	0.3954695%
D.C.	0.6071183%
Florida	0.0000000%
Georgia	2.4544575%
Hawaii	0.6018650%
Idaho	0.3632632%
Illinois	4.6542472%
Indiana	2.0398033%
Iowa	0.8696670%
Kansas	0.8336712%
Kentucky	1.7611586%
Louisiana	2.2553531%
Maine	0.7693505%
Maryland	2.2604570%
Massachusetts	4.0389790%
Michigan	4.3519476%
Minnesota	0.0000000%
Mississippi	0.0000000%
Missouri	2.2746011%
Montana	0.4247591%
Nebraska	0.5949833%
Nevada	0.6099351%
New Hampshire	0.6659340%
New Jersey	3.8669963%
New Mexico	0.5963897%
New York	12.7620310%
North Carolina	2.3322850%
North Dakota	0.3660138%
Ohio	5.0375098%
Oklahoma	1.0361370%
Oregon	1.1476582%
Pennsylvania	5.7468588%
Rhode Island	0.7189054%
South Carolina	1.1763519%
South Dakota	0.3489458%
Tennessee	2.4408945%
Texas	0.0000000%
Utah	0.4448869%
Vermont	0.4111851%
Virginia	2.0447451%
Washington	2.0532582%
West Virginia	0.8864604%
Wisconsin	2.0720390%
Wyoming	0.2483449%
American Samoa	0.0152170%
N. Mariana Isld.	0.0084376%
Guam	0.0219371%
U.S. Virgin Isld.	0.0173593%
Puerto Rico	1.1212774%
Total	100.0000000%

EXHIBIT B
FORM OF ESCROW AGREEMENT

This Escrow Agreement is entered into as of _______________, 1998 by the undersigned State officials (on behalf of their respective Settling States), the undersigned Participating Manufacturers and ____________________ as escrow agent (the "Escrow Agent").

WITNESSETH:

WHEREAS, the Settling States and the Participating Manufacturers have entered into a settlement agreement entitled the "Master Settlement Agreement" (the "Agreement"); and

WHEREAS, the Agreement requires the Settling States and the Participating Manufacturers to enter into this Escrow Agreement.

NOW, THEREFORE, the parties hereto agree as follows:

SECTION 1. *Appointment of Escrow Agent.*

The Settling States and the Participating Manufacturers hereby appoint ______________________ to serve as Escrow Agent under this Agreement on the terms and conditions set forth herein, and the Escrow Agent, by its execution hereof, hereby accepts such appointment and agrees to perform the duties and obligations of the Escrow Agent set forth herein. The Settling States and the Participating Manufacturers agree that the Escrow Agent appointed under the terms of this Escrow Agreement shall be the Escrow Agent as defined in, and for all purposes of, the Agreement.

SECTION 2. *Definitions.*

(a) Capitalized terms used in this Escrow Agreement and not otherwise defined herein shall have the meaning given to such terms in the Agreement.

(b) "Escrow Court" means the court of the State of New York to which the Agreement is presented for approval, or such other court as agreed to by the Original Participating Manufacturers and a majority of those Attorneys General who are both the Attorney General of a Settling State and a member of the NAAG executive committee at the time in question.

SECTION 3. *Escrow and Accounts.*

(a) All funds received by the Escrow Agent pursuant to the terms of the Agreement shall be held and disbursed in accordance with the terms of this Escrow Agreement. Such funds and any earnings thereon shall constitute the "Escrow" and shall be held by the Escrow Agent separate and apart from all other funds and accounts of the Escrow Agent, the Settling States and the Participating Manufacturers.

(b) The Escrow Agent shall allocate the Escrow among the following separate accounts (each an "Account" and collectively the "Accounts"):

SUBSECTION VI(B) ACCOUNT
SUBSECTION VI(C) ACCOUNT (FIRST)
SUBSECTION VI(C) ACCOUNT (SUBSEQUENT)
SUBSECTION VIII(B) ACCOUNT
SUBSECTION VIII(C) ACCOUNT
SUBSECTION IX(B) ACCOUNT (FIRST)
SUBSECTION IX(B) ACCOUNT (SUBSEQUENT)
SUBSECTION IX(C)(1) ACCOUNT
SUBSECTION IX(C)(2) ACCOUNT
SUBSECTION IX(E) ACCOUNT
DISPUTED PAYMENTS ACCOUNT
STATE-SPECIFIC ACCOUNTS WITH RESPECT TO EACH SETTLING STATE IN WHICH STATE-SPECIFIC FINALITY OCCURS.

(c) All amounts credited to an Account shall be retained in such Account until disbursed therefrom in accordance with the provisions of this Escrow Agreement pursuant to (i) written instructions from the Independent Auditor; or (ii) written instructions from all of the following: all of the Original Participating Manufacturers; all of the Subsequent Participating Manufacturers that contributed to such amounts in such Account; and all of the Settling States (collectively, the "Escrow Parties"). In the event of a conflict, instructions pursuant to clause (ii) shall govern over instructions pursuant to clause (i).

(d) On the first Business Day after the date any payment is due under the Agreement, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount of such payment (or indicating that no payment was made, if such is the case), the source of such payment, the Account or Accounts to which such payment has been credited, and the payment instructions received by the Escrow Agent from the Independent Auditor with respect to such payment.

(e) The Escrow Agent shall comply with all payment instructions received from the Independent Auditor unless before 11:00 a.m. (New York City time) on the scheduled date of payment it receives written instructions to the contrary from all of the Escrow Parties, in which event it shall comply with such instructions.

(f) On the first Business Day after disbursing any funds from an Account, the Escrow Agent shall deliver to each other Notice Party a written statement showing the amount disbursed, the date of such disbursement and the payee of the disbursed funds.

SECTION 4. *Failure of Escrow Agent to Receive Instructions.*

In the event that the Escrow Agent fails to receive any written instructions contemplated by this Escrow Agreement, the Escrow Agent shall be fully protected in refraining from taking any action required under any section of this Escrow Agreement other than Section 5 until such written instructions are received by the Escrow Agent.

SECTION 5. *Investment of Funds by Escrow Agent.*

The Escrow Agent shall invest and reinvest all amounts from time to time credited to the Accounts in either (i) direct obligations of, or obligations the principal and interest on which are unconditionally guaranteed by, the United States of America; (ii) repurchase agreements fully collateralized by securities described in clause (i) above; (iii) money market accounts maturing within 30 days of the acquisition thereof and issued by a bank or trust company organized under the laws of the United States of America or of any of the 50 States thereof (a "United States Bank") and having combined capital, surplus and undistributed profits in excess of $500,000,000; or (iv) demand deposits with any United States Bank having combined capital, surplus and undistributed profits in excess of $500,000,000. To the extent practicable, monies credited to any Account shall be invested in such a manner so as to be available for use at the times when monies are expected to be disbursed by the Escrow Agent and charged to such Account. Obligations purchased as an investment of monies credited to any Account shall be deemed at all times to be a part of such Account and the income or interest earned, profits realized or losses suffered with respect to such investments (including, without limitation, any penalty for any liquidation of an investment required to fund a disbursement to be charged to such Account), shall be credited or charged, as the case may be, to, such Account and shall be for the benefit of, or be borne by, the person or entity entitled to payment from such Account. In choosing among the investment options described in clauses (i) through (iv) above, the Escrow Agent shall comply with any instructions received from time to time from all of the Escrow Parties. In the absence of such instructions, the Escrow Agent shall invest such sums in accordance with clause (i) above. With respect to any amounts credited to a State-Specific Account, the Escrow Agent shall invest and reinvest all amounts credited to such Account in accordance with the law of the applicable Settling State to the extent such law is inconsistent with this Section 5.

SECTION 6. *Substitute Form W-9; Qualified Settlement Fund.*

Each signatory to this Escrow Agreement shall provide the Escrow Agent with a correct taxpayer identification number on a substitute Form W-9 or if it does not have such a number, a statement evidencing its status as an entity exempt from back-up withholding, within 30 days of the date hereof (and, if it supplies a Form W-9, indicate thereon that it is not subject to backup withholding). The escrow established pursuant to this Escrow Agreement is intended to be treated as a Qualified Settlement Fund for federal tax purposes pursuant to Treas. Reg. § 1.468B-l. The Escrow Agent shall comply with all applicable tax filing, payment and reporting requirements, including, without limitation, those imposed under Treas. Reg. § 1.468B, and if requested to do so shall join in the making of the relation-back election under such regulation.

SECTION 7. *Duties and Liabilities of Escrow Agent.*

The Escrow Agent shall have no duty or obligation hereunder other than to take such specific actions as are required of it from time to time under the provisions of this Escrow Agreement, and it shall incur no liability hereunder or in connection herewith for anything whatsoever other than any liability resulting from its own gross negligence or willful misconduct. The Escrow Agent shall not be bound in any way by any agreement or contract between the Participating Manufacturers and the Settling States (whether or not the Escrow Agent has knowledge thereof) other than this Escrow Agreement, and the only duties and responsibilities of the Escrow Agent shall be the duties and obligations specifically set forth in this Escrow Agreement.

SECTION 8. *Indemnification of Escrow Agent.*

The Participating Manufacturers shall indemnify, hold harmless and defend the Escrow Agent from and against any and all losses, claims, liabilities and reasonable expenses, including the reasonable fees of its counsel, which it may suffer or incur in connection with the performance of its duties and obligations under this Escrow Agreement, except for those losses, claims, liabilities and expenses resulting solely and directly from its own gross negligence or willful misconduct.

SECTION 9. *Resignation of Escrow Agent.*

The Escrow Agent may resign at any time by giving written notice thereof to the other parties hereto, but such resignation shall not become effective until a successor Escrow Agent, selected by the Original Participating Manufacturers and the Settling States, shall have been appointed and shall have accepted such appointment in writing. If an instrument of acceptance by a successor Escrow Agent shall not have been delivered to the resigning Escrow Agent within 90 days after the giving of such notice of resignation, the resigning Escrow Agent may, at the expense of the Participating Manufacturers (to be shared according to their pro rata Market Shares), petition the Escrow Court for the appointment of a successor Escrow Agent.

SECTION 10. *Escrow Agent Fees and Expenses.*

The Participating Manufacturers shall pay to the Escrow Agent its fees as set forth in Appendix A hereto as amended from time to time by agreement of the Original Participating Manufacturers and the Escrow Agent. The Participating Manufacturers shall pay to the Escrow Agent its reasonable fees and expenses, including all reasonable expenses, charges, counsel fees, and other disbursements incurred by it or by its attorneys, agents and employees in the performance of its duties and obligations under this Escrow Agreement. Such fees and expenses shall be shared by the Participating Manufacturers according to their pro rata Market Shares.

SECTION 11. *Notices.*

All notices, written instructions or other communications to any party or other person hereunder shall be given in the same manner as, shall be given to the same person as, and shall be effective at the same time as provided in subsection XVIII(k) of the Agreement.

SECTION 12. *Setoff; Reimbursement.*

The Escrow Agent acknowledges that it shall not be entitled to set off against any funds in, or payable from, any Account to satisfy any liability of any Participating Manufacturer. Each Participating Manufacturer that pays more than its pro rata Market Share of any payment that is made by the Participating Manufacturers to the Escrow Agent pursuant to Section 8, 9 or 10 hereof shall be entitled to reimbursement of such excess from the other Participating Manufacturers according to their pro rata Market Shares of such excess.

SECTION 13. *Intended Beneficiaries; Successors.*

No persons or entities other than the Settling States, the Participating Manufacturers and the Escrow Agent are intended beneficiaries of this Escrow Agreement, and only the Settling States, the Participating Manufacturers and the Escrow Agent shall be entitled to enforce the terms of this Escrow Agreement. Pursuant to the Agreement, the Settling States have designated NAAG and the Foundation as recipients of certain payments; for all purposes of this Escrow Agreement, the Settling States shall be the beneficiaries of such payments entitled to enforce payment thereof. The provisions of this Escrow Agreement shall be binding upon and inure to the benefit of the parties hereto and, in the case of the Escrow Agent and Participating Manufacturers, their respective successors. Each reference herein to the Escrow Agent or to a Participating Manufacturer shall be construed as a reference to its successor, where applicable.

SECTION 14. *Governing Law.*

This Escrow Agreement shall be construed in accordance with and governed by the laws of the State in which the Escrow Court is located, without regard to the conflicts of law rules of such state.

SECTION 15. *Jurisdiction and Venue.*

The parties hereto irrevocably and unconditionally submit to the continuing exclusive jurisdiction of the Escrow Court for purposes of any suit, action or proceeding seeking to interpret or enforce any provision of, or based on any right arising out of, this Escrow Agreement, and the parties hereto agree not to commence any such suit, action or proceeding except in the Escrow Court. The parties hereto hereby irrevocably and unconditionally waive any objection to the laying of venue of any such suit, action or proceeding in the Escrow Court and hereby further irrevocably waive and agree not to plead or claim in the Escrow Court that any such suit, action or proceeding has been brought in an inconvenient forum.

SECTION 16. *Amendments.*

This Escrow Agreement may be amended only by written instrument executed by all of the parties hereto that would be affected by the amendment. The waiver of any rights conferred hereunder shall be effective only if made in a written instrument executed by the waiving party. The waiver by any party of any breach of this Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Escrow Agreement, nor shall such waiver be deemed to be or construed as a waiver by any other party.

SECTION 17. *Counterparts.*

This Agreement may be signed in any number of counterparts, each of which shall be an original, with the same effect as if the signatures thereto and hereto were upon the same instrument. Delivery by facsimile of a signed counterpart shall be deemed delivery for purposes of acknowledging acceptance hereof; however, an original executed Escrow Agreement most promptly thereafter be delivered to each party.

SECTION 18. *Captions.*

The captions herein are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 19. *Conditions to Effectiveness.*

This Escrow Agreement shall become effective when each party hereto shall have signed a counterpart hereof. The parties hereto agree to use their best efforts to seek an order of the Escrow Court approving, and retaining continuing jurisdiction over, the Escrow Agreement as soon as possible, and agree that such order shall relate back to, and be deemed effective as of, the date this Escrow Agreement became effective.

SECTION 20. *Address for Payments.*

Whenever funds are under the terms of this Escrow Agreement required to be disbursed to a Settling State, a Participating Manufacturer, NAAG or the Foundation, the Escrow Agent shall disburse such funds by wire transfer to the account specified by such payee by written notice delivered to all Notice Parties in accordance with Section 11 hereof at least five Business Days prior to the date of payment. Whenever funds are under the terms of this Escrow Agreement required to be disbursed to any other person or entity, the Escrow Agent shall disburse such funds to such account as shall have been specified in writing by the Independent Auditor for such payment at least five Business Days prior to the date of payment.

SECTION 21. *Reporting.*

The Escrow Agent shall provide such information and reporting with respect to the escrow as the Independent Auditor may from time to time request.

IN WITNESS WHEREOF, the parties have executed this Escrow Agreement as of the day and year first hereinabove written.

[Signature Blocks]

Appendix A
Schedule Of Fees And Expenses

EXHIBIT C
FORMULA FOR CALCULATING INFLATION ADJUSTMENTS

(1) Any amount that, in any given year, is to be adjusted for inflation pursuant to this Exhibit (the "Base Amount") shall be adjusted upward by adding to such Base Amount the Inflation Adjustment.

(2) The Inflation Adjustment shall be calculated by multiplying the Base Amount by the Inflation Adjustment Percentage applicable in that year.

(3) The Inflation Adjustment Percentage applicable to payments due in the year 2000 shall be equal to the greater of 3% or the CPI%. For example, if the Consumer Price Index for December 1999 (as released in January 2000) is 2% higher than the Consumer Price Index for December 1998 (as released in January 1999), then the CPI% with respect to a payment due in 2000 would be 2%. The Inflation Adjustment Percentage applicable in the year 2000 would thus be 3%.

(4) The Inflation Adjustment Percentage applicable to payments due in any year after 2000 shall be calculated by applying each year the greater of 3% or the CPI% on the Inflation Adjustment Percentage applicable to payments due in the prior year. Continuing the example in subsection (3) above, if the CPI% with respect to a payment due in 2001 is 6%, then the Inflation Adjustment Percentage applicable in 2001 would be 9.1800000% (an additional 6% applied on the 3% Inflation Adjustment Percentage applicable in 2000), and if the CPI% with respect to a payment due in 2002 is 4%, then the Inflation Adjustment Percentage applicable in 2002 would be 13.5472000% (an additional 4% applied on the 9.1800000% Inflation Adjustment Percentage applicable in 2001).

(5) "Consumer Price Index" means the Consumer Price Index for All Urban Consumers as published by the Bureau of Labor Statistics of the U.S. Department of Labor (or other similar measures agreed to by the Settling States and the Participating Manufacturers).

(6) The "CPI%" means the actual total percent change in the Consumer Price Index during the calendar year immediately preceding the year in which the payment in question is due.

(7) Additional Examples.

(A) Calculating the Inflation Adjustment Percentages:

Payment Year	Hypothetical CPI%	Percentage to be applied on the Inflation Adjustment Percentage for the prior year (i.e., the greater of 3% or the CPI%)	Inflation Adjustment Percentage
2000	2.4%	3.0%	3.0000000%
2001	2.1%	3.0%	6.0900000%
2002	3.5%	3.5%	9.8031500%
2003	3.5%	3.5%	13.6462603%
2004	4.0%	4.0%	18.1921107%
2005	2.2%	3.0%	21.7378740%
2006	1.6%	3.0%	25.3900102%

(B) Applying the Inflation Adjustment:

Using the hypothetical Inflation Adjustment Percentages set forth in section (7)(A):

-- the subsection IX(c)(1) base payment amount for 2002 of $6,500,000,000 as adjusted for inflation would equal $7,137,204,750;

-- the subsection IX(c)(1) base payment amount for 2004 of $8,000,000,000 as adjusted for inflation would equal $9,455,368,856;

-- the subsection IX(c)(1) base payment amount for 2006 of $8,000,000,000 as adjusted for inflation would equal $10,031,200,816.

EXHIBIT D
LIST OF LAWSUITS

1. Alabama
Blaylock et al. v. American Tobacco Co. et al.,
Circuit Court, Montgomery County, No. CV-96-1508-PR

2. Alaska
State of Alaska v. Philip Morris, Inc., et al., Superior Court, First Judicial District of Juneau, No. 1JU-97915 CI (Alaska)

3. Arizona
State of Arizona v. American Tobacco Co., Inc., et al., Superior Court, Maricopa County, No. CV-96-14769 (Ariz.)

4. Arkansas
State of Arkansas v. The American Tobacco Co., Inc., et al., Chancery Court, 6th Division, Pulaski County, No. IJ 97-2982 (Ark.)

5. California
People of the State of California et al. v. Philip Morris, Inc., et al., Superior Court, Sacramento County, No. 97-AS-30301

6. Colorado
State of Colorado et al., v. R.J. Reynolds Tobacco Co., et al., District Court, City and County of Denver, No. 97CV3432 (Colo.)

7. Connecticut
State of Connecticut v. Philip Morris, et al., Superior Court, Judicial District of Waterbury No. X02 CV96-0148414S (Conn.)

8. Georgia
State of Georgia et al. v. Philip Morris, Inc., et al., Superior Court, Fulton County, No. CA E-61692 (Ga.)

9. Hawaii
State of Hawaii v. Brown & Williamson Tobacco Corp., et al., Circuit Court, First Circuit, No. 97-0441-01 (Haw.)

10. Idaho
State of Idaho v. Philip Morris, Inc., et al., Fourth Judicial District, Ada County, No. CVOC 9703239D (Idaho)

11. Illinois
People of the State of Illinois v. Philip Morris et al., Circuit Court of Cook County, No. 96-L13146 (Ill.)

12. Indiana
State of Indiana v. Philip Morris, Inc., et al., Marion County Superior Court, No. 49D 07-9702-CT-000236 (Ind.)

13. Iowa
State of Iowa v. R.J. Reynolds Tobacco Company et al., Iowa District Court, Fifth Judicial District, Polk County, No. CL71048 (Iowa)

14. Kansas
State of Kansas v. R.J. Reynolds Tobacco Company, et al., District Court of Shawnee County, Division 2, No. 96-CV-919 (Kan.)

15. Louisiana
Ieyoub v. The American Tobacco Company, et al., 14th Judicial District Court, Calcasieu Parish, No. 96-1209 (La.)

16. Maine
State of Maine v. Philip Morris, Inc., et al., Superior Court, Kennebec County, No. CV 97-134 (Me.)

17. Maryland
Maryland v. Philip Morris Incorporated, et al., Baltimore City Circuit Court, No. 96-122017-CL211487 (Md.)

18. Massachusetts
Commonwealth of Massachusetts v. Philip Morris Inc., et al., Middlesex Superior Court, No. 95-7378 (Mass.)

19. Michigan
Kelley v. Philip Morris Incorporated, et al., Ingham County Circuit Court, 30th Judicial Circuit, No. 96-84281-CZ (Mich.)

20. Missouri
State of Missouri v. American Tobacco Co., Inc. et al., Circuit Court, City of St. Louis, No. 972-1465 (Mo.)

21. Montana
State of Montana v. Philip Morris, Inc., et al., First Judicial Court, Lewis and Clark County, No. CDV 9700306-14 (Mont.)

22. Nebraska
State of Nebraska v. R.J. Reynolds Tobacco Co., et al., District Court, Lancaster County, No. 573277 (Neb.)

23. Nevada
Nevada v. Philip Morris, Incorporated, et al., Second Judicial Court, Washoe County, No. CV97-03279 (Nev.)

24. New Hampshire
New Hampshire v. R.J. Reynolds, Tobacco Co., et al., New Hampshire Superior Court, Merrimack County, No. 97-E-165 (N.H.)

25. New Jersey
State of New Jersey v. R.J. Reynolds Tobacco Company, et al., Superior Court, Chancery Division, Middlesex County, No. C-254-96 (N.J.)

26. New Mexico
State of New Mexico, v. The American Tobacco Co., et al., First Judicial District Court, County of Santa Fe, No. SF-1235 c (N.M.)

27. New York State
State of New York et al. v. Philip Morris, Inc., et al., Supreme Court of the State of New York, County of New York, No. 400361/97 (N.Y.)

28. Ohio
State of Ohio v. Philip Morris, Inc., et al., Court of Common Pleas, Franklin County, No. 97CVH055114 (Ohio)

29. Oklahoma
State of Oklahoma, et al. v. R.J. Reynolds Tobacco Company, et al., District Court, Cleveland County, No. CJ-96-1499-L (Okla.)

30. Oregon
State of Oregon v. The American Tobacco Co., et al., Circuit Court, Multnomah County, No. 9706-04457 (Or.)

31. Pennsylvania
Commonwealth of Pennsylvania v. Philip Morris, Inc., et al., Court of Common Pleas, Philadelphia County, April Term 1997, No. 2443

32. Puerto Rico
Rossello, et al. v. Brown & Williamson Tobacco Corporation, et al., U.S. District Court, Puerto Rico, No. 97-1910JAF

33. Rhode Island
State of Rhode Island v. American Tobacco Co., et al., Rhode Island Superior Court, Providence, No. 97-3058 (R.I.)

34. South Carolina
State of South Carolina v. Brown & Williamson Tobacco Corporation, et al., Court of Common Pleas, Fifth Judicial Circuit, Richland County, No. 97-CP-40-1686 (S.C.)

35. South Dakota
State of South Dakota, et al. v. Philip Morris, Inc., et al., Circuit Court, Hughes County, Sixth Judicial Circuit, No. 98-65 (S.D.)

36. Utah
State of Utah v. R.J. Reynolds Tobacco Company, et al., U.S. District Court, Central Division, No. 96 CV 0829W (Utah)

37. Vermont
State of Vermont v. Philip Morris, Inc., et al., Chittenden Superior Court, Chittenden County, No. 744-97 (Vt.) and 5816-98 (Vt.)

38. Washington
State of Washington v. American Tobacco Co. Inc., et al., Superior Court of Washington, King County, No. 96-2-15056OSSEA (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
Other Number
Primary Type
Person Attending
Person Author
Person Copied
Organization Author
Organization Copied
Organization Attending
Physical Attachment 1
Characteristics
Site
Verbatim Title
Primary Brand
Page Count

Master ID
Document Date
Other Type
Person Noted
Person Recipient
Person Mentioned
Organization Recipient
Organization Mentioned
Organization Noted
Physical Attachment 2
File Name
Area
Old Brand
Mentioned Brand

(c) Each Original Participating Manufacturer and Tobacco-Related Organization will add, if not already available, a user-friendly document retrieval feature on the Website consisting of a "view all pages" function with enhanced image viewer capability that will enable users to choose to view and/or print either "all pages" for a specific document or "page-by-page".

(d) Each Original Participating Manufacturer and Tobacco-Related Organizations will provide at its own expense to NAAG a copy set in electronic form of its website document images and its accompanying subsection IV(b) index in ASCII-delimited form for all of the documents currently on its website and all of the documents described in subsection IV(d) of this Agreement. The Original Participating Manufacturers and Tobacco-Related Organizations will not object to any subsequent distribution and/or reproduction of these copy sets.

EXHIBIT J
TOBACCO ENFORCEMENT FUND PROTOCOL

The States' Antitrust/Consumer Protection Tobacco Enforcement Fund ("Fund") is established by the Attorneys General of the Settling States, acting through NAAG, pursuant to section VIII(c) of the Agreement. The following shall be the primary and mandatory protocol for the administration of the Fund.

Section A
Fund Purpose

Section 1

The monies to be paid pursuant to section VIII(c) of the Agreement shall be placed by NAAG in a new and separate interest bearing account, denominated the States' Antitrust/ Consumer Protection Tobacco Enforcement Fund, which shall not then or thereafter be commingled with any other funds or accounts. However, nothing herein shall prevent deposits into the account so long as monies so deposited are then lawfully committed for the purpose of the Fund as set forth herein.

Section 2

A committee of three Attorneys General ("Special Committee") shall be established to determine disbursements from the account, using the process described herein. The three shall be the Attorney General of the State of Washington, the Chair of NAAG's antitrust committee, and the Chair of NAAG's consumer protection committee. In the event that an Attorney General shall hold either two or three of the above stated positions, that Attorney General may serve only in a single capacity, and shall be replaced in the remaining positions by first, the President of NAAG, next by the President-Elect of NAAG and if necessary the Vice-President of NAAG.

Section 3

The purpose of the Fund is: (1) to enforce and implement the terms of the Agreement, in particular, by partial payment of the monetary costs of the Independent Auditor as contemplated by the Agreement; and (2) to provide monetary assistance to the various states' attorneys general: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute ("Qualifying Actions"). The Special Committee shall entertain requests only from Settling States for disbursement from the fund associated with a Qualifying Action ("Grant Application").

Section B
Administration Standards Relative to Grant Applications

Section 1

The Special Committee shall not entertain any Grant Application to pay salaries or ordinary expenses of regular employees of any Attorney General's office.

Section 2

The affirmative vote of two or more of the members of the Special Committee shall be required to approve any Grant Application.

Section 3

The decision of the Special Committee shall be final and non-appealable.

Section 4

The Attorney General of the State of Washington shall be chair of the Special Committee and shall annually report to the Attorneys General on the requests for funds from the Fund and the actions of the Special Committee upon the requests.

Section 5

When a Grant Application to the Fund is made by an Attorney General who is then a member of the Special Committee, such member will be temporarily replaced on the Committee, but only for the determination of such Grant Application. The remaining members of the Special Committee shall designate an Attorney General to replace the Attorney General so disqualified, in order to consider the application.

Section 6

The Fund shall be maintained in a federally insured depository institution located in Washington, D.C. Funds may be invested in federal government-backed vehicles. The Fund shall be regularly reported on NAAG financial statements and subject to annual audit.

Section 7

Withdrawals from and checks drawn on the Fund will require at least two of three authorized signatures. The three persons so authorized shall be the executive director, the deputy director, and controller of NAAG.

Section 8

The Special Committee shall meet in person or telephonically as necessary to determine whether a grant is sought for assistance with a Qualifying Action and whether and to what extent the Grant Application is accepted. The chair of the

Special Committee shall designate the times for such meetings, so that a response is made to the Grant Application as expeditiously as practicable.

Section 9

The Special Committee may issue a grant from the Fund only when an Attorney General certifies that the monies will be used in connection with a Qualifying Action, to wit: (A) to investigate and/or litigate suspected violations of the Agreement and/or Consent Decree; (B) to investigate and/or litigate suspected violations of state and/or federal antitrust or consumer protection laws with respect to the manufacture, use, marketing and sales of tobacco products; and (C) to enforce the Qualifying Statute. The Attorney General submitting such application shall further certify that the entire grant of monies from the Fund will be used to pay for such investigation and/or litigation. The Grant Application shall describe the nature and scope of the intended action and use of the funds which may be granted.

Section 10

To the extent permitted by law, each Attorney General whose Grant Application is favorably acted upon shall promise to pay back to the Fund all of the amounts received from the Fund in the event the state is successful in litigation or settlement of a Qualifying Action. In the event that the monetary recovery, if any, obtained is not sufficient to pay back the entire amount of the grant, the Attorney General shall pay back as much as is permitted by the recovery. In all instances where monies are granted, the Attorney General(s) receiving monies shall provide an accounting to NAAG of all disbursements received from the Fund no later than the 30th of June next following such disbursement.

Section 11

In addition to the repayments to the Fund contemplated in the preceding section, the Special Committee may deposit in the Fund any other monies lawfully committed for the precise purpose of the Fund as set forth in section A(3) above. For example, the Special Committee may at its discretion accept for deposit in the Fund a foundation grant or court-ordered award for state antitrust and/or consumer protection enforcement as long as the monies so deposited become part of and subject to the same rules, purposes and limitations of the Fund.

Section 12

The Special Committee shall be the sole and final arbiter of all Grant Applications and of the amount awarded for each such application, if any.

Section 13

The Special Committee shall endeavor to maintain the Fund for as long a term as is consistent with the purpose of the Fund. The Special Committee will limit the total amount of grants made to a single state to no more than $500,000.00. The Special Committee will not award a single grant in excess of $200,000.00, unless the grant involves more than one state, in which case, a single grant so made may not total more than $300,000.00. The Special Committee may, in its discretion and by unanimous vote, decide to waive these limitations if it determines that special circumstances exist. Such decision, however, shall not be effective unless ratified by a two-thirds majority vote of the NAAG executive committee.

Section C
Grant Application Procedures

Section 1

This Protocol shall be transmitted to the Attorneys General within 90 days after the MSA Execution Date. It may not be amended unless by recommendation of the NAAG executive committee and majority vote of the Settling States. NAAG will notify the Settling States of any amendments promptly and will transmit yearly to the attorneys general a statement of the Fund balance and a summary of deposits to and withdrawals from the Fund in the previous calendar or fiscal year.

Section 2

Grant Applications must be in writing and must be signed by the Attorney General submitting the application.

Section 3

Grant Applications must include the following:

(A) A description of the contemplated/pending action, including the scope of the alleged violation and the area (state/regional/multi-state) likely to be affected by the suspected offending conduct.

(B) A statement whether the action is actively and currently pursued by any other Attorney General or other prosecuting authority.

(C) A description of the purposes for which the monies sought will be used.

(D) The amount requested.

(E) A directive as to how disbursements from the Fund should be made, e.g., either directly to a supplier of services (consultants, experts, witnesses, and the like), to the Attorney General's office directly, or in the case of multi-state action, to one or more Attorneys General's offices designated as a recipient of the monies.

(F) A statement that the applicant Attorney(s) General will, to the extent permitted by law, pay back to the Fund all, or as much as is possible, of the monies received, upon receipt of any monetary recovery obtained in the contemplated/pending litigation or settlement of the action.

(G) A certification that no part of the grant monies will be used to pay the salaries or ordinary expenses of any regular employee of the office of the applicant(s) and that the grant will be used solely to pay for the stated purpose.

(H) A certification that an accounting will be provided to NAAG of all monies received by the applicant(s) by no later than the 30th of June next following any receipt of such monies.

Section 4

All Grant Applications shall be submitted to the NAAG office at the following address: National Association of Attorneys General, 750 1st Street, NE, Suite 1100, Washington D.C. 20002.

Section 5

The Special Committee will endeavor to act upon all complete and properly submitted Grant Applications within 30 days of receipt of said applications.

Section D
Other Disbursements from the Fund

Section 1

To enforce and implement the terms of the Agreement, the Special Committee shall direct disbursements from the Fund to comply with the partial payment obligations set forth in section XI of the Agreement relative to costs of the Independent Auditor. A report of such disbursements shall be included in the accounting given pursuant to section C(1) above.

Section E
Administrative Costs

Section 1

NAAG shall receive from the Fund on July 1, 1999 and on July 1 of each year thereafter an administrative fee of $100,000 for its administrative costs in performing its duties under the Protocol and this Agreement. The NAAG executive committee may adjust the amount of the administrative fee in extraordinary circumstances.

EXHIBIT K
MARKET CAPITALIZATION PERCENTAGES

Philip Morris Incorporated	68.0000000%
Brown & Williamson Tobacco Corporation	17.9000000%
Lorillard Tobacco Company	7.3000000%
R.J. Reynolds Tobacco Company	6.8000000%
Total	100.0000000%

EXHIBIT L
MODEL CONSENT DECREE

IN THE [XXXXXX] COURT OF THE STATE OF [XXXXXX]
IN AND FOR THE COUNTY OF [XXXXX]

-------------------------------- x CAUSE NO. XXXXXX

STATE OF [XXXXXXXXXXX],
Plaintiff,
v.
[XXXXXX XXXXX XXXX], et al.,
Defendants.

CONSENT DECREE AND FINAL JUDGMENT

-------------------------------- x

WHEREAS, Plaintiff, the State of [name of Settling State], commenced this action on [date], [by and through its Attorney General [name]], pursuant to [her/his/its] common law powers and the provisions of [state and/or federal law];

WHEREAS, the State of [name of Settling State] asserted various claims for monetary, equitable and injunctive relief on behalf of the State of [name of Settling State] against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint [and amended complaints, if any] and denied the State's allegations [and asserted affirmative defenses];

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this [county/district].

II. DEFINITIONS

The definitions set forth in the Agreement (a copy of which is attached hereto) are incorporated herein by reference.

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of [name of Settling State] or a Released Party. The State of [name of Settling State] may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of [name of Settling State] in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of [name of Settling State].

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of [name of Settling State] any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of [name of Settling State] any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of [name of Settling State], any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of [name of Settling State] any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of [name of Settling State] any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VI. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of [name of Settling State] and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of [name of Settling State] and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections V(A) and V(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI and VII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of [name of Settling State] and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of [name of Settling State] and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred by the State of [name of Settling State] in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of [name of Settling State] may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for [name of Settling State] to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of [name of Settling State] of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of [name of Settling State] or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection V(A) or V(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the person[s] signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of [name of Settling State].

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this _____ day of _____________, 1998.

EXHIBIT M
LIST OF PARTICIPATING MANUFACTURERS' LAWSUITS AGAINST THE SETTLING STATES

1. Philip Morris, Inc., et al. v. Margery Bronster, Attorney General of the State of Hawaii, In Her Official Capacity, Civ. No. 96-00722HG, United States District Court for the District of Hawaii

2. Philip Morris, Inc., et al. v. Bruce Botelho, Attorney General of the State of Alaska, In His Official Capacity, Civ. No. A97-0003CV, United States District Court for the District of Alaska

3. Philip Morris, Inc., et al. v. Scott Harshbarger, Attorney General of the Commonwealth of Massachusetts, In His Official Capacity, Civ. No. 95-12574-GAO, United States District Court for the District of Massachusetts

4. Philip Morris, Inc., et al. v. Richard Blumenthal, Attorney General of the State of Connecticut, In His Official Capacity, Civ. No. 396CV01221 (PCD), United States District Court for the District of Connecticut

5. Philip Morris, et al. v. William H. Sorrell, et al., No. 1:98-cv-132, United States District Court for the District of Vermont

EXHIBIT N
LITIGATING POLITICAL SUBDIVISIONS

1. City of New York, et al. v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of New York, Index No. 406225/96

2. County of Erie v. The Tobacco Institute, Inc. et al., Supreme Court of the State of New York, County of Erie, Index No. I 1997/359

3. County of Los Angeles v. R.J. Reynolds Tobacco Co. et al., San Diego Superior Court, No. 707651

4. The People v. Philip Morris, Inc. et al., San Francisco Superior Court, No. 980864

5. County of Cook v. Philip Morris, Inc. et al., Circuit Court of Cook County, 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 Originul 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 (h) of this section (including any Approved Cost Statement determined pursuant to arbitration before the Panel or the separate three-member panel of independent arbitrators described therein) shall not be entered as or reduced to a judgment against the Original Participating Manufacturers or considered as a basis for requiring a bond or imposing a lien or any other incumbrance.

SECTION 20. *Distribution of Payments among STATE Outside Counsel.*

(a) All payments made to the Designated Representative pursuant to this STATE Fee Payment Agreement shall be for the benefit of each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], each of which shall receive from the Designated Representative a percentage of each such payment in accordance with the fee sharing agreement, if any, among STATE Outside Counsel (or any written amendment thereto).

(b) The Original Participating Manufacturers shall have no obligation, responsibility or liability with respect to the allocation among those persons or entities identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision], or with respect to any claim of misallocation, of any amounts paid to the Designated Representative pursuant to this STATE Fee Payment Agreement.

SECTION 21. *Calculations of Amounts.*

All calculations that may be required hereunder shall be performed by the Original Participating Manufacturers, with notice of the results thereof to be given promptly to the Designated Representative. Any disputes as to the correctness of calculations made by the Original Participating Manufacturers shall be resolved pursuant to the procedures described in Section XI(c) of the Agreement for resolving disputes as to calculations by the Independent Auditor.

SECTION 22. *Payment Responsibility.*

(a) Each Original Participating Manufacturer shall be severally liable for its share of all payments pursuant to this STATE Fee Payment Agreement. Under no circumstances shall any payment due hereunder or any portion thereof become the joint obligation of the Original Participating Manufacturers or the obligation of any person other than the Original Participating Manufacturer from which such payment is originally due, nor shall any Original Participating Manufacturer be required to pay a portion of any such payment greater than its Relative Market Share.

(b) Due to the particular corporate structures of R. J. Reynolds Tobacco Company ("Reynolds") and Brown & Williamson Tobacco Corporation ("Brown & Williamson") with respect to their non-domestic tobacco operations, Reynolds and Brown & Williamson shall each be severally liable for its respective share of each payment due pursuant to this STATE Fee Payment Agreement up to (and its liability hereunder shall not exceed) the full extent of its assets used in, and earnings and revenues derived from, its manufacture and sale in the United States of Tobacco Products intended for domestic consumption, and no recourse shall be had against any of its other assets or earnings to satisfy such obligations.

SECTION 23. *Termination.*

In the event that the Agreement is terminated with respect to the State of STATE pursuant to Section XVIII(u) of the Agreement (or for any other reason) the Designated Representative and each person or entity identified in Exhibit S to the Agreement by the Attorney General of the State of STATE [or as certified by the governmental prosecuting authority of the Litigating Political Subdivision] shall immediately refund to the Original Participating Manufacturers all amounts received under this STATE Fee Payment Agreement.

SECTION 24. *Intended Beneficiaries.*

No provision hereof creates any rights on the part of, or is enforceable by, any person or entity that is not a Party or a person covered by either of the releases described in section 4 hereof, except that sections 5 and 20 hereof create rights on the part of, and shall be enforceable by, the State of STATE. Nor shall any provision hereof bind any non-signatory or determine, limit or prejudice the rights of any such person or entity.

SECTION 25. *Representations of Parties.*

The Parties hereto hereby represent that this STATE Fee Payment Agreement has been duly authorized and, upon execution, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the Parties hereto.

SECTION 26. *No Admission.*

This STATE Fee Payment Agreement is not intended to be and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of any liability or wrongdoing whatsoever on the part of any signatory hereto or any person covered by either of the releases provided under section 4 hereof. The Original Participating Manufacturers specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the claims released under section 4 hereof and enter into this STATE Fee Payment Agreement for the sole purposes of memorializing the Original Participating Manufacturers' rights and obligations with respect to payment of attorneys' fees pursuant to the Agreement and avoiding the further expense, inconvenience, burden and uncertainty of potential litigation.

SECTION 27. *Non-admissibility.*

This STATE Fee Payment Agreement having been undertaken by the Parties hereto in good faith and for settlement purposes only, neither this STATE Fee Payment Agreement nor any evidence of negotiations relating hereto shall be offered or received in evidence in any action or proceeding other than an action or proceeding arising under this STATE Fee Payment Agreement.

SECTION 28. *Amendment and Waiver.*

This STATE Fee Payment Agreement may be amended only by a written instrument executed by the Parties. The waiver of any rights conferred hereunder shall be effective only if made by written instrument executed by the waiving Party. The waiver by any Party of any breach hereof shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this STATE Fee Payment Agreement.

SECTION 29. *Notices.*

All notices or other communications to any party hereto shall be in writing (including but not limited to telex, facsimile or similar writing) and shall be given to the notice parties listed on Schedule A hereto at the addresses therein indicated. Any Party hereto may change the name and address of the person designated to receive notice on behalf of such Party by notice given as provided in this section including an updated list conformed to Schedule A hereto.

SECTION 30. *Governing Law.*

This STATE Fee Payment Agreement shall be governed by the laws of the State of STATE without regard to the conflict of law rules of such State.

SECTION 31. *Construction.*

None of the Parties hereto shall be considered to be the drafter hereof or of any provision hereof for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter hereof.

SECTION 32. *Captions.*

The captions of the sections hereof are included for convenience of reference only and shall be ignored in the construction and interpretation hereof.

SECTION 33. *Execution of STATE Fee Payment Agreement.*

This STATE Fee Payment Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this STATE Fee Payment Agreement.

SECTION 34. *Entire Agreement of Parties.*

This STATE Fee Payment Agreement contains an entire, complete and integrated statement of each and every term and provision agreed to by and among the Parties with respect to payment of attorneys' fees by the Original Participating Manufacturers in connection with the Action and is not subject to any condition or covenant, express or implied, not provided for herein.

IN WITNESS WHEREOF, the Parties hereto, through their fully authorized representatives, have agreed to this STATE Fee Payment Agreement as of this __th day of ________, 1998.

[SIGNATURE BLOCK]

APPENDIX
to MODEL FEE PAYMENT AGREEMENT
PROTOCOL OF PANEL PROCEEDINGS

This Protocol of procedures has been agreed to between the respective parties to the STATE Fee Payment Agreement, and shall govern the arbitration proceedings provided for therein.

SECTION 1. *Definitions.*

All definitions contained in the STATE Fee Payment Agreement are incorporated by reference herein.

SECTION 2. *Chairman.*

The person selected to serve as the permanent, neutral member of the Panel as described in paragraph (b)(ii) of section 11 of the STATE Fee Payment Agreement shall serve as the Chairman of the Panel.

SECTION 3. *Arbitration Pursuant to Agreement.*

The members of the Panel shall determine those matters committed to the decision of the Panel under the STATE Fee Payment Agreement, which shall govern as to all matters discussed therein.

SECTION 4. *ABA Code of Ethics.*

Each of the members of the Panel shall be governed by the *Code of Ethics for Arbitrators in Commercial Disputes* prepared by the American Arbitration Association and the American Bar Association (the "*Code of Ethics*") in conducting the arbitration proceedings pursuant to the STATE Fee Payment Agreement, subject to the terms of the STATE Fee Payment Agreement and this Protocol. Each of the party-appointed members of the Panel shall be governed by Canon VII of the *Code of Ethics*. No person may engage in any *ex parte* communications with the permanent, neutral member of the Panel selected pursuant to paragraph (b)(ii) of section 11, in keeping with Canons I, II and III of the *Code of Ethics*.

SECTION 5. *Additional Rules and Procedures.*

The Panel may adopt such rules and procedures as it deems necessary and appropriate for the discharge of its duties under the STATE Fee Payment Agreement and this Protocol, subject to the terms of the STATE Fee Payment Agreement and this Protocol.

SECTION 6. *Majority Rule.*

In the event that the members of the Panel are not unanimous in their views as to any matter to be determined by them pursuant to the STATE Fee Payment Agreement or this Protocol, the determination shall be decided by a vote of a majority of the three members of the Panel.

SECTION 7. *Application for Fee Award and Other Materials.*

(a) The Application of STATE Outside Counsel and any materials submitted to the Director relating thereto (collectively, "submissions") shall be forwarded by the Director to each of the members of the Panel in the manner and on the dates specified in the STATE Fee Payment Agreement.

(b) All materials submitted to the Director by either Party (or any other person) shall be served upon all Parties. All submissions required to be served on any Party shall be deemed to have been served as of the date on which such materials have been sent by either (i) hand delivery or (ii) facsimile and overnight courier for priority next-day delivery.

(c) To the extent that the Panel believes that information not submitted to the Panel may be relevant for purposes of determining those matters committed to the decision of the Panel under the terms of the STATE Fee Payment Agreement, the Panel shall request such information from the Parties.

SECTION 8. *Hearing.*

Any hearing held pursuant to section 12 of the STATE Fee Payment Agreement shall not take place other than in the presence of all three members of the Panel upon notice and an opportunity for the respective representatives of the Parties to attend.

SECTION 9. *Miscellaneous.*

(a) Each member of the Panel shall be compensated for his services by the Original Participating Manufacturers on a basis to be agreed to between such member and the Original Participating Manufacturers.

(b) The members of the Panel shall refer all media inquiries regarding the arbitration proceeding to the respective Parties to the STATE Fee Payment Agreement and shall refrain from any comment as to the arbitration proceedings to be conducted pursuant to the STATE Fee Payment Agreement during the pendency of such arbitration proceedings, in keeping with Canon IV(B) of the *Code of Ethics*.

EXHIBIT P
NOTICES

[Intentionally Omitted]

EXHIBIT Q
1996 AND 1997 DATA

(1) 1996 Operating Income

Original Participating Manufacturer	Operating Income
Brown & Williamson Tobacco Corp.	$801,640,000
Lorillard Tobacco Co.	$719,100,000
Philip Morris Inc.	$4,206,600,000
R.J. Reynolds Tobacco Co.	$1,468,000,000
Total (Base Operating Income)	$7,195,340,000

(2) 1997 volume (as measured by shipments of Cigarettes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,911,000,000
Lorillard Tobacco Co.	42,288,000,000
Philip Morris Inc.	236,203,000,000
R.J. Reynolds Tobacco Co.	118,254,000,000
Total (Base Volume)	475,656,000,000

(3) 1997 volume (as measured by excise taxes)

Original Participating Manufacturer	Number of Cigarettes
Brown & Williamson Tobacco Corp.*	78,758,000,000
Lorillard Tobacco Co.	42,315,000,000
Philip Morris Inc.	236,326,000,000
R.J. Reynolds Tobacco Co.	119,099,000,000

* The volume includes 2,847,595 pounds of "roll your own" tobacco converted into the number of Cigarettes using 0.0325 ounces per Cigarette conversion factor.

EXHIBIT R
EXCLUSION OF CERTAIN BRAND NAMES

Brown & Williamson Tobacco Corporation

GPC
State Express 555
Riviera

Philip Morris Incorporated

Players
B&H
Belmont
Mark Ten
Viscount
Accord
L&M
Lark
Rothman's
Best Buy
Bronson
F&L
Genco
GPA
Gridlock
Money
No Frills
Generals
Premium Buy
Shenandoah
Top Choice

Lorillard Tobacco Company

None

R.J. Reynolds Tobacco Company

Best Choice
Cardinal
Director's Choice
Jacks
Rainbow
Scotch Buy
Slim Price
Smoker Friendly
Valu Time
Worth

EXHIBIT S
DESIGNATION OF OUTSIDE COUNSEL

[Intentionally Omitted]

EXHIBIT T
MODEL STATUTE

Section __. Findings and Purpose.[1]

(a) Cigarette smoking presents serious public health concerns to the State and to the citizens of the State. The Surgeon General has determined that smoking causes lung cancer, heart disease and other serious diseases, and that there are hundreds of thousands of tobacco-related deaths in the United States each year. These diseases most often do not appear until many years after the person in question begins smoking.

(b) Cigarette smoking also presents serious financial concerns for the State. Under certain health-care programs, the State may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance.

(c) Under these programs, the State pays millions of dollars each year to provide medical assistance for these persons for health conditions associated with cigarette smoking.

(d) It is the policy of the State that financial burdens imposed on the State by cigarette smoking be borne by tobacco product manufacturers rather than by the State to the extent that such manufacturers either determine to enter into a settlement with the State or are found culpable by the courts.

(e) On _______, 1998, leading United States tobacco product manufacturers entered into a settlement agreement, entitled the "Master Settlement Agreement," with the State. The Master Settlement Agreement obligates these manufacturers, in return for a release of past, present and certain future claims against them as described therein, to pay substantial sums to the State (tied in part to their volume of sales); to fund a national foundation devoted to the interests of public health; and to make substantial changes in their advertising and marketing practices and corporate culture, with the intention of reducing underage smoking.

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

Section __. Definitions.

(a) "Adjusted for inflation" means increased in accordance with the formula for inflation adjustment set forth in Exhibit C to the Master Settlement Agreement.

(b) "Affiliate" means a person who directly or indirectly owns or controls, is owned or controlled by, or is under common ownership or control with, another person. Solely for purposes of this definition, the terms "owns," "is owned" and "ownership" mean ownership of an equity interest, or the equivalent thereof, of ten percent or more, and the term "person" means an individual, partnership, committee, association, corporation or any other organization or group of persons.

(c) "Allocable share" means Allocable Share as that term is defined in the Master Settlement Agreement.

(d) "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (1) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (2) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette; or (3) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (1) of this definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette," 0.09 ounces of "roll-your-own" tobacco shall constitute one individual "cigarette."

(e) "Master Settlement Agreement" means the settlement agreement (and related documents) entered into on _______, 1998 by the State and leading United States tobacco product manufacturers.

(f) "Qualified escrow fund" means an escrow arrangement with a federally or State chartered financial institution having no affiliation with any tobacco product manufacturer and having assets of at least $1,000,000,000 where such arrangement requires that such financial institution hold the escrowed funds' principal for the benefit of releasing parties and prohibits the tobacco product manufacturer placing the funds into escrow from using, accessing or directing the use of the funds' principal except as consistent with section ___(b)-(c) of this Act.

(g) "Released claims" means Released Claims as that term is defined in the Master Settlement Agreement.

(h) "Releasing parties" means Releasing Parties as that term is defined in the Master Settlement Agreement.

[1] [A State may elect to delete the "findings and purposes" section in its entirety. Other changes or substitutions with respect to the "findings and purposes" section (except for particularized state procedural or technical requirements) will mean that the statute will no longer conform to this model.]

(i) "Tobacco Product Manufacturer" means an entity that after the date of enactment of this Act directly (and not exclusively through any affiliate):

(1) manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer (as that term is defined in the Master Settlement Agreement) that will be responsible for the payments under the Master Settlement Agreement with respect to such cigarettes as a result of the provisions of subsections II(mm) of the Master Settlement Agreement and that pays the taxes specified in subsection II(z) of the Master Settlement Agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States);

(2) is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States; or

(3) becomes a successor of an entity described in paragraph (1) or (2).

The term "Tobacco Product Manufacturer" shall not include an affiliate of a tobacco product manufacturer unless such affiliate itself falls within any of (1) - (3) above.

(j) "Units sold" means the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the State on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the State. The [fill in name of responsible state agency] shall promulgate such regulations as are necessary to ascertain the amount of State excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Section __. Requirements.

Any tobacco product manufacturer selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary or intermediaries) after the date of enactment of this Act shall do one of the following:

(a) become a participating manufacturer (as that term is defined in section II(jj) of the Master Settlement Agreement) and generally perform its financial obligations under the Master Settlement Agreement; or

(b) (1) place into a qualified escrow fund by April 15 of the year following the year in question the following amounts (as such amounts are adjusted for inflation) --

1999: $.0094241 per unit sold after the date of enactment of this Act;[2]

2000: $.0104712 per unit sold after the date of enactment of this Act;[3]

for each of 2001 and 2002: $.0136125 per unit sold after the date of enactment of this Act;

for each of 2003 through 2006: $.0167539 per unit sold after the date of enactment of this Act;

for each of 2007 and each year thereafter: $.0188482 per unit sold after the date of enactment of this Act.

(2) A tobacco product manufacturer that places funds into escrow pursuant to paragraph (1) shall receive the interest or other appreciation on such funds as earned. Such funds themselves shall be released from escrow only under the following circumstances --

(A) to pay a judgment or settlement on any released claim brought against such tobacco product manufacturer by the State or any releasing party located or residing in the State. Funds shall be released from escrow under this subparagraph (i) in the order in which they were placed into escrow and (ii) only to the extent and at the time necessary to make payments required under such judgment or settlement;

(B) to the extent that a tobacco product manufacturer establishes that the amount it was required to place into escrow in a particular year was greater than the State's allocable share of the total payments that such manufacturer would have been required to make in that year under the Master Settlement Agreement (as determined pursuant to section IX(i)(2) of the Master Settlement Agreement, and before any of the adjustments or offsets described in section IX(i)(3) of that Agreement other than the Inflation Adjustment) had it been a participating manufacturer, the excess shall be released from escrow and revert back to such tobacco product manufacturer; or

(C) to the extent not released from escrow under subparagraphs (A) or (B), funds shall be released from escrow and revert back to such tobacco product manufacturer twenty-five years after the date on which they were placed into escrow.

(3) Each tobacco product manufacturer that elects to place funds into escrow pursuant to this subsection shall annually certify to the Attorney General [or other State official] that it is in compliance with this subsection. The Attorney General [or other State official] may bring a civil action on behalf of the State against any tobacco product manufacturer that fails to place into escrow the funds required under this section. Any tobacco product manufacturer that fails in any year to place into escrow the funds required under this section shall --

(A) be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 5 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 100 percent of the original amount improperly withheld from escrow;

(B) in the case of a knowing violation, be required within 15 days to place such funds into escrow as shall bring it into compliance with this section. The court, upon a finding of a knowing violation of this subsection, may impose a civil penalty [to be paid to the general fund of the state] in an amount not to exceed 15 percent of the amount improperly withheld from escrow per day of the violation and in a total amount not to exceed 300 percent of the original amount improperly withheld from escrow; and

(C) in the case of a second knowing violation, be prohibited from selling cigarettes to consumers within the State (whether directly or through a distributor, retailer or similar intermediary) for a period not to exceed 2 years.

Each failure to make an annual deposit required under this section shall constitute a separate violation.[4]

[2] [All per unit numbers subject to verification]

[3] [The phrase "after the date of enactment of this Act" would need to be included only in the calendar year in which the Act is enacted.]

[4] [A State may elect to include a requirement that the violator also pay the State's costs and attorney's fees incurred during a successful prosecution under this paragraph (3).]

EXHIBIT U
STRATEGIC CONTRIBUTION FUND PROTOCOL

The payments made by the Participating Manufacturers pursuant to section IX(c)(2) of the Agreement ("Strategic Contribution Fund") shall be allocated among the Settling States pursuant to the process set forth in this Exhibit U.

Section 1

A panel committee of three former Attorneys General or former Article III judges ("Allocation Committee") shall be established to determine allocations of the Strategic Contribution Fund, using the process described herein. Two of the three members of the Allocation Committee shall be selected by the NAAG executive committee. Those two members shall choose the third Allocation Committee member. The Allocation Committee shall be geographically and politically diverse.

Section 2

Within 60 days after the MSA Execution Date, each Settling State will submit an itemized request for funds from the Strategic Contribution Fund, based on the criteria set forth in Section 4 of this Exhibit U.

Section 3

The Allocation Committee will determine the appropriate allocation for each Settling State based on the criteria set forth in Section 4 below. The Allocation Committee shall make its determination based upon written documentation.

Section 4

The criteria to be considered by the Allocation Committee in its allocation decision include each Settling State's contribution to the litigation or resolution of state tobacco litigation, including, but not limited to, litigation and/or settlement with tobacco product manufacturers, including Liggett and Myers and its affiliated entities.

Section 5

Within 45 days after receiving the itemized requests for funds from the Settling States, the Allocation Committee will prepare a preliminary decision allocating the Strategic Contribution Fund payments among the Settling States who submitted itemized requests for funds. All Allocation Committee decisions must be by majority vote. Each Settling State will have 30 days to submit comments on or objections to the draft decision. The Allocation Committee will issue a final decision allocating the Strategic Contribution Fund payments within 45 days.

Section 6

The decision of the Allocation Committee shall be final and non-appealable.

Section 7

The expenses of the Allocation Committee, in an amount not to exceed $100,000, will be paid from disbursements from the Subsection VIII(c) Account.

APPENDIX D

CONSENT DECREE

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APPENDIX D

CONSENT DECREE

At IAS Part 56 of the Supreme Court of the State of New York, held in and for the County of New York, at the Courthouse located at 60 Centre Street, New York, New York, on the 23rd day of December, 1998

PRESENT:

HON. STEPHEN G. CRANE, Justice

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK

THE STATE OF NEW YORK and DENNIS C. VACCO, Attorney General of the State of New York, for and on behalf of the PEOPLE OF THE STATE OF NEW YORK,

Plaintiffs,

-against-

PHILIP MORRIS INCORPORATED; PHILIP MORRIS COMPANIES, INC.; RJR NABISCO, INC.; RJR NABISCO HOLDINGS CORP.; R.J. REYNOLDS TOBACCO CO.; THE AMERICAN TOBACCO CO., INC.; AMERICAN BRANDS, INC.; BROWN & WILLIAMSON TOBACCO CORP.; LORILLARD TOBACCO COMPANY; LORILLARD INCORPORATED; LOEWS CORPORATION; UNITED STATES TOBACCO COMPANY; UST, INC.; B.A.T. INDUSTRIES, P.L.C.; BRITISH AMERICAN TOBACCO COMPANY, LTD.; BATUS HOLDINGS, INC.; THE COUNCIL FOR TOBACCO RESEARCH - U.S.A., INC.; and TOBACCO INSTITUTE, INC.,

Defendants.

CONSENT DECREE AND
FINAL JUDGMENT

Index No.: 400361/97
Hon. Stephen G. Crane, Justice.

WHEREAS, Plaintiffs, the State of New York and Attorney General Dennis C. Vacco, commenced this action on January 27, 1997, pursuant to their common law powers and the provisions of N.Y. Executive Law, Public Health Law, General Business Law, Business Corporations Law, Penal Law, Social Services Law, Not-for-Profit Corporations Law, Unconsolidated Law, the Civil Practice Law and Rules, and the State Constitution;

WHEREAS, Plaintiffs asserted various claims for monetary, equitable and injunctive relief, on behalf of the State of New York, including its Counties under GBL §342-b, against certain tobacco product manufacturers and other defendants;

WHEREAS, Defendants have contested the claims in the State's complaint and amended complaint and denied the State's allegations;

WHEREAS, the parties desire to resolve this action in a manner which appropriately addresses the State's public health concerns, while conserving the parties' resources, as well as those of the Court, which would otherwise be expended in litigating a matter of this magnitude; and

WHEREAS, the Court has made no determination of any violation of law, this Consent Decree and Final Judgment being entered prior to the taking of any testimony and without trial or final adjudication of any issue of fact or law;

NOW, THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED, AS FOLLOWS:

I. JURISDICTION AND VENUE

This Court has jurisdiction over the subject matter of this action and over each of the Participating Manufacturers. Venue is proper in this county.

II. DEFINITIONS

The definitions set forth in the Master Settlement Agreement (''MSA'' or ''Agreement'') (a copy of which is attached hereto as Exhibit 1) are incorporated herein by reference. ''County'' means a county of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; ''Counties'' means the counties of the State of New York, including New York City, with New York City to be treated as a single county and none of its constituent counties to be treated separately; provided, however, that any county that properly excludes itself from the class provisionally certified for settlement purposes only by this Court's Order of November 24, 1998 (the ''Class'') is not included in the definitions of ''County'' or ''Counties.''

III. APPLICABILITY

A. This Consent Decree and Final Judgment applies only to the Participating Manufacturers in their corporate capacity acting through their respective successors and assigns, directors, officers, employees, agents, subsidiaries, divisions, or other internal organizational units of any kind or any other entities acting in concert or participation with them. The remedies, penalties and sanctions that may be imposed or assessed in connection with a violation of this Consent Decree and Final Judgment (or any order issued in connection herewith) shall only apply to the Participating Manufacturers, and shall not be imposed or assessed against any employee, officer or director of any Participating Manufacturer, or against any other person or entity as a consequence of such violation, and there shall be no jurisdiction under this Consent Decree and Final Judgment to do so.

B. This Consent Decree and Final Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof. No portion of this Consent Decree and Final Judgment shall provide any rights to, or be enforceable by, any person or entity other than the State of New York or a Released Party. The State of New York may not assign or otherwise convey any right to enforce any provision of this Consent Decree and Final Judgment. Provided, however, that a County or Counties may enforce the payment rights provided in Article V of this Consent Decree and Final Judgment, but only against other Counties or the State. Only the State may enforce the provisions of Article V against the Participating Manufacturers.

IV. VOLUNTARY ACT OF THE PARTIES

The parties hereto expressly acknowledge and agree that this Consent Decree and Final Judgment is voluntarily entered into as the result of arm's-length negotiation, and all parties hereto were represented by counsel in deciding to enter into this Consent Decree and Final Judgment.

V. MONETARY RELIEF

A. Under subsections II(r), (s), IX, and XI of the MSA, payments from the Participating Manufacturers will be made to the Escrow Agent for further disbursement, pursuant to an Escrow Agreement executed by the parties and approved by a Court of competent jurisdiction. The State shall instruct the Independent Auditor and the Escrow Agent to disburse funds from the New York State-Specific Account directly to the State of New York and directly to the Counties individually according to the payment schedule annexed hereto as Exhibit 2.

B. The payment schedule set forth in Exhibit 2 shall remain in effect for as long as payments are made from the Participating Manufacturers under the MSA. The portion of those payments credited to the New York State-Specific Account, if any, shall be allocable to the State of New York and the individual Counties as set forth in Exhibit 2.

C. Effective upon the occurrence of State-Specific Finality in the State of New York, and to the extent that such claims may not otherwise be released by operation of the MSA, the Counties (as defined in this Consent Decree and Final Judgment) hereby absolutely and unconditionally release and forever discharge all Released Parties from all Released Claims that the Counties directly, indirectly, derivatively or in any other capacity ever had, now have, or hereafter can, shall, or may have, to the same extent that the Settling States are releasing Released Claims against Released Parties under the MSA.

D. Each County (as defined in this Consent Decree and Final Judgment) further covenants and agrees that it shall not after the occurrence of State-Specific Finality in the State of New York sue or seek to establish civil liability against any Released Party based, in whole or in part, upon any of the Released Claims, and further agrees that such covenant and agreement shall be a complete defense to any such civil action or proceeding.

E. Upon the occurrence of State-Specific Finality in the State of New York, the City of New York (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of the action entitled *City of New York et al. v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of New York, Index No. 406225/96, and the County of Erie (unless it has properly excluded itself from the Class) will move forthwith for a dismissal with prejudice of its action entitled *County of Erie v. The Tobacco Institute, Inc. et al.*, Supreme Court of the State of New York, County of Erie, Index No. 1997/359.

F. If a County or Counties properly excludes itself from the Class, such County or Counties shall not receive any funds under the MSA, and the State may, in its sole discretion, place the funds allocated to such County or Counties under Exhibit 2 to this Consent Decree And Final Judgment in escrow.

G. If any funds are recouped from the State of New York by the Federal Government, pursuant to an Act of Congress or otherwise, from monies received or to be received by the State (including its political subdivisions) from the New York State-Specific Account, then the State shall recoup from the Counties the Counties' share of such funds, through offsets or any other mechanisms selected by the State, according to the allocation percentages of the settlement funds in the year or years in question assigned to the respective Counties pursuant to the allocation schedule set forth in Exhibit 2. Nothing herein acknowledges a right of the Federal Government to recoup any such funds.

VI. INJUNCTIVE AND OTHER EQUITABLE RELIEF

Each Participating Manufacturer is permanently enjoined from:

A. Taking any action, directly or indirectly, to target Youth within the State of New York in the advertising, promotion or marketing of Tobacco Products, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of Youth smoking within the State of New York.

B. After 180 days after the MSA Execution Date, using or causing to be used within the State of New York any Cartoon in the advertising, promoting, packaging or labeling of Tobacco Products.

C. After 30 days after the MSA Execution Date, making or causing to be made any payment or other consideration to any other person or entity to use, display, make reference to or use as a prop within the State of New York any Tobacco Product, Tobacco Product package, advertisement for a Tobacco Product, or any other item bearing a Brand Name in any Media; provided, however, that the foregoing prohibition shall not apply to (1) Media where the audience or viewers are within an Adult-Only Facility (provided such Media are not visible to persons outside such Adult-Only Facility); (2) Media not intended for distribution or display to the public; (3) instructional Media concerning non-conventional cigarettes viewed only by or provided only to smokers who are Adults; and (4) actions taken by any Participating Manufacturer in connection with a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) and III(c)(2)(B)(i) of the Agreement, and use of a Brand Name to identify a Brand Name Sponsorship permitted by subsection III(c)(2)(B)(ii).

D. Beginning July 1, 1999, marketing, distributing, offering, selling, licensing or causing to be marketed, distributed, offered, sold, or licensed (including, without limitation, by catalogue or direct mail), within the State of New York, any apparel or other merchandise (other than Tobacco Products, items the sole function of which is to advertise Tobacco Products, or written or electronic publications) which bears a Brand Name. Provided, however, that nothing in this section shall (1) require any Participating Manufacturer to breach or terminate any licensing agreement or other contract in existence as of June 20, 1997 (this exception shall not apply beyond the current term of any existing contract, without regard to any renewal or option term that may be exercised by such Participating Manufacturer); (2) prohibit the distribution to any Participating Manufacturer's employee who is not Underage of any item described above that is intended for the personal use of such an employee; (3) require any Participating Manufacturer to retrieve, collect or otherwise recover any item that prior to the MSA Execution Date was marketed, distributed, offered, sold, licensed or caused to be marketed, distributed, offered, sold or licensed by such Participating Manufacturer; (4) apply to coupons or other items used by Adults solely in connection with the purchase of Tobacco Products; (5) apply to apparel or other merchandise used within an Adult-Only Facility that is not distributed (by sale or otherwise) to any member of the general public; or (6) apply to apparel or other merchandise (a) marketed, distributed, offered, sold, or licensed at the site of a Brand Name Sponsorship permitted pursuant to subsection III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement by the person to which the relevant Participating Manufacturer has provided payment in exchange for the use of the relevant Brand Name in the Brand Name Sponsorship or a third-party that does not receive payment from the relevant Participating Manufacturer (or any Affiliate of such Participating Manufacturer) in connection with the marketing, distribution, offer, sale or license of such apparel or other merchandise, or (b) used at the site of a Brand Name Sponsorship permitted pursuant to subsections III(c)(2)(A) or III(c)(2)(B)(i) of the Agreement (during such event) that are not distributed (by sale or otherwise) to any member of the general public.

E. After the MSA Execution Date, distributing or causing to be distributed within the State of New York any free samples of Tobacco Products except in an Adult-Only Facility. For purposes of this Consent Decree and Final Judgment, a "free sample" does not include a Tobacco Product that is provided to an Adult in connection with (1) the purchase, exchange or redemption for proof of purchase of any Tobacco Products (including, but not limited to, a free offer in connection with the purchase of Tobacco Products, such as a "two-for-one" offer), or (2) the conducting of consumer testing or evaluation of Tobacco Products with persons who certify that they are Adults.

F. Using or causing to be used as a brand name of any Tobacco Product pursuant to any agreement requiring the payment of money or other valuable consideration, any nationally recognized or nationally established brand name or trade name of any non-tobacco item or service or any nationally recognized or nationally established sports team, entertainment group or individual celebrity. Provided, however, that the preceding sentence shall not apply to any Tobacco Product brand name in existence as of July 1, 1998. For the purposes of this provision, the term "other valuable consideration" shall not include an agreement between two entities who enter into such agreement for the sole purpose of avoiding infringement claims.

G. After 60 days after the MSA Execution Date and through and including December 31, 2001, manufacturing or causing to be manufactured for sale within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco); and, after 150 days after the MSA Execution Date and through and including December 31, 2001, selling or distributing within the State of New York any pack or other container of Cigarettes containing fewer than 20 Cigarettes (or, in the case of roll-your-own tobacco, any package of roll-your-own tobacco containing less than 0.60 ounces of tobacco).

H. Entering into any contract, combination or conspiracy with any other Tobacco Product Manufacturer that has the purpose or effect of: (1) limiting competition in the production or distribution of information about health hazards or other consequences of the use of their products; (2) limiting or suppressing research into smoking and health; or (3) limiting or suppressing research into the marketing or development of new products. Provided, however, that nothing in the preceding sentence shall be deemed to (1) require any Participating Manufacturer to produce, distribute or otherwise disclose any information that is subject to any privilege or protection; (2) preclude any Participating Manufacturer from entering into any joint defense or joint legal interest agreement or arrangement (whether or not in writing), or from asserting any privilege pursuant thereto; or (3) impose any affirmative obligation on any Participating Manufacturer to conduct any research.

I. Making any material misrepresentation of fact regarding the health consequences of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients. Provided, however, that nothing in the preceding sentence shall limit the exercise of any First Amendment right or the assertion of any defense or position in any judicial, legislative or regulatory forum.

VII. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained by the Court for the purposes of implementing and enforcing the Agreement and this Consent Decree and Final Judgment and enabling the continuing proceedings contemplated herein. Whenever possible, the State of New York and the Participating Manufacturers shall seek to resolve any issue that may exist as to compliance with this Consent Decree and Final Judgment by discussion among the appropriate designees named pursuant to subsection XVIII(m) of the Agreement. The State of New York and/or any Participating Manufacturer may apply to the Court at any time for further orders and directions as may be necessary or appropriate for the implementation and enforcement of this Consent Decree and Final Judgment. A County may apply for further orders and directions as may be necessary or appropriate for the implementation or enforcement of the fourth sentence of Article III(B) of this Consent Decree and Final Judgment. Provided, however, that with regard to subsections VI(A) and VI(I) of this Consent Decree and Final Judgment, the Attorney General shall issue a cease and desist demand to the Participating Manufacturer that the Attorney General believes is in violation of either of such sections at least ten Business Days before the Attorney General applies to the Court for an order to enforce such subsections, unless the Attorney General reasonably determines that either a compelling time-sensitive public health and safety concern requires more immediate action or the Court has previously issued an Enforcement Order to the Participating Manufacturer in question for the same or a substantially similar action or activity. For any claimed violation of this Consent Decree and Final Judgment, in determining whether to seek an order for monetary, civil contempt or criminal sanctions for any claimed violation, the Attorney General shall give good-faith consideration to whether: (1) the Participating Manufacturer that is claimed to have committed the violation has taken appropriate and reasonable steps to cause the claimed violation to be cured, unless that party has been guilty of a pattern of violations of like nature; and (2) a legitimate, good-faith dispute exists as to the meaning of the terms in question of this Consent Decree and Final Judgment. The Court in any case in its discretion may determine not to enter an order for monetary, civil contempt or criminal sanctions.

B. This Consent Decree and Final Judgment is not intended to be, and shall not in any event be construed as, or deemed to be, an admission or concession or evidence of (1) any liability or any wrongdoing whatsoever on the part of any Released Party or that any Released Party has engaged in any of the activities barred by this Consent Decree and Final Judgment; or (2) personal jurisdiction over any person or entity other than the Participating Manufacturers. Each Participating Manufacturer specifically disclaims and denies any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against it in this action, and has stipulated to the entry of this Consent Decree and Final Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as expressly provided otherwise in the Agreement, this Consent Decree and Final Judgment shall not be modified (by this Court, by any other court or by any other means) unless the party seeking modification demonstrates, by clear and convincing evidence, that it will suffer irreparable harm from new and unforeseen conditions. Provided, however, that the provisions of sections III, V, VI, VII and VIII of this Consent Decree and Final Judgment shall in no event be subject to modification without the consent of the State of New York and all affected Participating Manufacturers. In the event that any of the sections of this Consent Decree and Final Judgment enumerated in the preceding sentence are modified by this Court, by any other court or by any other means without the consent of the State of New York and all affected Participating Manufacturers, then this Consent Decree and Final Judgment shall be void and of no further effect. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that the Participating Manufacturers will comply with this Consent Decree and Final Judgment as originally entered, even if the Participating Manufacturers' obligations hereunder are greater than those imposed under current or future law (unless compliance with this Consent Decree and Final Judgment would violate such law). A change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Participating Manufacturers shall not support modification of this Consent Decree and Final Judgment.

D. In any proceeding which results in a finding that a Participating Manufacturer violated this Consent Decree and Final Judgment, the Participating Manufacturer or Participating Manufacturers found to be in violation shall pay the State's costs and attorneys' fees incurred only by the State of New York in such proceeding.

E. The remedies in this Consent Decree and Final Judgment are cumulative and in addition to any other remedies the State of New York may have at law or equity, including but not limited to its rights under the Agreement. Nothing herein shall be construed to prevent the State from bringing an action with respect to conduct not released pursuant to the Agreement, even though that conduct may also violate this Consent Decree and Final Judgment. Nothing in this Consent Decree and Final Judgment is intended to create any right for New York to obtain any Cigarette product formula that it would not otherwise have under applicable law.

F. No party shall be considered the drafter of this Consent Decree and Final Judgment for the purpose of any statute, case law or rule of interpretation or construction that would or might cause any provision to be construed against the drafter. Nothing in this Consent Decree and Final Judgment shall be construed as approval by the State of New York of the Participating Manufacturers' business organizations, operations, acts or practices, and the Participating Manufacturers shall make no representation to the contrary.

G. The settlement negotiations resulting in this Consent Decree and Final Judgment have been undertaken in good faith and for settlement purposes only, and no evidence of negotiations or discussions underlying this Consent Decree and Final Judgment shall be offered or received in evidence in any action or proceeding for any purpose. Neither this Consent Decree and Final Judgment nor any public discussions, public statements or public comments with respect to this Consent Decree and Final Judgment by the State of New York or any Participating Manufacturer or its agents shall be offered or received in evidence in any action or proceeding for any purpose other than in an action or proceeding arising under or relating to this Consent Decree and Final Judgment.

H. All obligations of the Participating Manufacturers pursuant to this Consent Decree and Final Judgment (including, but not limited to, all payment obligations) are, and shall remain, several and not joint.

I. The provisions of this Consent Decree and Final Judgment are applicable only to actions taken (or omitted to be taken) within the States. Provided, however, that the preceding sentence shall not be construed as extending the territorial scope of any provision of this Consent Decree and Final Judgment whose scope is otherwise limited by the terms thereof.

J. Nothing in subsection VI(A) or VI(I) of this Consent Decree shall create a right to challenge the continuation, after the MSA Execution Date, of any advertising content, claim or slogan (other than use of a Cartoon) that was not unlawful prior to the MSA Execution Date.

K. If the Agreement terminates in this State for any reason, then this Consent Decree and Final Judgment shall be void and of no further effect.

VIII. FINAL DISPOSITION

A. The Agreement, the settlement set forth therein, and the establishment of the escrow provided for therein are hereby approved in all respects, and all claims are hereby dismissed with prejudice as provided therein.

B. The Court finds that the persons signing the Agreement have full and complete authority to enter into the binding and fully effective settlement of this action as set forth in the Agreement. The Court further finds that entering into this settlement is in the best interests of the State of New York and the Counties.

LET JUDGMENT BE ENTERED ACCORDINGLY

DATED this 23rd day of December, 1998

FILED
DEC 23, 1998

COUNTY CLERK'S OFFICE
NEW YORK

/s/ SGC
J.S.C.

STEPHEN G. CRANE
/s/ Norman Goodman
Clerk

EXHIBIT 2

At all times and under all circumstances specified in Section XI of the Master Settlement Agreement that require the Independent Auditor to instruct the Escrow Agent to disburse amounts to the State of New York pursuant to the terms of the Master Settlement Agreement (''New York Disbursal Share''), the Independent Auditor shall allocate all such New York Disbursal Share among the State of New York, the City of New York[1], and the individual counties of New York according to the schedule set forth below and instruct the Escrow Agent to disburse such allocated amounts directly to the State of New York, the City of New York and the specified counties.

(1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Section IX(b) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows:

Entity	Percentage of Payment
New York State	51.176%
New York City	26.670%
Albany	0.593%
Allegheny	0.107%
Broome	0.446%
Cattaraugus	0.179%
Cayuga	0.166%
Chautauqua	0.308%
Chemung	0.212%
Chenango	0.104%
Clinton	0.170%
Columbia	0.126%
Cortland	0.100%
Delaware	0.101%
Dutchess	0.500%
Erie	2.194%
Essex	0.075%
Franklin	0.098%
Fulton	0.121%
Genessee	0.118%
Greene	0.085%
Hamilton	0.013%
Herkimer	0.142%
Jefferson	0.190%
Lewis	0.054%
Livingston	0.112%
Madison	0.131%
Monroe	1.536%
Montgomery	0.114%
Nassau	2.739%
Niagara	0.467%

[1] The City of New York includes the five individual boroughs of Manhattan, Bronx, Brooklyn, Queens and Staten Island, and the New York City Health and Hospitals Corporation.

Entity	Percentage of Payment
Oneida	0.544%
Onondaga	0.972%
Ontario	0.181%
Orange	0.564%
Orleans	0.078%
Oswego	0.239%
Otsego	0.122%
Putnam	0.152%
Rensselaer	0.317%
Rockland	0.560%
St. Lawrence	0.239%
Saratoga	0.304%
Schenectady	0.319%
Schoharie	0.063%
Schuyler	0.038%
Seneca	0.069%
Steuben	0.211%
Suffolk	2.673%
Sullivan	0.155%
Tioga	0.100%
Tompkins	0.170%
Ulster	0.334%
Warren	0.113%
Washington	0.113%
Wayne	0.172%
Westchester	1.926%
Wyoming	0.081%
Yates	0.044%

(2) With respect to amounts paid by the Participating Manufacturers pursuant to Section IX(c)(2) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse the entire proceeds to the State of New York.

SUPREME COURT OF THE STATE OF NEW YORK — NEW YORK COUNTY

PRESENT: HON. STEPHEN G. CRANE, *Justice* — Part 56

THE STATE OF NEW YORK, et al.,

Plaintiff,

- v -

PHILIP MORRIS, INC., et al.,

Defendants.

INDEX NO.: 400361/97
MOTION DATE: 4/13/99
MOTION SEQ. NO.: 019
MOTION CAL. NO.: 139

The following papers, numbered 1 to ____ were read on this motion to/for ____

PAPERS NUMBERED

Notice of Motion/Order to Show Cause — Affidavits — Exhibits ____ ____

Answering Affidavits — Exhibits ____ ____

Replying Affidavits ____ ____

Cross-Motion: [ ] Yes [X] No

The State of New York and defendants Brown & Williamson Tobacco Corporation, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company, jointly move for an order, pursuant to CPLR 5019(a), correcting Exhibit 2 to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, so that the "Consent Decree and Final Judgment" accurately reflects the original intention of the parties and the terms of the Master Settlement Agreement with respect to the intra-State allocation of annual payments by the Participating Manufacturers pursuant to Section IX(c)(1) of the Master Settlement Agreement. The motion is granted on default.

Accordingly, it is

ORDERED that the motion is granted on default; and it is further

ORDERED that Paragraph (1) of "Exhibit 2" to the "Consent Decree and Final Judgment" relating to the Master Settlement Agreement, entered on December 23, 1998, shall be amended to read as follows:

> (1) With respect to the New York Disbursal Share of all amounts paid by the Participating Manufacturers pursuant to Sections IX(b) or IX(c)(1) of the Master Settlement Agreement, the Independent Auditor shall allocate and instruct the Escrow Agent to disburse such amounts as follows: . . . .

The foregoing constitutes the decision and order of the court.

Dated: April 14, 1999

/s/ SGC
STEPHEN G. CRANE J.S.C.

Check One: [ ] FINAL DISPOSITION [X] NON-FINAL DISPOSITION
/s/ MDAR

APPENDIX E

ARBITRATION FINAL AWARD RE: NEW YORK STATE IN THE 2003 NPM ADJUSTMENT PROCEEDINGS

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Hon. Fern M. Smith (Ret.)
JAMS
Two Embarcadero Center, Suite 1500
San Francisco, CA 94111
Telephone: (415) 982-5267
Fax: (415) 982-5287

ARBITRATOR

ARBITRATION

In the 2003 NPM Adjustment Proceedings

JAMS Ref No. 1100053390

FINAL AWARD RE: STATE OF NEW YORK

CHAPTER I: THE PARTIES TO A SPECIFIC STATE AWARD

Petitioners are manufacturers of tobacco products that have joined the MSA ("Master Settlement Agreement"), entered into in 1998, and agreed to be bound by its terms. The MSA refers to such manufacturers as "Participating Manufacturers" or "PMs." *See* MSA § II(jj). The PMs fall into two categories. The "Original Participating Manufacturers," or "OPMs," are those manufacturers that were original parties to the MSA: Philip Morris USA Inc., R.J. Reynolds Tobacco Company, and Lorillard Tobacco Company. *See* MSA § II(hh). (A fourth OPM, Brown & Williamson Tobacco Corporation, combined with R.J. Reynolds Tobacco Company in 2004.) The "Subsequent Participating Manufacturers," or "SPMs," are smaller manufacturers, most of which were never sued by the States, but joined the MSA thereafter. *See* MSA § II(tt). The following SPMs claim entitlement to an NPM Adjustment for 2003 and are petitioners in these proceedings: Commonwealth Brands, Inc., Compania Industrial de Tabacos Monte Paz, S.A., Daughters & Ryan, Inc., House of Prince A/S, Japan Tobacco International U.S.A. Inc., King Maker Marketing, Inc., Kretek International, Liggett Group LLC, Peter Stokkebye

Tobaksfabrik A/S, P.T. Djarum, Santa Fe Natural Tobacco Company, Inc., Sherman 1400 Broadway N.Y.C., Inc., Top Tobacco LP, and Von Eicken Group. All Petitioners are collectively referred to as PMs for purposes of this Award, and a finding as to one PM is a finding as to all, unless specifically noted.

Respondents in the Petitioners' claim were initially listed as the 52 States and Territories that are parties to the MSA. The MSA refers to these States and Territories as "Settling States."

The Settling States originally consisted of Alabama, Alaska, American Samoa, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Georgia, Guam, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, the Northern Marianas Islands, Ohio, Oklahoma, Oregon, Pennsylvania, Puerto Rico, Rhode Island, South Carolina, South Dakota, Tennessee, U.S. Virgin Islands, Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, and Wyoming. (Four States–Florida, Minnesota, Mississippi, and Texas–had entered into separate settlements with certain PMs prior to the MSA and, therefore, are not parties to the MSA.) Since this proceeding began, the PMs have dismissed their allegations against several states (Alaska, Delaware, Hawaii, Idaho, Massachusetts, New Jersey, Rhode Island, South Dakota, Utah, Vermont, Wisconsin, Wyoming, Guam, the Northern Mariana Islands, American Samoa, and the U.S. Virgin Islands; *see* Participating Manufacturers' Notice of Contest as to Certain States' Claims of Diligent Enforcement, filed November 3, 2011). Further, numerous other states entered into a Settlement Agreement with the PMs, dated March 12, 2013, leaving 15 States who remain in this proceeding for whom Awards are now addressed by this Arbitration Panel (the "Panel"). Numerous issues ("Global Issues") are decided and applicable to all remaining Parties; however, because each remaining Settling State may have recourse to its own MSA Court, the Panel will issue a separate Award for each specific state, including therein both the Global Issues and also determinations that are specific to that state only.

Although numerous references may be made to the National Association of Attorneys General ("NAAG") and the "NAAG Tobacco Project," which assist the states in implementing the MSA and through which the states often act with respect to NPM Adjustment issues and enforcement of the Escrow Statutes, NAAG was never made a party to this Arbitration proceeding. NAAG is defined in the Definitions section of the MSA as "the National Association of Attorneys General, or its successor organization that is directed by the Attorneys General to perform certain functions under this Agreement." MSA § II(bb). It is undisputed that NAAG served as an advisory and legal resource to the Settling States, including interpreting the MSA and opining on potential requirements for "diligent enforcement." These Awards may also refer to determinations made by the MSA's "Independent Auditor," which since 1998 has been PricewaterhouseCoopers LLP ("PwC"). The MSA provides that the "Independent Auditor" is responsible for "calculat[ing] and determin[ing] all payments" under the MSA, applying the MSA's various "adjustments, reductions and offsets" (including the NPM Adjustment) to those payments, and determining "the allocation of such payments, reductions, offsets . . . among the Settling States." MSA § XI(a)(1). Although the Independent Auditor plays a major role in the implementation of the MSA, it is not a party to this Arbitration, and the Panel has no jurisdiction over its actions or determinations.

CHAPTER II: THE BACKGROUND

A. Origin of the Dispute.

This section is set forth as a summary and does not constitute either findings of fact or conclusions of law by the Panel.

Both the Supreme Court and the Settling States have referred to the MSA as a "landmark" public health agreement. *Lorillard Tobacco Co. v. Reilly*, 533 U.S. 525, 533 (2001); NAAG March 8, 2006 News Release. The MSA settled and released past and future claims by the Settling States for, among other things, recovery of health-care costs attributed to smoking-related illnesses. In exchange, the PMs agreed to make substantial annual payments in perpetuity based upon their annual nationwide cigarette sales and to be subject to an array of advertising, marketing, and other restrictions. Since the MSA was first signed in November 1998, over 50 tobacco companies have agreed to be bound by its terms. Tobacco product manufacturers who have not joined the MSA and agreed to its terms are referred to as Non-Participating

Manufacturers ("NPMs").

Pursuant to the MSA, each PM makes a single annual payment based on its nationwide cigarette sales volume during each calendar year. The annual payment on a year's volume is due on April 15 of the following year. It is alleged, and not disputed, that these annual payments total in the billions of dollars each year. For example, the OPMs' aggregate base payment obligation was approximately $8 billion for 2003 (the year in question here). *See* MSA §§ IX(c)(1)-(2). The SPMs make separate annual payments also based on their sales volume during the year. *See* MSA § IX(i). The PMs' annual payments are calculated by an "Independent Auditor" agreed to by the parties. *See* MSA § XI(a)(1).

The MSA's annual base payment amounts are subject to various adjustments, including an Inflation Adjustment and a Volume Adjustment (under which the base payments are increased or decreased in proportion to changes in the OPMs' nationwide volume of sales). *See* MSA §§ IX(c), XI(a). According to the PMs, and not disputed, the OPMs' aggregate annual payments after these and other adjustments (other than the NPM Adjustment) since the MSA was entered into have been as follows: 1999–$3.545 billion; 2000–$4.022 billion; 2001–$5.066 billion; 2002–$4.967 billion; 2003–$5.950 billion; 2004–$6.048 billion; 2005–$6.128 billion; 2006–$6.221 billion; 2007–$7.076 billion; 2008–$7.011 billion; and 2009–$6.497 billion. These payments are split among the OPMs in proportion to their relative market shares. *See* MSA §§ IX(c)(1)-(2).

Each SPM makes annual payments that, on a per-cigarette basis, approximate the OPMs' annual payments and that are likewise based on the SPMs' sales volume during the year in question. *See* MSA § IX(i). The SPMs' aggregate annual payments for each year have been claimed as follows: 1999–$46.4 million; 2000–$98.5 million; 2001–$200.4 million; 2002–$319.0 million; 2003–$484.5 million; 2004–$433.7 million; 2005–$441.5 million; 2006–$517.7 million; 2007–$475.0 million; 2008–$569.5 million; and 2009–$571.5 million.

These annual payments continue each year into perpetuity. The PMs' total MSA payments to the Settling States to date exceed $70 billion, including the annual payments listed above and additional "initial" payments made by the OPMs.

The PMs do not make these payments to individual States. Instead, each PM makes a single, nationwide payment in the overall amount calculated and determined by the Independent Auditor. The Independent Auditor then allocates those nationwide payments among the States by applying pre-set "Allocable Share" percentages previously negotiated by the States (and set forth in Exhibit A to the MSA), which represent each State's percentage share of the PMs' nationwide payments. *See* MSA §§ II(f)-(g); IX(b)-(c); IX(j), clause thirteenth; MSA Ex. A.

The MSA's payment obligations impose substantial costs on the PMs. The NPMs, by contrast, do not bear these MSA costs and thus do not reflect them in their pricing. Absent enforcement of statutes imposing similar costs on NPMs, that differential cost between the PMs and the NPMs could be harmful to both the PMs and to the States, as well as to the public, by undermining the goals and purpose of the MSA.

In an attempt to minimize that disadvantage, the MSA included the prospect of reduced payments to supply an incentive for each Settling State to enact and enforce a statute that imposes similar payment obligations on NPMs and thereby neutralizes the MSA-related cost disadvantage imposed on PMs. Moreover, if Settling States nevertheless failed to enact and enforce such a statute, the payment reduction would compensate the PMs for their MSA-related loss of sales.

The NPM Adjustment was made a part of the MSA to address that cost differential or, as the PMs describe it, to "level the playing field." The MSA provides that "[t]o protect the public health gains achieved by this Agreement," the PMs' annual MSA payments "shall" be subject to an NPM Adjustment. *See* MSA § IX(d)(1)(A). The Adjustment provides for a potential reduction in the PMs' MSA payments in event of an MSA-related market-share shift to NPMs above a specified threshold. It is designed to give the States an incentive to eliminate the MSA cost disadvantage faced by PMs, and with it the threat to the MSA's public health gains–and to provide compensation to the PMs in the event such a market-share shift nevertheless occurs. The NAAG Tobacco Project has thus described the NPM Adjustment as follows:

> [The] NPM Adjustment provides [an] incentive to ameliorate these adverse effects [*i.e.*, "undermin[ing] the MSA's public health goals" and "unfairly

> disadvantag[ing] companies that had chosen to" join the MSA. It provides that if, because of the disadvantages imposed on them by the MSA, the PMs lose "Market Share" to NPMs, the PMs' payments to the States can be reduced.

NAAG Tobacco Project, *Understanding and Enforcing the NPM Statute*, MSA Issues Seminar (Oct. 15-16, 2001).

The NPM Adjustment is set forth in Section IX(d) of the MSA (beginning at page 58 of the Agreement). The first subsection, Section IX(d)(1), governs when the NPM Adjustment applies. It provides that the Adjustment "shall apply" to the PMs' annual payment for the year in question if two conditions are met. MSA § IX(d)(1)(C).

First, the PMs must have suffered a "Market Share Loss," which is defined to mean that the PMs' collective market share during that year decreased by more than two percentage points compared to their collective market share in 1997, the last full year before the MSA was signed. MSA §§ IX(d)(1)(A); IX(d)(1)(B).

Second, a nationally recognized firm of economic consultants jointly selected and retained by the OPMs and the States (the "Firm") must have determined that the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to the Market Share Loss for the year in question. *See* MSA § IX(d)(1)(C).

The only exception is where a State demonstrates that it has enacted and "diligently enforced" a "Qualifying Statute." MSA § IX(d)(2)(B). A "Qualifying Statute" is defined as a statute 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 MSA]." MSA § IX(d)(2)(E). States are thus not required either to enact or enforce such a statute, but if they want the benefit of the contractual exemption from the NPM Adjustment, they must do both.

If an individual Settling State demonstrates that it diligently enforced such a statute during the year in question, the NPM Adjustment still applies to the PMs' MSA payments for that year, but none of it is allocated to that Settling State's share of those payments. *See* MSA § IX(d)(2)(B). It is of critical import that nowhere in the MSA or any of the supporting exhibits, is the term "diligent enforcement" defined. The MSA merely states that an exception to the NPM

Adjustment shall be available ". . . 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 . . ." *Id.* Thus, defining what standard is required before a State qualifies for this critical exception is left for this Panel to decide.

Where an individual Settling State qualifies for this exception, the MSA provides that its share of the NPM Adjustment will be reallocated to all other States that do not qualify for the exception because they have not demonstrated diligent enforcement of their own Qualifying Statute. Section IX(d)(2)(C) of the MSA thus provides that the "aggregate amount of the NPM Adjustments that would have applied" to Settling States that prove they fall within the diligent enforcement exception "shall be reallocated among all other Settling States pro rata in proportion to their respective [payment shares]," and that those States' MSA payments "shall be further reduced" up to the full amount of their MSA payments for that year. MSA § IX(d)(2)(C); *see also id.* § IX(d)(2)(D). As a result of this reallocation provision, the greater the number of Settling States that did not diligently enforce a Qualifying Statute, the more widely the NPM Adjustment is spread and the less the share of the Adjustment that each such State bears. Conversely, if only a few Settling States fail to prove diligent enforcement, those Settling States face a more concentrated application of the NPM Adjustment – and hence a greater reduction of their payments, subject only to the limitation that the Adjustment applied to a Settling State can be no greater than the total MSA payment it received for that year. The diligent enforcement and reallocation provisions thus create a dual incentive for individual Settling States to enact and enforce a Qualifying Statute.

The MSA defines a "Qualifying Statute" as one that, among other things, "effectively and fully neutralizes the cost disadvantages that the [PMs] experience vis-à-vis [NPMs] within such Settling State as a result of" the MSA. MSA § IX(d)(2)(E). Exhibit T to the MSA provides a model for such a statute: a "model" Escrow Statute. The MSA provides that this "model" Escrow Statute, if enacted with those modifications necessary to reflect "particularized state procedural or technical requirements" will "constitute a Qualifying Statute." *Id.*

The "model" Escrow Statute provides for each NPM to make escrow deposits on the cigarettes it sells in the enacting Settling State in the year in question. The escrow deposits are to be made into a "[q]ualified escrow fund," which is defined as an escrow arrangement with a qualifying financial institution in which the deposits are held for the benefit of the State. *See* MSA, Ex. T, at T-2 (§ (f)). The deposits are to remain in escrow for 25 years except insofar as they are used to pay a judgment to or settlement with the State for liability on claims like those the Settling States settled against the PMs in the MSA. *See* MSA, Ex. T, at T-4 & T-5 (§ (b)(2)(A)-(C)). The escrow deposits thus guarantee the State a source of recovery should it subsequently sue or settle with that NPM on claims like those the State settled against the PMs in the MSA, and avoid the risk that NPMs would otherwise use their MSA-related "cost advantage to derive large, short-term profits . . . and then becom[e] judgment-proof before liability [to the State] may arise." MSA Ex. T, at T-1 (§§ (a), (f)).

The Settling States all enacted Escrow Statutes following the MSA. But following the signing of the MSA in 1998, and despite the Settling States' universal enactment of Escrow Statutes imposing payment obligations on NPMs, the NPMs' market share increased at significant rates.

This shift of market share from PMs to NPMs has triggered the NPM Adjustment provision of the MSA for multiple years. The PMs and the States settled the NPM Adjustments through 2002. The NPM Adjustments for 2003 and subsequent years, however, were not resolved, and the dispute over the Adjustment for the first of these years–2003–has culminated in the proceedings before this Panel.

As a beginning and necessary step leading to this Arbitration, in connection with its April 2004 calculation of the PMs' MSA payment for 2003, the Independent Auditor determined that the MSA's first condition for application of the 2003 NPM Adjustment was satisfied: the PMs had suffered a "Market Share Loss" for 2003. The Auditor calculated that there had been a market-share shift of approximately 8% to the NPMs from 1997 to 2003, and thus a Market Share Loss of approximately 6% after giving effect to the two percentage point buffer.

The States have not disputed the Independent Auditor's determination that the PMs suffered a Market Share Loss for 2003, the magnitude of that loss or the amount of the 2003 NPM Adjustment.

After the Independent Auditor's finding of a Market Share Loss, the States and OPMs instituted proceedings in April 2005 for a determination by the Firm as to whether the disadvantages experienced by the PMs as a result of the provisions of the MSA were a "significant factor" contributing to that Market Share Loss. The OPMs and States engaged the Brattle Group to make this "significant factor" determination.

The OPMs and the States then participated in a 10-month evidentiary proceeding before the Firm. On March 27, 2006, the Firm issued a 163-page opinion and final determination, finding that the disadvantages experienced by the PMs as a result of the MSA were a "significant factor" contributing to the 2003 Market Share Loss. The MSA expressly provides that the Firm's significant factor determination is "conclusive and binding upon all parties" and "final and non-appealable." *See* MSA § IX(d)(1)(C).

Following the Firm's determination in March 2006, the PMs requested that the Independent Auditor apply the 2003 NPM Adjustment as a credit against their next MSA payments. The Settling States opposed the request, asking the Independent Auditor to "presume" diligent enforcement and to refuse to apply the 2003 adjustment.

Following the Independent Auditor's determination not to apply the NPM Adjustment, some of the PMs paid the disputed amounts into a "Disputed Payment Account," and the PMs requested that the Settling States arbitrate the dispute pursuant to the MSA's Arbitration Clause. That clause, which is set forth in Section XI(c) of the MSA, provides that "[a]ny dispute, controversy or claim arising out of or relating to" the Independent Auditor's calculations or determinations "shall be submitted to binding arbitration" before a panel of three former federal judges.

The Settling States initially refused to agree to arbitration, and sought relief in their individual state courts, which was denied in virtually every case. It was not until January 30, 2009, that 45 Settling States had signed an Agreement to Arbitrate ("the ARA"). Pursuant to the

ARA's "partial liability reduction," the PMs will reimburse each of those 45 Settling States that the Panel determines did not diligently enforce its Escrow Statute in 2003 with 20% of the portion of the 2003 NPM Adjustment that it bears as a result. *See* ARA § 3(b). Four Settling States–Ohio, Oklahoma, North Carolina, and Wisconsin–refused to sign the ARA, but were ordered to arbitration by their state courts, and participated in this Arbitration. Thereafter, the PMs and 48 Settling States, including the four Settling States that declined to sign the ARA, negotiated a separate "Agreement Regarding Procedures for Formation of Arbitration Panel." Pursuant to that Agreement and Section XI(c) of the MSA, this Panel was selected to resolve the 2003 NPM Adjustment dispute.

B. The Arbitration Clause.

The MSA is approximately 150 pages long, plus numerous exhibits. Despite the complexity and uniqueness of the issues in this matter, and the large number of parties involved, the Arbitration Clause ("the Clause") is virtually devoid of any procedural guidelines or objective criteria to be used by the Panel in deciding this matter. The Clause merely states as follows:

> 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.

MSA § XI(c).

C. The Arbitration Panel.

The Panel consists of the following Arbitrators, each of whom is a former Article III federal judge:

Judge William G. Bassler, selected by the PMs;

Judge Abner J. Mikva, selected by the Settling States; and

Judge Fern M. Smith, selected by Judges Bassler and Mikva.

CHAPTER III: THE PROCEDURAL HISTORY

The actual proceedings in the Arbitration began with the Parties filing mutual Motions for Case Management Schedule and Discovery Plan on July 2, 2010. The first joint status hearing took place in Chicago, Illinois. At that time, 17 PMs and 52 States and territories were parties of record, although several States appeared only with reservations of rights, including objections to the Panel's jurisdiction. Because neither the Agreement nor the Clause gave direction, decisions had to be made by the Panel as to the governing law, governing procedural rules, *e.g.*, rules of evidence, type of hearings required, dispositive motions, if any, burden of proof, priorities, and location of hearings, as well as other questions that arose as the Panel proceeded. Because the pre-hearing process was lengthy, as well as complex and significant, a meaningful summary is virtually impossible; therefore, the Panel has attached, as Appendix I, a list of all of the Panel's pre-hearing rulings. (Note: The Panel's rulings, as well as all of the Parties' filings, are posted on a LexisNexis data bank, which is available to authorized readers.)

CHAPTER IV: THE CONTENTIONS OF THE PARTIES

A. The Claimants' Contentions.

The PMs' Claim for Arbitration is almost 200 pages long, which is understandable, given the number of Settling States against whom claims are made. In essence, however, the PMs request that this Panel determine the following:

1. Determine that the Independent Auditor was required to apply the 2003 NPM Adjustment to the PMs' April 2006 annual payments once the Firm determined that the MSA was a significant factor contributing to the PMs' Market Share Loss for 2003.
2. Determine that the Independent Auditor erred when it refused to apply the 2003 NPM Adjustment to the PMs' April 2006 annual payments and when it adopted a presumption that each State had diligently enforced its Escrow Statute.
3. Determine that the Independent Auditor is required to immediately credit the 2003 NPM Adjustment, with applicable interest, to the PMs' next MSA payments.

4. Determine that individual States have the burden of proving diligent enforcement of a Qualifying Statute.

5. Allow the discovery necessary for the parties–and the Panel–to evaluate and determine individual States' claims that they diligently enforced a Qualifying Statute during 2003.

6. Determine the claims of individual States that they diligently enforced a Qualifying Statute during 2003 and that, accordingly, their Allocable Share of the 2003 NPM Adjustment should be reallocated to other States.

7. Determine such other issues related to the application, allocation, and recovery of the 2003 NPM Adjustment as the parties shall raise and the Panel shall deem appropriate.

The primary focus of this Arbitration has been on Contention Six, *i.e.*, which Settling States "diligently enforced" their respective Qualifying Statute in 2003, and the individual state-specific hearings have focused solely on that question. The first five Contentions were expressly or implicitly decided in the pre-hearing determinations set forth in Appendix I. Contention Seven will be addressed, if necessary, in these Awards.

B. The Respondents' Contentions.

Each of the Settling States filed its own response to the PMs' claims and contentions; however, the majority of the defenses raised were duplicative and common to each of the Settling States. There was also a joint response filed on behalf of all of the Settling States. By the time the state-specific hearings were held, the only remaining question for the Panel to answer was that set forth in PMs' Contention Six, *i.e.*, did the Settling State "diligently enforce" its Qualifying Statute in 2003.

CHAPTER V: DISCUSSION AND DECISION

A. Common Findings/Conclusions.

1. Introduction.

As stated above, the majority of defenses and issues raised by both the PMs and the Settling States were common to all parties and were either resolved in pre-arbitration motion proceedings, or were deferred until all of the state-specific hearings were completed. Included in this Award, therefore, are final determinations of those deferred issues, each of which was a significant factor in the Panel's ultimate Awards and each of which is common to the each state-specific Award. They include the following:

- The Panel's definition of Diligent Enforcement
- The Panel's definition of Units Sold
- Whether a State used the Fabricator or Control Test in its enforcement efforts
- Defining "two knowing violations" in seeking injunctive relief
- Enforcement efforts against House of Prince/Carolina/Leonidias
- Whether a State had the obligation to amend or enact legislation as an aid to enforcement
- The use of Allocable Share Releases
- The significance, *i.e.*, use/weight of a State's "collection rate"

It is critical to note that although all of the above were "factors," which the Panel considered in deciding whether the defined diligent enforcement standard was met, the Panel did not rank the factors or give them a numerical score, *i.e.*, each, except for the definition of "diligent enforcement," was considered in the over-all context of a Settling State's existing policies and circumstances in 2003. It is therefore not a useful exercise, or even valid, to compare the decision as to one State against the decision as to another. It is also important to note that the Panel has not distinguished between "Findings" and "Conclusions." Most of the questions addressed are mixed questions, and the Panel views each with equal weight. All findings and/or conclusions were decided by a unanimous Panel.

It was decided during pre-hearing motions (*see* Appendix 1) that the Settling States had the burden of proof on the question of diligent enforcement. Thus, each State presented its case in chief first.

2. "Diligent Enforcement" Defined.

Diligent Enforcement is an ongoing and intentional consideration of the requirements of a Settling State's Qualifying Statute, and a significant attempt by the Settling State to meet those requirements, taking into account a Settling State's competing laws and policies that may conflict with its MSA contractual obligations. Both the legislative and executive branches of a Settling State are bound by the MSA obligations.

That definition is measured by an objective standard, and the Panel has considered numerous factors in determining whether that standard has been met. The Panel has not ranked the factors, but has considered them as a whole in making its determination.

3. "Units Sold" Defined.

"Units Sold" is defined in Exhibit T to the MSA (commonly referred to in this Arbitration as the "Model Statute") as follows:

> "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 . . . .

MSA Exhibit T, T-3, Definitions, (j).

As opposed to much of the MSA, that definition seems clear and unambiguous, and many of the Settling States requested that the Panel find to be binding, as a question of law. The PMs, however, as well as several of the Settling States, disagreed.

The PMs argued that the issue of "units sold" was state-specific and depended on the facts and circumstances of each individual state. For example, the PMs argued that while a minority of states attempted to exempt entire categories of NPM cigarette sales from the escrow payment obligations, such as NPM cigarettes sold through Native American reservations or unstamped roll-your-own cigarettes ("RYO"), other states assessed and attempted to enforce escrow with respect to all NPM cigarettes sold in their state. The PMs argued that the different states' understanding and course of performance in enforcing the NPM escrow obligations were thus factual issues subject to discovery which would have bearing on the Panel's determination of the "units sold" issue.

Because each side to this dispute raised colorable arguments, the Panel deferred ruling until all state-specific hearings were completed. That time has now arrived, and the Panel finds that the PMs have failed to support their arguments that the express definition means anything other than what it says.

The collective evidence did show that different Settling States reacted in different ways to the Model Statute definition, *e.g.*, some Settling States modified their Qualifying Statute, some changed their practices regarding RYO or sales by tribes, and some took the stated definition literally and declined to include certain types of sales as "units sold." What the Panel did not see was any evidence of collusive behavior, *i.e.*, no Settling State, in the Panel's opinion, manipulated the definition or counting of "units sold" in order to purposefully evade their enforcement obligations. In particular, although some Settling States with large numbers of cigarettes sold on Tribal Lands declined to change their policy regarding non-taxation of such sales, those Settling States presented valid policy reasons for their decisions. Although the Settling States had binding contractual obligations to "diligently enforce," they were not required to elevate those obligations above other statutory or rational policy considerations. Unless otherwise stated in a state-specific Award, the Panel reaches the same conclusion for RYO sales.

For these reasons, the Panel finds, as a matter of law, that the Model Statute definition of "units sold" is unambiguous and binding. Further, even if parol evidence were considered, the PMs have failed to show that a different meaning should be applicable to any specific Settling State.

4. Whether a State Used the "Fabricator" or "Control" Test.

This issue also arises under the "Model Statute," which sets forth certain remedies that a State has against a "Tobacco Product Manufacturer" ("TPM"), a term specifically defined under the "Definitions" section of the Model Statute. In that definition, a TPM is defined as an entity that "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 . . . ." MSA Ex. T, T-3.

The "Requirements" section of the Model Statute establishes that the Attorney General of a Settling State may file a civil action against a TPM under certain express conditions. MSA Ex. T, T-5. The right to file a civil action is the only express remedy against TPMs that is set forth in the MSA or Model Statute. The PMs argued in all state-specific hearings that the right to file a lawsuit was critical to diligent enforcement and that the Settling States had an obligation to file such suits often and as soon as possible.

The controversy over this term arose because some Settling States interpreted the definition strictly, *i.e.*, as applying solely to manufacturers, many of which were in foreign jurisdictions, and not easily amenable to jurisdiction (the "Fabricator Test"). Other Settling States were more liberal in their interpretation, and included entities within the United States who played a significant role in getting the subject cigarettes into the market, *e.g.*, distributors and wholesalers (the "Control Test"). For obvious reasons, the Control Test made it easier and faster to file lawsuits. The PMs argue that Settling States that used the Fabricator Test were less "diligent" than followers of the Control Test. The Panel disagrees. The problem, if any, lies with the drafting of the Model Statute, which expressly limits the right to file civil actions to suits against "manufacturers." In hindsight, the definition of TPM should have been broader, but the fault for that does not lie with the Settling States.

5. Defining "Two Knowing Violations" in Seeking Injunctive Relief.

This question also arises out of the "Remedies" section of the Model Statute which limited injunctive relief to TPMs that have committed "two knowing violations." The dispute centers on defining a "knowing violation," and the differences among the Settling States in making that determination. Again, the PMs ask the Panel to penalize those States that accepted a more restrictive and literal definition of that term. The Panel finds no legal or equitable basis to penalize a Settling State who reads the express words of the Model Statute in a rational way. Again, the fault, if any, lies in the drafting of the Model Statute, for which the Settling States are no more to blame than the PMs.

6. Enforcement Effort Against House of Prince/Carolina/Leonidias.

Much time was spent in discussing the role that these entities played, and, more important, their status during the 2003 time period, *i.e.*, were they NPMs, SPMs, contract manufacturers, etc. The value of understanding the relationships lies only in how their status affected a given Settling State's "compliance rate," *i.e.*, the percentage of escrow paid against the total number of units sold in a Settling State by NPMs. The PMs' case rested in great part on the use of expert testimony, an important facet of which was establishing a compliance rate for each state. Because of the legitimate confusion over whether the above entities were NPMs or not, many Settling States took a "wait and see" attitude and did not seek escrow from them, resulting in a lower compliance rate, based on the PMs' calculations. The Panel understands the PMs' theory, but also is unwilling, in hindsight, to classify such decisions as a failure in diligent enforcement. This is especially true because the status of those entities has since resolved.

7. *Whether a Settling State Had the Obligation to Amend or Enact Legislation as an Aid to Diligent Enforcement.*

The PMs have argued both implicitly and explicitly that Settling States could have and should have passed legislation that made enforcement easier to accomplish. The Panel has considered that as a factor, especially the alacrity of a Settling State in passing what has been referred to as "Complementary Legislation," which was specifically aimed at increasing remedies available against non-performing NPMs. On the other hand, the Panel has given less weight to the argument that a Settling State should have legislatively changed, for example, its taxation laws, in order to increase its escrow collection rate. The MSA put no such demand on the Settling States.

8. *Allocable Share Release.*

Significant time was spent by the PMs discussing the negative effect of the Allocable Share Release ("ASR"), which is set forth in the Model Statute. The Panel understands the PMs' theory, but does not agree that the Settling States should be faulted for what was a poorly conceived policy, set forth in the Model Statute. The deficiencies, if any, caused by the ASR provision, were eliminated by most states in 2003 with the passing of additional legislation. The Panel mentions the ASR in individual cases, if at all, only if it found that a Settling State's procedure for releasing ASR funds had a material effect on its enforcement results.

9. *The Significance, i.e., Use/Weight of a State's "Collection Rate."*

The PMs' case-in-chief relied almost completely on the testimony of expert witnesses. One category of expert testimony was provided by economists, who based their opinions primarily on the "collection rate" of a Settling State, *i.e.*, what amount of money was deposited by NPMs into escrow accounts in a given year, as compared to thc experts' determination of what amount was actually due. The collection rates among and bctwcen the Settling States differed significantly, and the variance was intended to be used in a comparative way for the Panel to determine the lack of diligent enforcement. The Panel concurs that the collection rate is a significant factor, but it is not the only factor, nor is it always the primary factor. Predicating a Settling State's diligence, therefore, based solely on the collection rate is unlikely to bc fruitful. Further, because in most cases, the "underreported" collection rate is similar across states, the Panel has not factored that into its analysis, except in unusual circumstances

B. State-Specific Findings and Conclusions as to the State of New York.

1. The Attorneys and Witnesses for the New York Hearing.

a. The Attorneys for New York

i. New York State Office of the Attorney General

Louis Willenken

Sarah Evans

Dana Biberman

b. The Attorneys for the PMs

i. Jones Day

Peter Biersteker

Barbara Harding

Kelly Marino

William Laxton

ii. Winston & Strawn LLP

Alexander Shaknes

c. The Witnesses for New York

i. David Nocenti

Office of the Attorney General in 2002-2003 (served as counsel to the Attorney General)

ii. Pedro Perez

New York State Police

iii. Bernard Reddy

Expert Witness, Economic Consultant at NERA Economic Consulting

iv. William Comiskey

New York Office of Taxation and Finance

d. The Witnesses for the PMs

i. James Levinsohn

Expert Witness

ii. Colleen Waring

Expert Witness

iii. Richard Briffault

Expert Witness

iv. James Calvin

New York Association of Convenience Stores

2. Analysis.

The following is an analysis of those facts found by the Panel to be true and necessary to the Award. To the extent that this recitation differs from any Party's position, that is the result of determinations as to credibility of witnesses, including experts, determinations of relevance, burden-of-proof considerations, and the weighing of the evidence, both oral and written. The Panel has also considered the inferences that could or could not be drawn from the testimony and documents.

New York is in a class by itself in these arbitrations, in that the only contested issue was whether New York failed to diligently enforce its escrow statute because it did not impose an excise tax on sales of units sold by Native American Tribes on their Reservations in New York State, or make any attempt to have escrow collected on those sales. The PMs contend that New York unilaterally excluded NPM sales from excise tax, something that they could not do, and so failed to diligently enforce their escrow statute. In light of the narrow issue, the Pancl foregoes its usual analysis of various factors in determining diligent enforcement.

While the issue presented to the Panel is narrow, its significance is not. Excluding 2002 NPM sales through New York's Native American Reservations, New York had a collection ratc exceeding 100%, a statistic far exceeding any Settling State's collection rate, contested or not, and supporting the conclusion that New York had a robust enforcement environment. But if 2002 NPM sales through New York's Native American Reservations are included, the collection rate drops to a devastating 9–16%.

There is no question that NPMs had a considerable cost advantage over PMs, who had to make MSA payments on reservation sales because such sales generate federal tax payments and are so counted for MSA purposes. On the other hand, NPM sales on Native American Reservations did not result in state excise taxes.

The PMs' argument that New York did not diligently enforce its escrow statute depends on the definition of "Units Sold." New York's position was that, under the plain meaning of "units sold," it did not have to collect escrow on sales on Native American lands because no excise tax was imposed on such sales. The Panel has already agreed with New York's understanding of the meaning of "units sold." *See* pp. 14-15, *supra.* New York cannot be faulted for not collecting escrow on un-taxed cigarettes when the statute on its face did not require collection of escrow on cigarettes that were not taxed.

The PMs further argue that New York was somehow obliged to do what its escrow statute did not require—that, in fact, it should have changed the definition of "units sold," or changed its policy of not imposing state excise tax ("SET") on cigarettes sold on Native American lands. The PMs' position fundamentally comes down to an argument that New York was not acting in good faith and contrary to the spirit of the MSA.

There is no evidence that New York's policy of not collecting excise taxes on cigarettes sold on Native American Reservations was done in the face of a recognized obligation to do so. In fact, the testimony is just the contrary.

From January 1999 through December 2006, David Nocenti was the person with ultimate responsibility for overseeing all tobacco enforcement matters. He persuasively testified at length and without contradiction about New York's policy of forbearance of imposing excise taxes on cigarettes sold through Native American Reservations. Although New York law did require the taxation of such sales, there was a policy of forbearance that originated in the late 1930s. The policy was declared unconstitutional in 1996, but when New York began to interdict illegal sales, it led to significant destruction and violence on many of the Reservations. In May 1997, the policy of interdiction was enjoined and the policy of forbearance continued. In October 1997, the Appellate Division declared the policy unconstitutional, but in April 1998, Governor Pataki issued regulations that explicitly said the State was not collecting SET on cigarette sales on Native American Reservations. In July 1998, three or four months before the MSA was signed, the New York State Court of Appeals held the forbearance policy was not unconstitutional and remanded the case. In July 1999, the trial court declared the forbearance policy to be rational. The decision was affirmed by the Appellate Division in August 2000.

In light of that tortious history, it cannot be said that the decision of the Attorney General's office to continue the forbearance policy amounted to a bad-faith decision in derogation of its MSA obligations to diligently enforce its escrow statute.

Mr. Nocenti's good-faith decision that he did not have a basis to collect a tax not authorized by the statute and to adhere to New York's long-standing policy of forbearance does not amount to an absence of diligent enforcement.

Nor was Mr. Nocenti's testimony in other respects contradicted. He testified that from 1999 through 2003 he had many one-on-one phone conversations with the PMs as well as attending biannual meetings between Settling States and PMs where a variety of issues relating to enforcement, marketing, and provisions of the MSA were discussed. He had no recollection that during that time the PMs ever asserted that New York should be collecting escrow or excise tax on any Native American cigarette sales.

It is inconceivable that the PMs were not aware of this situation since the escrow statute itself requires that excise taxes were based on tax stamps and without such taxation there was no possibility of ascertaining the amount owed on untaxed cigarettes. Moreover, some of the PMs themselves were selling cigarettes on Native American Reservations, so they had to know their sales were not tax stamped. As Mr. Nocenti testified: "Everybody knew we weren't collecting taxes" on Native American sales. At the very least, the PMs were put on inquiry notice.

The evidence of record discloses that it was the policy of New York before the MSA was signed, during the negotiations of the MSA, and immediately afterwards that New York was not seeking to collect excise taxes on those sales. There is no evidence to support the argument that New York arbitrarily decided not to impose excise taxes on and collect escrow from sales of cigarettes on Native American Reservations.

The argument of the PMs that Section XVIII (ff) MSA imposes such an obligation is without merit. That section reads:

> (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.

In other words, an obligation of a Settling State applies to Native American lands in a state. But for that provision to be operative, an obligation has to first exist. It does not impose an obligation that did not already exist. As discussed above, there was no obligation under the definition of "Units Sold" to collect escrow on cigarettes that were not subject to an excise tax. Nor does it require a Settling State to collect excise tax where it had a long-standing public policy not to impose excise taxes where it never before imposed them.

3. Conclusion.

For the reasons set forth above, the Panel unanimously finds that New York has satisfied its burden of proving that it diligently enforced the provisions of its Qualifying Statute during calendar year 2003.

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FINAL AWARD

The Panel unanimously finds that the State of New York diligently enforced its Qualifying Statute during calendar year 2003 and therefore is not subject to an NPM Adjustment pursuant to Section IX(d)(2)(B) of thc Master Settlement Agreement.

All other claims, if any, not specifically addressed in the Final Award are Denied. This Final Award therefore resolves all claims set forth in this proceeding.

SO ORDERED.

Dated: September 11, 2013

The Honorable William G. Bassler
Arbitrator

The Honorable Abner J. Mikva
Arbitrator

The Honorable Fern M. Smith
Chairperson

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APPENDIX F

IHS GLOBAL REPORT

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A Forecast of
U.S. Cigarette
Consumption
(2013-2022) for
The Tobacco Settlement Financing Corporation

Submitted to:

The Tobacco Settlement Financing Corporation

James Diffley
Senior Director

Prepared by:

IHS Global Inc.

IHS Global Inc.
1650 Arch Street, Suite 20000
Philadelphia, PA 191035

(215) 789-7422

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December 5, 2013

Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2012. 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 2013 through 2022. Our forecast indicates that total consumption in 2022 will be 203 billion cigarettes (or 204 billion including roll-your-own tobacco equivalents), a 30% decline from the 2012 level. From 2012 through 2022 the average annual rate of decline is projected to be 3.4%.

Our model was constructed based on widely accepted economic principles and IHS Global Insight's considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning cigarette demand. We considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking amongst underage youth, and qualitative variables that captured the impact of anti-smoking regulations, legislation, 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 workplace smoking restrictions first instituted widely in the 1980s, the stricter restrictions on smoking in public places instituted over the last decade, and the trend over time in individual behavior and preferences. This forecast is based on reasonable assumptions regarding the future paths of these factors.

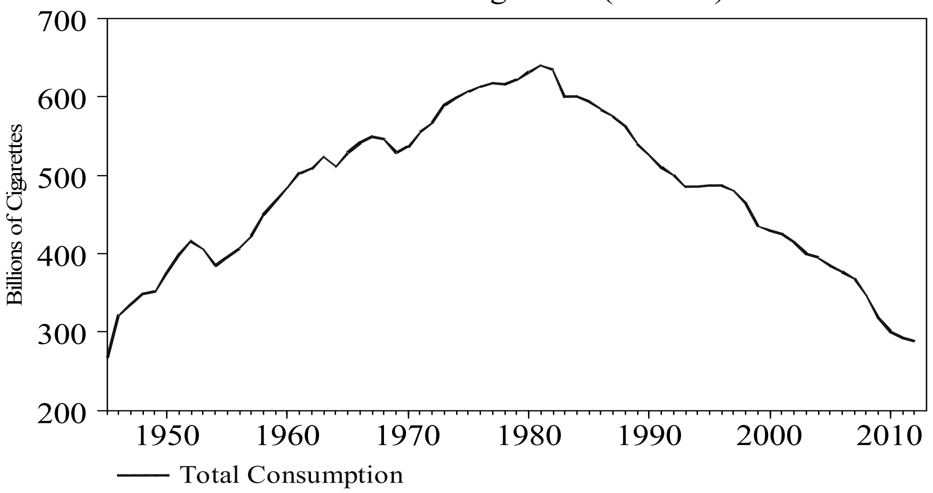
Disclaimer

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

Cigarette Use in the United States

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[1]. Prior to 1900, tobacco was most frequently used in pipes, cigars, and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable U.S. consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico, and other U.S. possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol, Tobacco, Firearms, and Explosives. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion cigarettes in 1900 to a peak of 640 billion in 1981[3]. Consumption declined in the 1980s, 1990s, and 2000s, reaching a level of 465 billion cigarettes in 1998 and decreased to less than 400 billion cigarettes in 2003[4] and 290 billion in 2012[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.

Historical U.S. Cigarette Consumption: 1945-2012
Number of Cigarettes (Billions)



While the historical trend in consumption prior to 1981 was increasing, there was a decline in cigarette consumption of 9.8% during the Great Depression between 1931 and 1932. Notwithstanding, this steep decline, consumption rapidly increased after 1932, exceeding previous levels by 1934. Following the release of the Surgeon General's

[1] *Source*: "Tobacco Timeline," Gene Borio (1998).

[2] Bureau of Alcohol, Tobacco, Firearms, and Explosives reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.

[3] *Source*: "Tobacco Situation and Outlook", U.S. Department of Agriculture-Economic Research Service, September 1999 (USDA-ERS).

[4] *Source*: USDA-ERS. April 2005.

[5] *Source*: US Tobacco and Tax Bureau

Report in 1964, cigarette consumption continued to increase at an average annual rate of 1.2% between 1965 and 1981. Between 1981 and 1990, however, U.S. cigarette consumption declined at an average annual rate of 2.2%. From 1990 to 1998, the average annual rate of decline in cigarette consumption was 1.5%; but for 1998 the decline increased to 3.1% and increased further to 6.5% for 1999. These declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA") and previously settled states agreements. In 2000 and 2001, the rate of decline moderated, to 1.2%. In the early part of the decade, coincident with a large number of state excise tax increases, the rate of decline accelerated in 2002-2003 to an annual rate of 3.0%. The decline moderated for the next four years, through 2007, averaging 2.3%.

The rate of decline accelerated dramatically beginning in 2008, with a 3.8% decline in the number of cigarettes (including roll-your-own equivalents to cigarettes as defined by the MSA at 0.0325 ounces of loose tobacco per cigarette) for that year, 9.1% in 2009, and 6.4% in 2010 before finally decelerating to 2.7% in 2011 and 2.0% in 2012.

The following table sets forth United States domestic cigarette consumption, with and without roll-your-own equivalents, for the fifteen years ended December 31, 2012[6]. The data in this table vary from statistics on cigarette shipments in the United States. While this Report is based on consumption, payments made under the MSA dated November 23, 1998 between certain cigarette manufacturers and certain settling states are computed based in part on shipments in or to the fifty United States, the District of 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.

[6] *Source:* USDA-ERS; 2004, 2005, 2006, estimates by IHS Global Insight. USDA estimates for 2004, 2005, and 2006 diverge significantly from estimates based on independent data from the industry and from the US Tobacco and Tax Bureau. In 2004, the manufacturers report domestic shipments of 394.5 billion, and the TTB reports a total of 397.7 billion. These contrast with a USDA estimate of 388 billion. In 2005, the manufacturers report 381.7 billion, TTB reports 381.1 billion, and USDA 376 billion. In 2006, the manufacturers report 372.5 billion, TTB reports 380.9 billion, and USDA 372 billion. The USDA has discontinued this service, publishing its final report on October 24, 2007. For 2007 TTB reports 361.6 billion, while the manufacturers report 357.2 billion.

U.S. Cigarette Consumption

Year Ended December 31,	Consumption (Billions of Cigarettes)	Percentage Change	Consumption (Billions of Cigarettes with roll-your-own equivalents)	Percentage Change
2012	288	-1.87	290	-1.98
2011	293	-2.48	296	-2.67
2010	301	-5.62	304	-6.45
2009	319	-8.08	325	-9.14
2008	348	-4.35	358	-3.79
2007	368	-2.28	372	-4.97
2006	377	-1.93	391	0.26
2005	384	-2.69	390	-3.51
2004	395	-1.28	404	0.09
2003	400	-3.66	404	-3.30
2002	415	-2.35	418	-2.68
2001	425	-1.16	429	-1.51
2000	430	-1.15	436	-1.30
1999	435	-6.45	442	
1998	465	-3.13		

There was a confluence of factors which led to the dramatically reduced consumption through 2009. First, indoor smoking bans spread rapidly across the country in the latter half of the decade. We now estimate that their impact on decreased smoking and cigarette consumption was approximately 6 billion sticks in 2009. Second, the latter months of 2008 saw a very deep recession. Our model projects that, given the lower realized levels of household income in 2009, consumption was negatively impacted by about 8 billion sticks. Third, the increase in the federal excise tax to $1.01 per pack, effective April 1, 2009 decreased cigarette demand by about 10 billion in 2009 according to our model of price elasticity. Fourth, the acceleration, prompted by the recession, of state excise tax increases similarly reduced consumption by a further 4 billion.

The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according the National Association of Attorneys General, the three leading manufacturers accounted for 84.5% of U.S. shipments in 2012, 84.5% in 2011, and 83.6% in 2010. These top companies are Philip Morris USA, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 46.92%, 23.9%, and 13.9%, respectively of the domestic market in 2012[7]. The market share of the leading manufacturers has declined from over 96% in 1998 due to inroads by smaller manufacturers and importers following the MSA and other state settlement agreements.

The United States government has raised revenue through tobacco taxes since the Civil War. Although the federal excise taxes have risen through the years, excise taxes as a percentage of total federal revenue had fallen from 3.4% in 1950 to approximately 0.4% prior to the 2009 federal excise tax increase. In fiscal year 2012, the federal government received $15.7 billion in excise tax revenue from tobacco sales. In addition, state governments also raised significant revenues, $17.1 billion in 2012 from excise taxes. Cigarettes constitute the majority of these sales, which also include cigars and other tobacco products.

Survey of the Economic Literature on Smoking

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

Incidence of Smoking

Approximately 43.8 million American adults were current smokers in 2011, representing approximately 19.0% of the population age 18 and older, a decline from 19.3% in 2010, according to a Centers for Disease Control and Prevention ("CDC") study[8] released in 2012. 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 and 24.1% in 1998, the incidence rate has declined relatively slowly since 1998.. The decline had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when the incidence rate dropped to 20.9%, though it remained as high as 20.6% in 2009.

[7] IHS Global Insight calculation based on industry shipments data.

[8] *Source*: CDC. Morbidity and Mortality Weekly Report. “Tobacco Use Among Adults – United States, 2011”. November, 2012.

The CDC, in November 2011, released the results of a study of quitting smoking[9]. It found that, in 2010, 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit.

A recent trend, likely influenced by extensive indoor smoking bans in the U.S., is growing numbers of "light smokers", those who smoke just a few cigarettes per day. Thus the decline in the overall prevalence of smoking has slowed while the rate of decline of the volume of cigarettes consumed has accelerated. In a similar fashion electronic cigarettes have replaced cigarette consumption in locations subject to indoor smoking bans.

Youth Smoking

Certain studies have focused in whole or in part on youth cigarette consumption. Surveys of youth typically define a "current smoker" as a person who has smoked a cigarette on one or more of the 30 days preceding the survey. The CDC's Youth Risk Behavior Survey ("YRBS") estimated that from 1991 to 1999 incidence among high school students (grades 9 through 12) rose from 27.5% to 34.8%, representing an increase of 26.5%. By 2003, incidence had fallen to 21.9%, a decline of 37.1% over four years. The rate of decline has continued, though at a slower pace. By 2011, the prevalence was 18.1%.[10]

According to the Monitoring the Future Study, a school-based study of cigarette consumption and drug use conducted by the Institute for Social Research at the University of Michigan, smoking incidence over the prior 30 days among twelfth graders was lower in 2012 than in 2011, continuing trends that began in 1996. Smoking incidence in all grades is well below where it was in 1991, having fallen below that mark in 2001 for eighth graders and in 2002 for tenth and twelfth graders.

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

Grade	1991 (%)	2011 (%)	2012 (%)	'91-'12 Change (%)
8th	14.3	6.1	4.9	-65.7%
10th	20.8	11.8	10.8	-48.1%
12th	28.3	18.7	17.1	-39.6%

The 2011 National Survey on Drug Use and Health (formerly called National Household Survey on Drug Abuse) conducted by the Substance Abuse and Mental Health Services Administration of the United States Department of Health and Human Services ("SAMHSA") estimated that approximately 68.2 million Americans age 12 and older

[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2010". September, 2011.

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were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). The survey found that an estimated 7.8% of youths age 12 to 17 were current cigarette smokers in 2011, down from 8.4% in 2010 and 13.0% in 2002.

The CDC reported on November 15, 2013 that the National Youth Tobacco Survey found that in 2012 the prevalence of tobacco product use among middle and high school students was 6.7% and 23.3%, respectively. These rates decreased from 2011 when they were 7.5% and 24.3%, respectively.

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These surveys all indicate that youth smoking, which had increased during the 1990s following two decades of decline, is again decreasing. In most of the nation the minimum legal age to purchase cigarettes is 18. In 2013 New York City increased that age to 21. A similar proposal to raise the smoking age has also been introduced in the New York State and New Jersey legislatures, in the Council of the District of Columbia, and in Suffolk County, New York. Four states Alabama, Alaska, New Jersey, and Utah, and three New York counties currently set the minimum age at 19.

Price Elasticity of Cigarette Demand

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

Two studies published by the National Bureau of Economic Research examine the price elasticity of youth smoking. In their study on youth smoking in the United States, Gruber and Zinman estimate an elasticity of smoking participation (defined as smoking any cigarettes in the past 30 days) of –0.67 for high school seniors in the period 1991 to 1997.[11] That is, a 1% increase in cigarette prices would result in a decrease of 0.67% in the number of those seniors who smoked. The study's findings state that the drop in cigarette prices in the early 1990's can explain 26% of the upward trend in youth smoking during the same period. The study also found that price has little effect on the smoking habits of younger teens (8th grade through 11th grade), but that youth access restrictions have a significant impact on limiting the extent to which younger teens smoke. Tauras and Chaloupka also found an inverse relationship between price and cigarette consumption among high school seniors.[12] 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

[11] *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.

[12] 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.

probability of smoking cessation for high school senior males and females of 1.12% and 1.19%, respectively. A study utilizing more recent data, from 1975 to 2003, by Grossman, estimated an elasticity of smoking participation of just -0.12.[13] Nevertheless it concludes that price increases subsequent to the 1998 MSA explain almost the entire 12% drop in youth smoking over that time.

In another study, Czart et al. (2001) looked at several factors which they felt could influence smoking among college students. These factors included price, school policies regarding tobacco use on campus, parental education levels, student income, student marital status, sorority/fraternity membership, and state policies regarding smoking. The authors considered two ways in which smoking behavior could be affected: (1) smoking participation; and (2) the amount of cigarettes consumed per smoker. The results of the study suggest that, (1) the average estimated price elasticity of smoking participation is –0.26, and (2), the average conditional demand elasticity is –0.62. These results indicate that a 1% increase in cigarette prices, will reduce smoking participation among college students by 0.26% and will reduce the level of smoking among current college students by 0.62%.[14]

Tauras et al. (2001) conducted a study that looked at the effects of price on teenage smoking initiation.[15] The authors used data from the Monitoring the Future study which examines smoking habits, among other things, of 8th, 10th, and 12th graders. They defined smoking initiation in three different ways: smoking any cigarettes in the last 30 days, smoking at least one to five cigarettes per day on average, or smoking at least one-half pack per day on average. The results suggest that the estimated price elasticities of initiation are –0.27 for any smoking, -0.81 for smoking at least one to five cigarettes, and –0.96 for smoking at least one-half pack of cigarettes. These results above indicate that a 10% increase in the price of cigarettes will decrease the probability of smoking initiation between approximately 3% and 10% depending on how initiation is defined. In a related study, Powell et al. (2003) estimated a price elasticity of youth smoking participation of –0.46, implying that a 1% increase in price leads to a 0.46% reduction in smoking participation.[16]

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

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

[14] 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.

[15] Tauras et al. “Effects of Price and Access Laws on Teenage Smoking Initiation: A National Longitudinal Analysis”. University of Chicago Press. Copyright 2001.

[16] Powell et al. “Peer Effects, Tobacco Control Policies, and Youth Smoking Behavior”. Impacteen. February 2003.

Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. Many researchers now recommend that those trying to quit smoking use a variety of these methods in combination.

One study, by Hu et al., examines the effects of nicotine replacement products on cigarette consumption in the United States.[17] One of the results of the study found that, "a 0.076% reduction in cigarette consumption is associated with the availability of nicotine patches after 1992." In 2002, the Food and Drug Administration ("FDA") approved the Commit lozenge for over-the-counter sale. This product is similar to the gum and patch nicotine replacement products. NicoBloc, a liquid applied to cigarettes which blocks tar and nicotine from being inhaled, is another cessation product on the market since 2003. Zyban is a non-nicotine drug that has been available since 2000. It has been shown to be effective when combined with intensive behavioral support.[18]

In 2006, the FDA approved varenicline, a Pfizer product marketed as Chantix, for use as a prescription medicine. It is intended to satisfy nicotine cravings without being pleasurable or addictive. The drug binds to the same brain receptor as nicotine. Tests indicate that it is more effective as a cessation aid than Zyban. Pfizer introduced Chantix with a novel marketing program, GETQUIT, an integrated consumer support system which emphasizes personalized treatment advice with regular phone and e-mail contact. The drug debuted with strong sales in 2007, but suffered a reversal the following year due to safety concerns. It has since seen increased sales and marketing success. Free & Clear, a provider of tobacco treatment services, reported in June 2008, that Chantix has achieved higher average quit rates than Zyban, patches, gum, and lozenges. Though Pfizer reported additional positive results in 2009, the FDA required that Pfizer update the Chantix label with the most restrictive, "Black Box", safety labeling describing the risks. But the FDA does conclude: "The Agency continues to believe that the drug's benefits outweigh the risks and the current warnings in the Chantix label are appropriate." These warnings include changes in behavior, hostility, agitation, depressed mood, and suicidal thoughts or actions, as well as serious skin reactions and heart and blood vessel problems. Nevertheless the FDA said on October 24, 2011 that it will continue to evaluate the risk of mood changes and other psychiatric events associated with its use. In March 2013, researchers at the University of Texas M.D. Anderson Cancer Center reported a better quitting experience with varenicline than other treatments. In September 2013 researchers in a Pfizer sponsored study concluded that the drug does help some patients with depression or mood disorders to quit smoking without worsening symptoms of depression or anxiety. Also, in October 2013 researchers at the University of Bristol

[17] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. Summer 2000. http:\\tc.bmjjournals.com.

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

reported in the British Medical Journal that cessation drugs do not increase suicide risk. In September 2011, the New England Journal of Medicine reported positive smoking cessation efficacy and safety tests for Cytisine, an inexpensive compound long sold in Eastern Europe as Tabex, as a cessation aid.

Several new drugs may also appear on the market in the near future. In 2005, Cytos Biotechnology AG announced the successful completion of Phase II testing of a virus-based vaccine, genetically engineered to attract an immune system response against nicotine and its effects. In 2007 the company entered into a partnership with Novartis to commercialize the drug, NIC002, but a subsequent Phase II trial was unsuccessful. Novartis though has continued study and commenced a new Phase II trial in November 2011. In 2011 the FDA cleared an Investigational New Drug Application to conduct a Phase II-B trial of X-22, a smoking cessation kit of very low nicotine cigarettes made by the 22nd Century Group. In 2012, a team from Weill Cornell Medical College reported the development of an anti-nicotine vaccine using a genetically engineered virus. The vaccine was successful in test with mice, though it will take several years before it can be tested in humans. It is expected that products such as these and others will continue to be developed and that their introduction and use will contribute to the trend decline in smoking. Our forecast includes a strong negative trend in smoking rates which incorporates the influence of these factors.

Further aiding sales of these products is the decision by 45 state Medicaid programs to offer cessation benefits to Medicaid beneficiaries. And at least ten states (California, Colorado, Maryland, New Jersey, New Mexico, New York, North Dakota, Oregon, Rhode Island, and Vermont) have established minimum standards for private insurance coverage of cessation products and services. Most recently, in October 2010, Medicare coverage was expanded to provide cessation counseling to seniors without tobacco-related disease.

Electronic Cigarettes

Electronic cigarettes have also gained in popularity in recent years. NJOY, Vapor, Logic, and Blu, are marketing and advertising extensively across the US. Sales in 2012 have been estimated to be as much as $500 million, and increasing rapidly. The CDC in February 2013 reported survey results that indicate 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time. These were roughly double estimates in 2010. Lorillard acquired Blu Ecigs in 2012, Reynolds has tested an e-cigarette, Vuse, and Altria announced in 2013 that it would introduce a product later in the year.

They are, on one hand, alternatives to cigarettes as smokers cope with indoor bans, but also cessation devices whose nicotine content can be controlled. In 2010 the U.S. Court of Appeals for the District of Columbia Circuit ruled that the FDA could not regulate electronic cigarettes as a drug, rather it must regulate them as tobacco products. It is unclear what actions the FDA may take towards electronic cigarettes in the future. Their role though in smoking, and smoking cessation, is ambiguous. On the one hand they can be used as a cessation device weaning a smoker away from cigarettes. In this case, as a substitute for cigarettes, they result in lower cigarette consumption. On the other hand, they can, in the presence of indoor smoking bans, allow smokers to maintain a nicotine habit or addiction, offsetting some of the ban's effectiveness in reducing smoking and consumption of cigarettes. In this case electronic cigarettes are complements to cigarettes. Indoor smoking restrictions have reduced the consumption of cigarettes and created a demand for electronic cigarettes. But electronic cigarettes themselves do not further reduce consumption except to the extent that they are substitutes for cigarette usage. Nevertheless, a 2013 study in the United Kingdom found that 76% of e-cigarette users said they started using their devices to replace cigarettes entirely. And results of a trial in Italy, published by the journal Plos One in June 2013, found that 8.7% of electronic cigarette users stopped smoking cigarettes. In September 2013, The Lancet published a New Zealand study which concluded that smoking cessation attempts using e-cigarettes were at least as effective as those using nicotine patches. (In a sample the quit rate after six months with e-cigarettes was 7.3%, versus 5.8% with patches).

A Centers for Disease Control and Prevention study published in the November 15th issue of Morbidity and Mortality Weekly Report says that according to data from the National Youth Tobacco Survey of middle school and high school students in the US, e-cig use among middle school students increased from 0.6% in 2011 to 1.1% in 2012. Among high school students the prevalence increased from 1.5% in 2011 to 2.8% in 2012. In October 2013 a study at the University of Oklahoma Health Science Center concluded that e-cigarettes do not appear to entice teens to try smoking tobacco.

For the consumer, e-cigs are a less expensive alternative as they are not taxed as cigarettes. A cartridge and battery for an electronic cigarette would cost less than half as much as an equivalent pack of cigarettes in a average tax state.

Researchers have reported several safety concerns with the products, including concerns on the variability in delivered nicotine content. The U.S. Department of Transportation is proposing a ban on electronic cigarettes on all flights to and from the U.S., a prohibition already enacted by Amtrak on its trains. The states of North Dakota, New Jersey, and Utah prohibit e-cigarette use in workplaces, restaurants, and bars. Arkansas, Colorado, Delaware, New Hampshire, Oklahoma, and Oregon restrict e-cig use at state workplaces and school grounds. And there are, based on data from the ANRF, e-cigarette restrictions at indoor smokefree venues in 100 localities in the US. Ohio County, WV is one of a number of counties which are discussing banning e-cigarette use in indoor public places. In September 2013 forty state attorneys general sent a letter to the Food and Drug Administration (FDA) urging the agency to regulate electronic cigarettes in the same way it regulates tobacco products.

In August 2013 the Consumer Advocates for Smoke-free Alternatives Association released a study it funded by the Drexel University School of Public Health. It found that chemicals in electronic cigarettes (e-cigarettes) pose no health concern for users or bystanders.

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.[19] Their results suggest that workplace smoking bans reduce smoking prevalence by five percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day a smoker spent working in a smoking restricted environment, the greater the decline in the quantity of cigarettes that smoker consumed.

Factors Affecting Cigarette Consumption

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

Price Elasticity of Demand. Cigarette price elasticities from recent conventional research studies have generally fallen between an interval of -0.3 to -0.5. Based on Global Insight's multivariate regression analysis using U.S. data from 1965 to 2012, the long-run price elasticity of consumption for the entire population is -0.33; a 1.0% increase in the price of cigarettes decreases consumption by 0.33%.

In 1998, the average price of a pack of cigarettes in the U.S. in nominal terms was $2.20. This increased to $2.88 per pack in 1999, representing a nominal growth in the price of cigarettes of 30.9% from 1998. During 1999, consumption declined by 6.45%. This was primarily due to a $0.45 per pack increase in November 1998 which was intended to offset the costs of the MSA and agreements with previously settled states.

Over the next several years the cigarette manufacturers continued to increase wholesale prices, and state excise taxes rose dramatically across the nation. By 2008 the weighted average state excise tax was $1.23 per pack and cigarette prices averaged $5 per pack.

The 2008-2009 recession and its stress on state budget revenues prompted acceleration in excise tax increases, as sixteen states increased taxes, resulting in an average tax of $1.34

[19] *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.

at the end of 2009. In 2010, Hawaii, New Mexico, New York, South Carolina, Utah, and Washington, raised taxes. In 2011, excise tax increases went into effect in Connecticut, again in Hawaii, and in Vermont. In 2012, Illinois, by $1.00 per pack, and Rhode Island, by $0.04 per pack, raised cigarette excise taxes. In March 2013, Cook County, Illinois increased its cigarette excise tax by $1.00 per pack, to push city, county, and state taxes in Chicago to $6.67 per pack, and Mayor Emanuel's proposed 2014 budget includes a further $0.75 increase in the tax. This year, in July, Minnesota increased its excise tax by $1.60 per pack, and Massachusetts by $1.00 per pack. The average state tax rate is currently $1.53. Also in 2013 the legislatures in Florida, Maryland, New Hampshire, and Rhode Island are considering tax increases. A group in California is backing a 2014 ballot initiative to add $1.00 per pack to the state excise tax. A similar ballot initiative was unsuccessful at the polls in 2012. Nevertheless, in May 2013, two California Senate committees have recommended a bill to raise the state excise by $1.95 per pack.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009 when the U.S. Congress adopted legislation which raised the tax by $0.62, to $1.01, effective April 1, 2009. As a result the total state and federal excise tax now equals $2.47 on average in the U.S. In 2011 a U.S. senate bill was sponsored by 14 Democrats and would have raised the excise tax to $2.01 per pack, but it was not successful. On January 22, 2013 Senator Tom Harkin introduced legislation, the Healthy Lifestyles and Prevention America Act, which would double the Federal excise tax on cigarettes and roll-your-own tobacco and increase the tax on smokeless tobacco products. This year President Obama's 2013 federal budget proposal included an increase in the Federal Excise Tax to $2.00 per pack.

Purchases of roll-your-own cigarette tobacco were discouraged by 2009 legislation, as its excise tax was raised substantially. But the excise tax changes also had the effect of encouraging the use of pipe tobacco, combined with the availability of roll-your-own machines to circumvent the higher excise taxes. Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products.

During much of the period following the MSA, the major manufacturers refrained from wholesale price increases, and also actively pursued extensive promotional and dealer and retailer discounting programs which served to hold down retail prices. They did this in part due to the state tax increases, but primarily to maintain their market share from its erosion by a deep discount segment which grew rapidly following the MSA. The major manufacturers were finally successful in stemming the increase in the deep discount market share, which stabilized in 2004. The major manufacturers have raised prices or reduced discounts and promotions in each year since 2004. The average price, including excise taxes in October 2013 was $7.28 per pack.

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Over the longer term our forecast expects price increases to continue to exceed the general rate of inflation due to increases in the manufacturers' prices as well as further increases in excise taxes. In December 2012 R.J. Reynolds and Philip Morris USA announced list price increases of 6 cents per pack. This followed June increases of 6 cents, and of 8 cents per pack by Lorillard. In June 2013 Philip Morris USA reduced promotional allowances on Marlboro and L&M cigarettes by 6 cents per pack. And on November 25, Philip Morris USA announced that on December 1, 2013 it would reduce promotional allowances and raise prices by seven cents per pack.

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 some sales are typically exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes grew rapidly, though credit card companies and shippers including the U.S. Postal Service have now put significant restrictions on shipping of cigarettes, and the federal government has enacted the Prevent All Cigarette Trafficking ("PACT") Act which requires the collection of all applicable taxes on Internet and mail-order cigarette shipments. Under the MSA volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volume, but it may negatively impact MSA receipts.

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.[20] However, a few studies found cigarette consumption decreases as disposable income increases.[21] Based on our multivariate regression analysis the income elasticity of consumption is 0.27; a 1.0% increase in real disposable income per capita increases per capita cigarette consumption by 0.27%. In normal periods of economic growth this factor contributes a positive impact to cigarette demand, offsetting some of the negative impacts previously discussed. However, with the recession of 2008-2009 this factor also impacted cigarette demand and consumption in a negative way.

Youth Consumption. The number of teenagers who smoke is another likely determinant of future adult consumption. While this variable has been largely ignored in empirical studies of cigarette consumption,[22] almost all adult smokers first use cigarettes by high school, and very little first use occurs after age 20.[23] One study examines the effects of youth smoking on future adult smoking.[24] The study found that between 25% and 50% of any increase or decrease in youth smoking would persist into adulthood. According to the study, several factors may alter future correlation between youth and adult smoking: there are better means for quitting smoking than in the past, and there are more workplace bans in effect that those who are currently in their teen years will face as they age.

[20] Ippolito, et al.; Fuji.

[21] Wasserman, et al.; Townsend et al.

[22] Except for those such as Wasserman, et al. that studied the price elasticity for different age groups.

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

[24] *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.

We have compiled U.S. data from the CDC that measures the incidence of smoking in the 12-17 age group as the percentage of the population in this category that first become daily smokers. This percentage, after falling since the early 1970s, began to increase in 1990 and increased through the decade. We assume that this recent trend peaked in the late 1990s and youth smoking has resumed its longer term decline.

In 2012, the Surgeon General issued a report, "Preventing Tobacco Use among Youth and Young Adults". Among its major conclusions were, 1) that prevention efforts must focus on both adolescents and young adults, 2) that advertising and promotional activities by tobacco companies have been shown to cause the onset and continuation of smoking among youth, 3) that after years of steady progress, declines in tobacco use by the young have slowed, and 4) that coordinated, multi-component interventions that combine mass media campaigns, price increases, school-based programs, and community wide smoke-free policies and norms are effective in reducing tobacco use. Also in 2012 the CDC produced a mass-media advertising campaign featuring graphic descriptions of the adverse health effects of smoking. In August 2012 the CDC declared the campaign a major success, as the agency concluded that the ads helped to double the amount of calls to their telephone quit line. A new CDC campaign, with graphic adverse health images began in March 2013, and in September 2013 the CDC announced survey results which concluded that cessation attempts increased from 31.1% to 34.8% of smokers who had seen the graphic ads, which the CDC extrapolated to 100,000 sustained quitters, approximately 0.25% of US smokers. In November 2013 the journal Tobacco Control published research from the University of Illinois at Chicago which concluded that the FDA has underestimated the impact of graphic labels. Examining the experience in Canada the researchers concluded that graphic warning labels reduced smoking rates in Canada by from 3% to 5%.

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

Health Warnings. Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General’s warning, beginning November 1, 1970. The Comprehensive

Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The Family Smoking Prevention and Tobacco Control Act ("FSPTCA") requires that cigarette packages have larger and more visible graphic health warnings. Regulations that were to go into effect in September 2012 mandated that a series of nine graphic health warnings must appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels. Five manufacturers challenged the implementation of these new warnings on First Amendment grounds, and on November 7, 2011 a federal judge issued a preliminary injunction blocking the FDA requirement. The judge ruled that the labels were not factual, but rather, "…calculated to provoke the viewer to quit…." In 2012 a federal judge in Washington blocked the new requirement, while an appeals court in Ohio ruled to uphold parts of the Act. In March 2013 the Attorney General decided not to ask the U.S. Supreme Court to review the case. Instead the FDA announced on March 19, 2013 that it would undertake research to support new rulemaking. On April 22, 2013 the Supreme Court upheld the provisions of the 2009 law, allowing the FDA to develop and implement new graphic warning labels.

At least six states, Alabama, Georgia, Idaho, Kentucky, South Carolina, and West Virginia, charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. Several large corporations, including Meijer Inc., Gannett Co., American Financial Group Inc., Bank One, JP Morgan Chase, PepsiCo Inc., Northwest Airlines, Safeway, Tribune Co., and Whirlpool, are now charging smokers higher premiums.

Smoking Bans in Public Places. Beginning in the 1970s numerous states have passed laws banning smoking in public places as well as private workplaces. In September 2003 Alabama joined the other 49 states and the District of Columbia in requiring smoke-free indoor air to some degree or in some public places.[25]

The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 39 states and a number of large cities. Restrictions to all workplaces, restaurants, and bars cover 47.9% of the U.S, according to the American Nonsmokers' Rights Foundation ("ANRF"). In 2012 North Dakota became the most recent state to adopt these bans in public places. In 2013 Kentucky is considering a similar ban.

The ANRF documents clean indoor air ordinances by local governments throughout the U.S. As of October 1, 2013, there were 3,931 municipalities with indoor smoking restrictions. Of these, 861 local governments required non-hospitality workplaces to be 100% smoke-free while 893 governments required 100% smoke-free conditions in restaurants, and 762 required the same for bars. The number of such ordinances has grown rapidly in the past two decades. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade. In 1993 only 13 municipalities prohibited all smoking in restaurants, and 6 in bars.[26]

[25] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.

[26] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. July 2013.

Based on the regression analysis using data from 1965 to 2012, the restrictions on workplace smoking that proliferated in the 1980s appear to have an independent effect on per capita cigarette consumption. We estimate that the restrictions instituted beginning in the late 1970s have reduced smoking by about 2%. However, the timing of the restrictions within and across states makes such statistical identification difficult. Bauer, et al. estimates that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[27] Research in Canada, by the Ontario Tobacco Research Unit, concludes that consumption drops in workplaces where smoking is banned, by almost five cigarettes per person per day. Tauras, in a study based on a large survey of smokers, found that the more restrictive smoke-free air laws decrease average smoking, but have little influence on prevalence.[28] The study predicts that moving from no smoking restrictions at all to the most restrictive bans reduces average smoking from 5% to 8%.

The extension of the indoor bans to restaurants and bars in the last decade began largely in the Northeast and did not appear, in our econometric analysis, to have a significant independent impact on smoking there. However, with data available from later in the decade across a wider geography, econometric analysis reveals that the bans did have a significant impact and we have added a variable quantifying the effect in our consumption model.

The first extensive outdoor smoking restrictions were instituted in March 2006 in Calabasas, California. The cities of Los Angeles and Oakland, Contra Costa County, and the California municipalities of Belmont, Beverly Hills, Campbell, Concord, Dublin, El Cajon, Emeryville, Hayward, Loma Linda, Santa Cruz, Santa Monica, and Walnut Creek have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. In 2007, San Diego City and Los Angeles, Santa Cruz and San Mateo Counties banned smoking at beaches and parks, joining over 30 other Southern California cities in prohibiting smoking on the beach. They are now among 143 municipalities which have banned smoking on beaches, and 707 who have banned smoking in municipal parks. In 2011 the New York City Council approved a bill to ban smoking in all city parks, beaches and pedestrian plazas. That ban went into effect on May 23, 2011. According to ANRF, as of October 2013, 875 municipalities prohibit smoking in city parks, and 170 municipalities mandate smoke-free city beaches. In January 2014 a smoking ban will go into effect on Hawaii's beaches.

Additional restrictions are being placed in residential units as well. First, many hotels, including the Marriott, Sheraton, and Westin chains have adopted completely smoke-free room standards. And multi-family residential buildings have been increasingly subject to restrictions, beginning in 2008 in the California cities of Belmont and Calabasas, which have approved ordinances which restrict smoking anywhere in the city except for single-

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

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

family detached homes. Alameda, Oakland, Pasadena, Santa Monica, and Thousand Oaks are among eight other California cities with such extensive bans. In September 2011 Sonoma County imposed a similar ban, effective June 2012. In August 2011 the California Legislature passed legislation enabling landlords to ban smoking in residential rental units. In June 2012, the Towbes Group of Santa Barbara became the largest apartment portfolio, with 2,000 units, to impose a smoking ban. In April 2013 California Assembly Bill 746 was defeated; it would have prohibited smoking in, and within 20 feet of entrances of, condominiums, duplexes, and apartment units throughout the state. A similar bill has also been introduced in Massachusetts.

New York City's first non-smoking apartment building opened in late 2009. Many landlords and condominium associations in California, and in New York City, have also established smoke-free apartment policies. Most recently Related Companies, which manages 40,000 rental units, announced a ban on smoking for all new tenants. In July 2011 the San Antonio Housing Authority announced a ban, effective in January 2012, on smoking in its 6,175 rental units. Similar bans went into effect in 2012 for public housing in Boston and Minneapolis.

New Jersey has prohibited smoking in college dormitories since 2005. At least 798 colleges nationwide now prohibit smoking everywhere on campus. In 2013 the California and Louisiana state college and university systems have banned tobacco use, joining Arkansas and Oklahoma with no-smoking restrictions at public colleges and universities, and Iowa, which prohibits smoking at all colleges and universities. Twenty-one states have banned smoking, indoors and outdoors, at state prisons. Arkansas, California, Louisiana, Maine, Puerto Rico, Texas, and Rockland County, NY now prohibit smoking in a car where there are children present, and similar legislation has been proposed in Maryland, New York, Ohio, Oregon, Utah, Virginia, and other states.

In June 2006, the Office of The Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke". It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. We expect that the report will strengthen arguments in favor of further smoking restrictions across the country. Further ammunition for activists for smoke-free environments was provided by the California Environmental Protection Agency Air Resources Board, which in 2006 declared environmental tobacco smoke to be a toxic air contaminant.

Smokeless Tobacco Products. Unlike electronic cigarettes, smokeless tobacco products have been available for centuries. As cigarette consumption expanded in the last century, the use of smokeless products declined. Chewing tobacco and snuff are the most significant components. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. Chewing tobacco and dry snuff consumption had been declining in the U.S. into this century, but moist snuff consumption has increased at an annual rate of more than 5% since 2002. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST (purchased by Altria in 2009), was the largest producer of moist smokeless tobacco, and explicitly targeted adult smoker conversion in its growth strategy over the last decade. As with e-cigarettes, the leading cigarette manufacturers soon themselves added smokeless products, responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Philip Morris USA now markets Marlboro Snus which has experienced sales growth of over 6% annually into 2012, and Reynolds American has enjoyed similar gains with one of its smokeless products, Camel Snus.

In 2011, according to SAMHSA's National Survey on Drug Use & Health, 3.2% of adults used smokeless tobacco products. And young adults were twice as likely to use smokeless products. A Massachusetts survey in 2011 found that 29% of male smokers aged 18-24 in snus test markets had tried snus products.

Advocates of the use of snuff as part of a harm reduction strategy point to Sweden, where "snus", a moist snuff manufactured by Swedish Match, use has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men.[29] The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids.[30] A 2010 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.[31] Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

Nicotine Dependence. Nicotine is widely believed to be an addictive substance. The Surgeon General[32] and the American Medical Association[33] (AMA) both conclude that nicotine is an addictive drug that produces dependence. The American Psychiatric

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

[30] Rodu and Phillips, "Switching to Smokeless Tobacco as a Smoking Cessation Method: Evidence form the 2000 National Health Interview Survey". Harm Reduction Journal. 23 May 2008.

[31] Tomar, Alpert, and Connolly, "Patterns of Dual Use of Cigarettes and Smokeless Tobacco among US Males: Findings from National Surveys". Tobacco Control. 11 December 2009.

[32] *Source:* Surgeon General’s 1988 Report, “The Health Consequences of Smoking – Nicotine Addiction”.

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

Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

Regulation. Since June 22, 2009 when President Obama signed the FSPTCA, the FDA has had broad authority over the sale, distribution, and advertising of tobacco products. Such legislation significantly restricts tobacco marketing and sales to youth, requires the disclosure of cigarette ingredients, bigger and bolder health warnings, and bans labels thought to be deceptive, such as "light", and "low-tar" from cigarettes.

A significant issue before the FDA is the role of menthol cigarettes. It has been argued that menthol flavoring serves as an inducement to youth smoking and that its prevalence is especially high among minority groups, raising a call for a ban on its manufacture and sale. The FDA has established a working group to study the issue. Menthol cigarette sales represent almost 30% of total cigarette sales. Moreover, menthol smoking rates have increased among young adults during the past decade. In September 2012 the American Journal of Public Health published the first peer-reviewed data on menthol smokers. It reported the results of a national survey of those smokers showing that nearly 40% of menthol smokers say they would quit smoking if menthol cigarettes were no longer available. While an outright ban would no doubt prompt a significant number of these smokers to switch to other brands, any significant amount of quitting as a result would have a large negative effect on total consumption and sales. This survey suggests that the effect might be as large as a 12% reduction in cigarette consumption.

The FDA, in July 2013, released its review, "Preliminary Scientific Evaluation of the Possible Public Health Effects of Menthol Versus Nonmenthol Cigarettes". It concluded that menthol in cigarettes is likely to be associated with, first, altered physiological responses to tobacco smoke, second, increased dependence, third, reduced success in smoking cessation, and fourth, increased smoking initiation by youth. Though the report did not constitute a decision about regulatory action, the FDA did conclude that it is likely that menthol cigarettes pose a public health risk above that seen with nonmenthol cigarettes. In August 2013 the American Academy of Family Physicians advocated a menthol ban in an open letter to the Food and Drug Administration. And in November twenty-five state attorneys general asked U.S. public health regulators to ban menthol cigarettes.

In 2011 the FDA's Tobacco Products Scientific Advisory Committee ("TPSAC") determined that menthol use is most prevalent among younger smokers, and among African Americans. It concludes that the availability of menthol cigarettes more likely than not: 1.) increases experimentation and regular smoking, 2.) increases the likelihood and degree of addiction in youth smokers and, 3.) results in lower likelihood of smoking cessation success in African Americans. TPSAC continues to study the issue in 2013. The FDA submitted a draft report of its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011, adding that after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. In addition TPSAC has initiated discussions on the nature and impact of dissolvable tobacco products on public health.

Whether FDA regulation will result in a significantly faster rate of decline of smoking in the U.S. cannot be determined at this time. But it clearly does have that potential if regulators take an aggressive and effective approach towards that goal. One of the most profound actions it is empowered to take is to mandate the reduction of nicotine levels in cigarettes. It will surely study the issue, perhaps opting to phase out nicotine, the addictive factor in cigarettes over some time period. The smaller manufacturers believe, on the other hand, that FDA regulation will strengthen the role of the major producers, as it raises costs of compliance and narrows price gaps of discount cigarettes. In October 2011, the FDA and the U.S. National Institutes of Health announced a national study of the effects of new tobacco regulation on smokers. The study will examine, by following more than 40,000 smokers, susceptibility to tobacco use, use patterns, resulting health problems, and will evaluate how regulations affect tobacco-related attitudes and behaviors. In January 2013 a state legislator in Oregon took an unprecedented step in cigarette regulation by introducing a bill which would make nicotine a controlled substance, requiring a doctor's prescription.

Research has indicated, and our model incorporates, a negative impact on cigarette consumption due to tobacco tax increases, and a negative trend decline in levels of smoking since the Surgeon General's 1964 warning, subsequent anti-smoking initiatives, and regulations which restrict smoking. Our model and forecast acknowledges the efficacy of these activities in reducing smoking and assumes that the effectiveness of such anti-smoking efforts will continue. For instance, in 2001, Canada required cigarette labels to include large graphic depictions of adverse health consequences of smoking. Recent research suggests that these warnings have some effectiveness, as one-fifth of the participants in a survey reported smoking less as a result of the labels.[34] More recent survey research has found that smokers were more likely to say they wanted to quit after having seen such graphic images. As the prevalence of smoking declines, it is likely that the achievement of further declines will require either a greater level of spending, or more effective programs. This is the common economic principle of diminishing returns**.**

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

An Empirical Model of Cigarette Consumption

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

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

We used the tools of standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the U.S. Then, using that relationship, along with IHS Global Insight's standard population growth forecast, we projected actual cigarette consumption (in billions of cigarettes) out to 2022. 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 2012 on the variables described above, we developed the following regression equation.

$$
\begin{aligned}
\text{log (per capita consumption)} \quad &= \quad 54.1 \\
&- 0.024 * \text{trend} \\
&- 0.223 * \text{log (cigarette price)} \\
&- 0.104 * \text{log (cigarette price last year)} \\
&+ 0.274 * \text{log (per capita disposable income)} \\
&- 0.001 * \text{percentage of U.S. with strong indoor smoking ban} \\
&- 0.002 * \text{percentage of U.S. with strong indoor smoking ban last year.}
\end{aligned}
$$

This model has an R-square in excess of 0.99, meaning that it explains more than 99 percent of the variation in U.S. adult per capita cigarette consumption over the 1965 to 2012 period. In terms of explanatory power this indicates a very strong model with a high level of statistical significance.

According to the regression equation specified above, cigarette consumption per capita (CPC) displays a trend decline of 2.4% per year. The trend reflects the impact of a systematic change in the underlying data that is **not** explained by the included explanatory variables. In the case of cigarette consumption, the systematic change is in public attitudes toward smoking. The trend may also reflect the cumulative impact of health warnings, advertising restrictions, and other variables which are statistically insignificant when viewed in isolation. Some of the impact of the availability of e-cigarettes may be captured here, though it is also captured in the indoor smoking ban terms. This trend, primarily due to an increase in the health-conscious proportion of the population averse to smoking, would by itself account for 90.3% of the variation in consumption. This coefficient is estimated such that a statistical confidence interval of 95% for its value is from 0.0195 to 0.0269 (1.95% to 2.69%). This implies that there is a probability of 5% that the trend rate of decline is outside this range.

Forecast Assumptions

Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard IHS Global Insight forecasts. Annual population growth is projected to average 0.7%, and real per capita personal disposable income is projected to increase over the long term at just over 2.1% per year.

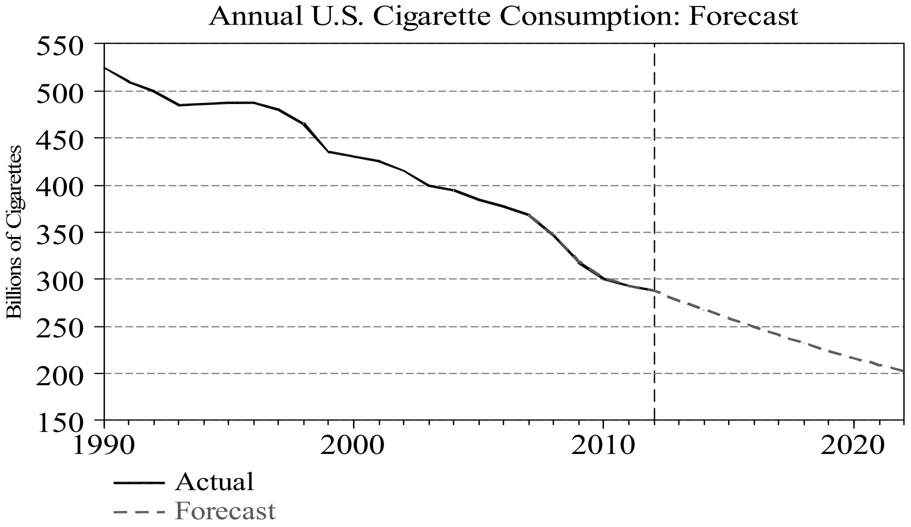
The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the MSA and other state settlement agreements and subsequent excise tax increases. Cigarette prices increased dramatically in November 1998, as manufacturers raised prices by $0.45 per pack. Subsequent increases by the manufacturers and numerous federal and state hikes in excise taxes brought prices to an average of $3.84 per pack in 2004, to $4.04 in 2005, to $4.18 in 2006, $4.47 in 2007, $4.75 in 2008, and to $5.99 in 2009, $6.62 in 2010, $6.85 in 2011, and $7.00 in 2012, following federal and state tax increases. Our forecast assumptions have incorporated price increases in excess of general inflation to offset excise and other taxes. Relative to other goods, cigarette prices will rise by an average of 1.9% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

President Obama's 2013 federal budget proposal included an increase in the Federal Excise Tax to $1.95 per pack. Our model predicts that, if enacted, the tax increase would reduce cigarette consumption by an additional 4.6%, resulting in a total decline of approximately 8% in the first year after enactment.

In addition, we assume that the prevalence of indoor and outdoor restrictions on smoking will continue to increase. It is assumed that by 2020 100% of states and municipalities will completely restrict smoking in workplaces, restaurants and bars. At the same time, outdoor and residential restrictions will proliferate over this, and the following decades. These bans are assumed to be as effective in reducing smoking as the indoor bans.

Forecast of Cigarette Consumption

The graph below illustrates total actual and projected cigarette consumption in the United States.



In addition to the expected trend decline in cigarette consumption, the sharp upward shock to cigarette prices in late 1998 and 1999 contributed to a 6.5% reduction in consumption in 1999. The rate of decline moderated considerably in the following years, averaging 2.1% from 1999 to 2007, before accelerating sharply in 2008.

The economic downturn in the US in 2008 turned into the deepest since the 1930s, with sharply negative effects on household disposable income. At the same time a rapid increase in gasoline and energy prices significantly reduced the discretionary spending of consumers. In addition, cigarette price increases continued, the federal excise tax was raised dramatically, and indoor smoking bans continued to proliferate. Consumption fell by nearly 4% in 2008 and by over 9% in 2009. Cigarette shipment declines moderated from 2010 to 2012, when the rate of decline was slightly less than 2%. (Roll-your-own tobacco had represented as much as 3% of tobacco volume under the MSA, but has declined in volume by over 70% since 2008, after federal excise taxes were substantially increased.)

In 2013, shipments reported by MSAI for the first three quarters of the year were 4.1% lower than a year ago. Through August the TTB reports shipments 4.0% lower than the comparable period in 2012. For the year we project a consumption decline of 3.7%, largely due to a weak per capita disposable income growth forecast of 1.0%.

Over the longer term our model includes estimates of the negative impact of indoor smoking bans, which we anticipate will ultimately be enacted in all states. For instance, in 2011 legislation to establish indoor bans in Texas and Louisiana made significant advances before being defeated. We also assume that stringent restrictions on smoking will continue to be enacted, including their gradual extension to outdoor public places, as well as to private indoor residential spaces such as in multi-family housing.

From 2012 through 2022 the average annual rate of decline is projected to be 3.4%.

Forecast U.S. Consumption of Cigarettes

	Total Consumption	Decline Rate	Consumption including Roll-Your-Own	Decline Rate
	(billions)	*(%)*	*(billions)*	*(%)*
2009	318.7	-8.1%	325.0	-9.1%
2010	300.8	-5.6%	304.1	-6.4%
2011	293.3	-2.5%	296.0	-2.7%
2012	287.9	-1.9%	290.1	-2.0%
FORECAST				
2013	277.1	-3.7%	279.3	-3.7%
2014	267.7	-3.4%	269.8	-3.4%
2015	258.5	-3.4%	260.5	-3.4%
2016	249.5	-3.5%	251.4	-3.5%
2017	240.5	-3.6%	242.4	-3.6%
2018	232.0	-3.6%	233.8	-3.6%
2019	223.9	-3.5%	225.6	-3.5%
2020	216.3	-3.4%	218.0	-3.4%
2021	209.2	-3.3%	210.9	-3.3%
2022	202.7	-3.1%	204.2	-3.1%

Comparison With Prior Forecasts

In June 2011 IHS Global, then DRI•WEFA presented a similar study, “A Forecast of U.S. Cigarette Consumption (2011-2022) for the Tobacco Settlement Financing Corporation.” That report projected consumption in 2022 of 201.1 billion cigarettes, reflecting an average decline rate of 3.3%. The current forecast projects an average decline rate of 3.4% through 2022, to an annual consumption level of 202.7 billion sticks. The new forecast was developed with consideration of the higher than projected cigarette consumption in 2011 and 2012, as well as a weaker than projected economic environment in 2013.

APPENDIX G

CERTAIN INFORMATION RELATING TO THE DOMESTIC TOBACCO INDUSTRY

The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their current or former parent companies, certain publicly available analyses of the tobacco industry and other public sources. Certain of those companies file annual, quarterly and certain other reports with the SEC. Such reports are available on the SEC's website (www.sec.gov) and upon request from the SEC's Investor Information Service, 100 F Street, NE, Washington, D.C. 20549 (phone: (800) SEC-0330 or (202) 551-5450; fax: (202) 343-1028; 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. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the New York Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2013 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2013 Bonds is consistent with their investment objectives.

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

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

Industry Overview

As reported by NAAG, based upon OPM shipments reported to MSAI, the OPMs accounted for approximately 84.81% of the U.S. domestic cigarette market in sales year 2012 measuring roll-your-own cigarettes at 0.09 ounces per cigarette conversion rate and approximately 84.52% measuring roll-your-own cigarettes at 0.0325 ounces per cigarette conversion rate. However, according to publicly available documents of the OPMs, at September 30, 2013, the OPMs collectively accounted for approximately 91.5% of the domestic cigarette retail industry (with Reynolds Tobacco measuring by sales, Lorillard measuring by shipments and Philip Morris using data from IRI/MSAi, a tracking service that uses a sample of stores and certain wholesale shipments to project market share and depict share trends). The market for cigarettes in the U.S. divides generally into premium and discount sales. As reported by Lorillard, at September 30, 2013, the discount segment of the domestic tobacco industry represented approximately 26.5% of domestic tobacco sales.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the U.S. Prior to a name change on January 27, 2003, Altria was named Philip Morris Companies Inc. In its Form 10-K filed with the SEC for the calendar year 2012, Altria reported that Philip

Morris's domestic cigarette market share for calendar year 2012 was 49.8% (based on retail sales) which represents an increase of 0.8 share points from its reported domestic market share (based on retail sales) of 49.0% for calendar year 2011. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Altria reported that Philip Morris's domestic cigarette market share in the nine-month ended September 30, 2013 was 50.6%, which represents an increase of 0.3 share points from its reported domestic market share of 50.3% in the nine-months ended September 30, 2012. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament (with Marlboro representing approximately 86% of Philip Morris's domestic cigarette shipment volume during the nine-months ended September 30, 2013, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013). Marlboro is the largest selling cigarette brand in the U.S., with approximately 43.6% of the U.S. domestic retail share at September 30, 2013 and September 30, 2012, according to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, and has been the world's largest-selling cigarette brand since 1972. Philip Morris's principal discount brands are Basic and L&M. In 2009, Altria acquired UST LLC, whose subsidiary, U.S. Smokeless Tobacco LLC ("**UST**"), is the largest producer of smokeless tobacco in the U.S. Effective in the first quarter of 2013, Philip Morris's market share results for cigarettes are based on a new tracking service, IRI/Management Science Associate Inc., which measures retail share in stores representing trade classes selling a significant majority of the volume of the product being measured. For other trade classes selling cigarettes, retail share is based on shipments from wholesalers to retailers reported through the Store Tracking Analytical Reporting System. According to Altria, retail market share results reported using the new services cannot be meaningfully compared to retail market shares previously reported by Altria's tobacco companies under the previous services. Altria has restated its retail share results for 2012 to reflect these new services. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Altria reported that Philip Morris's domestic cigarette market share for the nine-month period ended September 30, 2013 was 50.6%.

Reynolds American Inc. ("**Reynolds American**") is the second largest tobacco company in the U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corporation ("**B&W**"), previously the third largest tobacco company in the U.S., under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of American Snuff Co., owner of smokeless tobacco brands, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs.

In its Form 10-K filed with the SEC for the calendar year 2012, Reynolds American reported that Reynolds Tobacco's domestic retail cigarette market share at December 31, 2012 was 26.5% (measured by sales volume), which represents an approximately 4% decrease from the 27.6% market share at December 31, 2011. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Reynolds American reported that Reynolds Tobacco's domestic retail market share in the three months ended September 30, 2013 was 26.0%, which represents a decrease from its reported domestic retail market share of 26.4% in the three months ended September 30, 2012. Reynolds Tobacco's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds Tobacco's market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet, direct mail and some illicitly tax-advantaged outlets.

Lorillard, Inc., formerly a wholly-owned subsidiary of Loews Corporation prior to June 2008, is the parent company of Lorillard Tobacco Company ("**Lorillard**"), the third largest tobacco company in the U.S. In its Form 10-K filed with the SEC for the calendar year 2012, Lorillard, Inc. reported that its domestic retail cigarette market share in 2012 was 14.4% (measured by wholesale shipment volume), which represents an increase of 0.3 share points from calendar year 2011. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, Lorillard, Inc. reported that its domestic cigarette market share for the nine-months ended September 30, 2013 was 14.9% (measured by wholesale shipment volume), an increase of 0.5 share points from its reported domestic market share of 14.4% for the nine months ended September 30, 2012. Lorillard's principal brands are Newport, Kent, True, Maverick and Old Gold. Its largest selling brand is Newport, which accounted for approximately 88.2% of Lorillard's cigarette segment net sales for the nine months ended September 30, 2013, an increase from 87.8% of Lorillard's cigarette segment net sales for the nine months ended September 30, 2012. On November 1, 2010, Lorillard began shipping its new non-menthol varieties of Newport, called Newport Non-Menthol Box and Newport Non-Menthol Box 100s. Market share data reported by Lorillard is based on Lorillard's proprietary retail shipment data "EXCEL," which reflects shipments from wholesalers to retailers.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for the nine-month period ended September 30, 2013 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, LLC ("**Liggett**") (the operating successor to the Liggett & Myers Tobacco Company) and Vector Tobacco Inc. ("**Vector Tobacco**"), each wholly-owned subsidiaries of Vector Group Ltd. ("**Vector Group Ltd.**"), and Commonwealth Brands, Inc. ("**CBI**"), a wholly-owned subsidiary of Imperial Tobacco Group PLC ("**Imperial Tobacco**"), which markets deep discount brands. Liggett, Vector Tobacco and CBI are SPMs under the MSA.

Imperial Tobacco is listed on the London Stock Exchange and does not file quarterly or annual reports with the SEC. However, Imperial Tobacco reported in its half year results for the six months ended March 31, 2013 that it held a 3.3% market share of the U.S. cigarette market, a decrease from its 3.5% market share of the U.S. cigarette market in the six months ended March 31, 2012. CBI's brands include USA Gold, Sonoma and Fortuna.

In its Form 10-K filed with the SEC for the year ended December 31, 2012, Vector Group Ltd. reported that Liggett's domestic market share in calendar year 2012 was 3.5%, measured by shipment volume. Such market share represents a decrease from the 2011 domestic market share of 3.8%. In its Form 10-Q filed with the SEC for the nine months ended September 30, 2013, Vector Group Ltd. reported that Liggett and Vector's domestic shipments accounted for 3.3% of the total cigarettes sold in the United States in the first nine months of 2013. Vector Group Ltd. reports in its SEC filings that Liggett is required to make payments under the MSA only to the extent of the incremental market share above a base market share of approximately 1.65% of the U.S. cigarette market, and that Vector Tobacco is required to make payments under the MSA only to the extent of the incremental market share above a base market share of approximately 0.28% of the U.S. cigarette market. All of Liggett's unit sales volume for the calendar year 2012 (and all years since 2004) and for the first nine months of 2013 were in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid, Eagle 20's (relaunched as a deep discount brand in January 2013) and USA. Vector Tobacco is focused on developing reduced risk cigarette products. Vector Tobacco announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. However, Vector Tobacco has postponed the national launch of QUEST indefinitely. In February 2008, Liggett announced that it would begin selling "snus", a smokeless tobacco product, under its Grand Prix brand, but its presence in this market appears to be limited, as there is no mention of it in Vector Group Ltd.'s recent SEC filings.

Industry Market Share

The following table sets forth the approximate comparative positions of the leading producers of cigarettes in the U.S. tobacco industry, each of which is an OPM under the MSA. Individual and total domestic OPM market shares presented below are derived from the publicly available documents of the OPMs and, as a result of varying methodologies used by the OPMs to calculate market share, may not be comparable and may be inaccurate when combined as presented.

Manufacturers' Domestic Market Share of Cigarettes*

	Calendar Year			
Manufacturer	2009	2010	2011	2012
Philip Morris	49.9%	49.8%	49.0%	49.8%
Reynolds Tobacco	28.3	28.1	27.6	26.5
Lorillard**	11.8	12.9	14.1	14.4
Other***	10.0	9.2	9.3	9.3

* Aggregate market share as reported above is different from that utilized in the Collection Methodology and Assumptions.

** Lorillard utilizes MSAI market share data in its SEC reports. MSAI divides the cigarette market into two price segments, the premium price segment and the discount or reduced price segment. MSAI's information relating to unit sales volume and market share of certain of the smaller, primarily deep discount, cigarette manufacturers is based on estimates derived by MSAI. Lorillard management has indicated that it believes that volume and market share information for the deep discount manufacturers may be understated (and, correspondingly, volume and market share information for the larger manufacturers may be overstated).

*** The market share, other than the OPMs, has been determined by subtracting the total market share percentages of the OPMs as reported in their publicly available documents from 100%. Results may not be accurate and may not total 100% due to rounding and the differing sources and methodologies utilized to calculate market share.

Cigarette Shipment Trends

The following table sets forth the industry's approximate cigarette shipments in the U.S. for the six years ended December 31, 2012. The MSA payments are calculated in part on shipments by the OPMs in or to the U.S. rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*	Percent Change From Prior Year
2012	286.5	(2.3)%
2011	293.1	(3.5)
2010	303.7	(3.8)
2009	315.7	(8.6)
2008	345.3	(3.3)
2007	357.2	(5.0)

* As reported in SEC filings of Lorillard and Reynolds Tobacco, based on MSAI data.

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

According to data from NAAG, overall shipments dropped approximately 2.0% to 290.102 billion cigarettes in sales year 2012 from 295.956 billion cigarettes in sales year 2011 measuring roll-your-own tobacco sales at 0.0325 ounces per cigarette conversion rate (or approximately 1.9% to 288.670 billion cigarettes in sales year 2012 from 294.281 billion cigarettes in sales year 2011 measuring roll-your-own tobacco sales at 0.09 ounces per cigarette conversion rate). According to NAAG data, domestic U.S. cigarette consumption over the past 10 sales years was approximately as follows:

Sales Year	No. of Cigarettes (in billions) (with 0.0325 oz. RYO conversion)	% Change From Prior Year (with 0.0325 oz. RYO conversion)	No. of Cigarettes (in billions) (with 0.09 oz. RYO conversion)	% Change From Prior Year (with 0.09 oz. RYO conversion)
2012	290.102	(1.98)%	288.670	(1.91)%
2011	295.956	(2.67)	294.281	(2.55)
2010	304.079	(6.45)	301.989	(5.92)
2009	325.043	(9.14)	320.997	(8.47)
2008	357.738	(3.79)	350.711	(4.14)
2007	371.833	(4.96)	365.875	(5.14)
2006	391.256	0.26	385.711	0.25
2005	390.250	(3.51)	384.766	(3.86)
2004	404.439	0.09	400.224	0.07
2003	404.071	(3.30)	399.934	(3.44)

According to data from the Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau (the "**TTB**"), the overall quantity of cigarettes shipped domestically (not including a conversion for roll-your-own tobacco) dropped approximately 1.91% to 287.187 billion cigarettes in 2012 from 292.769 billion cigarettes in 2011. According to the TTB, the quantity of cigarettes shipped domestically for the past 10 calendar years was approximately as follows:

Calendar Year	No. of Cigarettes (in billions)	Percent Change From Prior Year
2012	287.187	(1.91)%
2011	292.769	(2.57)
2010	300.489	(5.52)
2009	318.029	(8.20)
2008	346.419	(4.22)
2007	361.665	(5.01)
2006	380.726	(0.10)
2005	381.107	(4.31)
2004	398.285	(0.37)
2003	399.768	(3.92)

According to data from MSAI, the overall quantity of cigarettes shipped domestically (not including a conversion for roll-your-own tobacco) dropped approximately 4.1% to 206.5 billion cigarettes in the nine months ended September 30, 2013 from 215.3 billion cigarettes in the nine months ended September 30, 2012.

Physical Plant, Distribution, Competition and Raw Materials. The production facilities of the OPMs tend to be highly concentrated. For instance, all of the cigarette production of Lorillard comes from a single facility in North Carolina. The other OPMs also have limited production facilities and have announced plans to continue to consolidate their production facilities. Material damage to these facilities could materially impact overall cigarette production. A prolonged interruption in the manufacturing operations of the cigarette manufacturers could have a material adverse effect on the ability of the cigarette manufacturers to effectively operate their respective businesses.

Cigarette manufacturers sell tobacco products to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. 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 domestic market for cigarettes is highly competitive. Competition is primarily based on a brand's price, including the level of discounting and other promotional activities, positioning, consumer loyalty, retail display, quality and taste. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

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

Smokeless Tobacco Products

Smokeless tobacco products have been available for centuries. Chewing tobacco and snuff are the most significant components of this market segment. Snuff is a ground or powdered form of tobacco that is placed under the lip to dissolve. It delivers nicotine effectively to the body. Moist snuff is both smoke-free and potentially spit-free. As cigarette consumption expanded in the last century, the use of smokeless products declined. Recently, however, the industry has expanded its smokeless tobacco products in response to the general decline in cigarette consumption, the proliferation of smoking bans and the perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. Snuff, for example, is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco (and a subsidiary of Altria, Philip Morris's parent company), which manufactures Copenhagen and Skoal smokeless products, among others, is explicitly targeting adult smoker conversion in its growth strategy. In 2006, the three largest U.S. cigarette manufacturers entered the market of smokeless tobacco products. Philip Morris introduced a snuff product, Taboka. Reynolds American acquired Conwood Company, L.P., the nation's second largest smokeless-tobacco manufacturer, and introduced Camel Snus, a snuff product. Lorillard entered into an agreement with Swedish Match North America to develop smokeless products in the United States, which has since been discontinued. In addition, Lorillard announced in 2010 that it intends to enter certain test markets with a traditional moist snuff product to assess opportunities to broaden its product offerings, but it makes no mention of such in its recent SEC filings. Product development has continued, however, with the introduction by Philip Morris of Marlboro snus (a smokeless, spitless tobacco product that originated in Sweden) and snuff products. In October 2007, Altria announced that it would accelerate the development of snuff and less-harmful cigarettes to counter a decline in smoking. In January 2012 Altria announced that it entered into an agreement with Okono, an affiliate of Fertin Pharma, a Danish maker of nicotine chewing gum, to develop non-combustible tobacco products, and in May 2012, Altria announced that its subsidiary Nu Mark LLC introduced Verve discs, a mint-flavored, chewable tobacco product that contains tobacco-derived nicotine, and on June 11, 2013, Altria announced that it intends to expand distribution of its Verve discs from 60 stores to about 1,200 stores throughout Virginia in the second half of the year. Liggett, in 2008, announced it would introduce Grand Prix snus, which has yet to be marketed based on a review of Vector Group Ltd.'s recent SEC filings.

Advocates of the use of snuff as part of a tobacco harm reduction strategy point to Sweden, where use of "snus", a moist snuff manufactured by Swedish Match, has increased sharply since 1970, and where cigarette smoking incidence among males has declined to levels well below that of other countries. A review of the literature on the Swedish experience concludes that snus, relative to cigarettes, delivers lower concentrations of some harmful chemicals, and does not appear to cause cancer or respiratory diseases. They conclude that snus use appears to have contributed to the unusually low rates of smoking among Swedish men. The Sweden experience is unique, even with respect to its Northern European neighbors. It is not clear whether it could be replicated elsewhere. A May 2008 study using data from the 2000 National Health Interview Survey reports that U.S. men who used smokeless tobacco as a smoking cessation method achieved significantly higher quit rates than those who used other cessation aids. Public health advocates in the U.S. emphasize that smokeless use results in both nicotine dependence and increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

In 2008, Fuisz Technologies formed a new firm, Fuisz Tobacco, to commercialize a film-based smokeless tobacco product. No developments have been reported on this product. The thin film strip would be spitless and would dissolve entirely in the cheek. Reynolds American has developed and is marketing Camel Sticks, a twisted, dissolvable stick made of tobacco, Camel Orbs, dissolvable tobacco tablets, and Camel Strips, dissolvable tobacco strips, each of which may be produced as flavored items.

As a result of these efforts, smokeless tobacco products have been increasing market share of tobacco products overall at the expense of the market share captured by cigarettes. According to Reynolds Tobacco's parent company, Reynolds American, as reported in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, U.S. moist snuff volumes grew approximately 5% in the first nine months of 2013, and in its Form 10-K filed with the SEC for the calendar year 2012, Reynolds American reported that U.S. moist snuff retail volumes grew approximately 5% in 2012 and 5% in 2011. Reynolds American reports that moist snuff's growth is partially attributable to cigarette smokers switching from cigarettes to smokeless tobacco products or using both. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, smokeless tobacco products accounted for approximately 7.50% of Altria's tobacco product net revenues for the nine months ended September 30, 2013, compared with approximately 6.96% for the nine months ended September 30, 2012.

E-Cigarettes

Numerous manufacturers have developed and are marketing "electronic cigarettes" (or "e-cigarettes"), which, while not tobacco products, are battery powered devices that vaporize liquid nicotine, which is then inhaled by the consumer. There are currently over 250 e-cigarette brands on the market. Because electronic cigarettes are not tobacco products, they are not subject to the advertising restrictions to which tobacco products are subject. Furthermore, electronic cigarettes are generally not subject to federal, state or local excise taxes; however, according to Lorillard, Inc. in its Form 10-K filed with the SEC for the calendar year 2012, one state has imposed an excise tax on electronic cigarettes and certain other jurisdictions are considering imposing excise taxes and other restrictions on electronic cigarettes. For example, a bill passed by the Oklahoma Senate in March 2013 would ban sales of electronic cigarettes to people under age 18 and would impose a five cent tax on electronic cigarettes (while limiting the maximum tax on electronic cigarettes to 10% of the tax levied on a pack of cigarettes). The Oklahoma House of Representatives has not yet voted on the bill. In addition, three U.S. states have banned the use of e-cigarettes in enclosed spaces. On December 4, 2013, the New York City Council considered legislation that would prohibit the use of electronic cigarettes in public places and in places of employment. The Council has yet to vote on the matter.

Lorillard's parent company has reported in its SEC filings that on April 24, 2012, it acquired, through its subsidiaries, blu eCigs and other assets used in the manufacture, distribution, development, research, marketing, advertising and sale of electronic cigarettes. The acquisition provides Lorillard, Inc. with the blu eCigs brand and an e-cigarette product line. Lorillard, Inc. reported in its Form 10-K filed with the SEC for the calendar year 2012 that it sells the blu eCigs electronic cigarettes to distributors as well as directly to consumers over the internet. It has been reported that Lorillard has boosted distribution of its blue Cigs to more than 127,000 stores since acquiring the brand in 2012. Reynolds American reported in October 2012 that it introduced an electronic cigarette, VUSE, in limited distribution. Reynolds American launched a revamped version of its e-cigarette, VUSE, in Colorado retail outlets in July 2013, with a plan to quickly expand sales nationwide, including print and television ads for VUSE starting in August 2013 and expanded the distribution of VUSE e-cigarettes to retail outlets throughout Colorado in the third quarter of 2013. Reynolds American has stated that it is targeting existing smokers with VUSE and expects some smokers to give up cigarettes in favor of VUSE. Reynolds American expects a national expansion of VUSE by mid-2014. Altria's subsidiary Nu Mark LLC introduced an electronic cigarette under the "MarkTen" brand into a lead market in Indiana in August 2013 and plans to expand distribution of MarkTen electronic cigarettes in Arizona in December 2013. MarkTen is a disposable e-cigarette that can be reused with a separate battery recharging kit and additional cartridges in both tobacco and menthol flavors. Altria stated that the MarkTen's "Four Draw" technology is designed to give users a "more consistent experience" that closely resembles the draw of a traditional cigarette. The NJOY, Vapor, Logic and blu eCigs electronic cigarette brands have recently been marketing and advertising extensively across the U.S. Lorillard reported in its Form 10-K filed with the SEC for the calendar year 2012 that the predominant forms of advertising and promotion in the electronic cigarette industry are television, print and web-based advertising, and sampling events. During 2012, the FDA indicated that it intends to regulate electronic cigarettes under the FSPTCA. It has been reported that the FDA may announce its plan for regulation in the Fall of 2013; see "—Regulatory Issues" below. According to news reports, sales of e-cigarettes in 2012 have been estimated to be $300 million, which was double the amount during the prior two years, and are projected to reach as much as $2 billion in 2013. The Centers for Disease Control ("**CDC**") in February 2013 reported results of a survey that indicated that 6.2% of the adult population, and 21% of smokers, had tried e-cigarettes at some time, which results were approximately double the estimates in 2010. A report released by the CDC and the FDA in September 2013 showed a doubling, to 10%, of the number of high school students who have tried e-cigarettes. In addition, it has been reported that increases in cigarette taxes have caused an increase in the sale of e-cigarettes. Certain reports have predicted that sales of e-cigarettes could outpace traditional cigarettes before 2050. No assurance can be given that regulation of e-cigarettes by the FDA will stop their growth trend. Growth in the electronic cigarette market may have an adverse effect on the tobacco-cigarette market.

Smoking Cessation Products

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

Private health insurance carriers are increasing premiums on smokers, which often are passed on by the employer to the smoker-employee. Certain of these and other health insurance policies, including Medicaid and Medicare, cover various forms of smoking cessation treatments, making smoking cessation treatments more affordable for covered smokers. Results of a study by the CDC, released in November 2011, found that in 2010 68.8% of smokers wanted to stop smoking, 52.4% had made a quit attempt in the past year, 6.2% had recently quit, 48.3% had been advised by a health professional to quit, and 31.7% had used counseling and/or medications when they tried to quit.

Gray Market

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

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products (including New York City which has raised the minimum age from 18 to 21, and New York State and New Jersey, which are considering proposals to raise the minimum age from 18 to 21), ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. Several states charge higher health insurance premiums to state employee smokers than non-smokers, and a number of states have implemented legislation that allows employers to provide incentives to employees who do not smoke. The Affordable Care Act will allow insurance companies to charge smokers up to 50% higher premiums than non-smokers, and several large corporations are now charging smokers higher premiums. Most recently, in January 2013, a state congressman from Oregon proposed legislation that would make cigarettes a Schedule III controlled substance in Oregon and therefore illegal to possess or distribute without a doctor's prescription.

Federal Regulation. In 1964, the Report of the Advisory Committee to the Surgeon General of the U.S. Public Health Service concluded that cigarette smoking was a health hazard of sufficient importance to warrant appropriate remedial action. Since this initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports that find the nicotine in cigarettes addictive and that link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. Most recently, in March 2012, the Surgeon General released a report on preventing tobacco use among youth and young adults.

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

In 1992, the federal Alcohol Drug Abuse and Mental Health Act was signed into law. This act required states to adopt a minimum age of 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on buses transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking. On March 31, 2010, President Obama signed into law the Prevent All Cigarette Trafficking (PACT) Act. This legislation, among other things, restricts the sale of tobacco products directly to consumers or unlicensed recipients, including over the Internet, through expanded reporting requirements, requirements for delivery and sales, and penalties. On November 4, 2011 a bill, the Smoke-Free Federal Buildings Act, was introduced in the U.S. House of Representatives to ban smoking in and 25 feet around all facilities owned or leased by the federal government, but was never enacted. A similar bill may be introduced in the future.

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

- establishes a Tobacco Products Scientific Advisory Committee ("**TPSAC**") to, among other things, evaluate the issues surrounding the use of menthol as a flavoring or ingredient in cigarettes within one year of such committee's establishment;

- grants the FDA the regulatory authority to consider and impose broad additional restrictions through a rule making process, including a ban on the use of menthol in cigarettes upon a finding that such a prohibition would be appropriate for the public health;

- requires larger and more severe health warnings on cigarette packs and cartons;

- bans the use of descriptors on tobacco products, such as "low tar" and "light";

- requires the disclosure of ingredients and additives to consumers;

- requires pre-market approval by the FDA for claims made with respect to reduced risk or reduced exposure products;

- allows the FDA to require the reduction of nicotine or any other compound in cigarettes;

- allows the FDA to mandate the use of reduced risk technologies in conventional cigarettes;

- permits inconsistent state regulation of the advertising or promotion of cigarettes and eliminates the existing federal preemption of such regulation; and

- allows the FDA to subject tobacco products that are modified or first introduced into the market after March 22, 2011 to application and premarket review and authorization requirements (the "**new product application process**") if the FDA does not find them to be "substantially equivalent" to products commercially marketed as of February 15, 2007, and to deny any such new product application thus preventing the distribution and sale of any product affected by such denial.

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

- established the collection of user fees from the tobacco industry;

- created and staffed the TPSAC;

- selected the Director of the Center for Tobacco Products;

- announced and began enforcing a ban on fruit, candy or clove flavored cigarettes (menthol is currently exempted from this ban);

- issued guidance on registration and product listing;

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

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

- required warning labels for smokeless tobacco products; and
- authorized the sale and marketing of new tobacco products and rejected applications to introduce certain new tobacco products into the market.

Pursuant to requirements of the FSPTCA, the FDA issued a proposed rule in November 2010 to modify the required warnings that appear on cigarette packages and in cigarette advertisements. The new required warnings consist of nine new textual warning statements accompanied by color pictures depicting the negative health consequences of smoking. The warnings would appear on the upper portion of the front and rear panels of each cigarette package and comprise at least the top 50 percent of these panels, and would also appear in each cigarette advertisement and occupy at least 20 percent of the advertisement. The FDA took public comments on the proposed rule through January 2011, and in June 2011, the FDA unveiled nine new graphic health warnings that were required to appear on cigarette packages and advertisements no later than September 2012. As discussed below under "*FSPTCA Litigation*," five tobacco companies in August 2011 filed a complaint against the FDA in the U.S. District Court for the District of Columbia challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The FDA is currently enjoined from enforcing the rule.

In July 2010, the TPSAC conducted hearings on the impact of dissolvable tobacco products and the use of menthol in cigarettes on public health. A report on these hearings was submitted to the FDA in 2011 and remains subject to continuing TPSAC hearings. Written comments regarding dissolvable tobacco products were submitted to the TPSAC ahead of its January 2012 meeting, at which the TPSAC continued its discussions of issues related to the nature and impact of dissolvable tobacco products on public health. The TPSAC's final report released to the FDA in March 2012 found that dissolvable tobacco products would reduce health risks compared to smoking cigarettes, but also have the potential to increase the number of tobacco users. The TPSAC could not reach any overall judgment as to whether or not the consequence of dissolvable tobacco products would be an increase or decrease in the number of people who successfully quit smoking. The FDA will consider the report and recommendations and determine what future action, if any, is warranted with respect to dissolvable tobacco products. There is no timeline or statutory requirement for the FDA to act on the TPSAC's recommendations.

The TPSAC or the Menthol Report Subcommittee held meetings throughout 2010 and 2011 to consider the issues surrounding the use of menthol in cigarettes. At its March 18, 2011 meeting, TPSAC presented its report and recommendations on menthol. The report's findings included that menthol likely increases experimentation and regular smoking, menthol likely increases the likelihood and degree of addiction for youth smokers, non-white menthol smokers (particularly African-Americans) are less likely to quit smoking and are less responsive to certain cessation medications, and consumers continue to believe that smoking menthol cigarettes is less harmful than smoking nonmenthol cigarettes as a result of the cigarette industry's historical marketing. TPSAC's overall recommendation to the FDA was that "removal of menthol cigarettes from the marketplace would benefit public health in the United States." The FDA submitted a draft report on its independent review of research related to the effects of menthol in cigarettes on public health, if any, to an external peer review panel in July 2011. The FDA stated that, after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. At the July 21, 2011 meeting, TPSAC considered revisions to its report, and the voting members unanimously approved the final report for submission to the FDA with no change in its recommendation. On January 26, 2012, the FDA provided a second progress report on its review of the science related to menthol cigarettes. In its January 2012 update, the FDA stated that the "FDA submitted its report to external scientists for peer review, and the agency is revising its report based on their feedback." The FDA stated its intent to make the final report, along with the peer review scientists' feedback and the FDA's response to the feedback, available for public comment in the Federal Register. The FDA also indicated that it would consider any public comments to the final report, which "may provide additional evidence or emerging data." Based on those comments, together with the TPSAC report, the industry's perspective report and prior public comments, the FDA stated that it will consider the collective evidence and "possible actions related to the public health impact of menthol in cigarettes." On July 23, 2013, the FDA released its Independent Preliminary Scientific Evaluation of the Public Health Effects of Menthol Versus Non-menthol Cigarettes (the "**Preliminary Evaluation**") and peer comments for 60 days of public comment (such public comment period was subsequently extended for an additional 60 days to November 22, 2013), and issued an Advance Notice of Proposed Rulemaking seeking additional information to help the FDA make informed decisions about menthol in cigarettes. The Preliminary Evaluation found that although there is little evidence to suggest menthol cigarettes are more toxic than regular cigarettes, the mint flavor of menthol masks the harshness of tobacco, which makes it easier to become addicted and harder to quit, and increases smoking initiation among youth. The FDA concluded that menthol cigarettes likely pose a public health risk above that seen with non-menthol cigarettes. During the public comment period, the FDA will consider all comments, data and research submitted to determine what regulatory action, if any, with respect to menthol cigarettes is appropriate, including the establishment of product standards. In the meantime it will conduct and support research on the differences between menthol and non-menthol cigarettes as they relate to menthol's likely impact on smoking cessation. The FDA is not required to follow the TPSAC's recommendations, and the FDA has not yet taken any action with respect to menthol use. Any ban or material limitation on the use of menthol in cigarettes could materially adversely affect the results of operations, cash flow and financial condition of the PMs, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 31.4% and 31.0% of the U.S. cigarette market for the nine-month periods ended September 30, 2013 and 2012, respectively. Menthol smoking rates have also increased among young adults during the past decade.

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

The FDA announced on June 25, 2013 that it authorized the sale of two new Newport cigarettes made by Lorillard and rejected four other new tobacco products. Since the FSPTCA's enactment, the FDA has received approximately 4,000 applications for products that tobacco companies claimed were "substantially equivalent" to ones already on the market. The FDA approved the applications for two types of non-menthol cigarettes after determining that the cigarettes, while slightly different than previous products, would not pose new health issues. The four other applications were rejected based on new health concerns raised by some ingredients and a lack of detail about product design. It was the first instance of a federal agency rejecting an application by a tobacco manufacturer to bring a new tobacco product to the market based on the product's threat to public health. Four additional tobacco products were rejected by the FDA on August 28, 2013 because they were found to be "not substantially equivalent" to the predicate products to which they were compared, and in September 2013 four roll-your-own products were approved for marketing and sale by the FDA because the products were determined to be "substantially equivalent" to the predicate products to which they were compared. Approximately 500 products submitted for review after March 2011 cannot be sold until the FDA approves them.

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

According to Lorillard, during 2012, the FDA indicated that it intends to regulate electronic cigarettes under the FSPTCA through the issuance of deeming regulations that would include electronic cigarettes under the definition of a "tobacco product" under the FSPTCA subject to the FDA's jurisdiction. Lorillard reports that the FDA has not yet taken such action. In a letter to the Commissioner of the FDA dated September 24, 2013, the attorneys general of 41 states requested that the FDA "take all available measures" to issue proposed regulations that will address the advertising, ingredients, and sale to minors of electronic cigarettes by the FDA's previously stated deadline of October 31, 2013. The letter asked the FDA to regulate electronic cigarettes like other tobacco products, and to move quickly to ensure that all tobacco products are tested and regulated to ensure that tobacco companies do not continue to sell or advertise to young people. In addition, fifteen public health organizations sent a letter to President Obama, dated September 19, 2013, asking for his leadership in ensuring that the FDA moves forward promptly with rules that would assert the FDA's authority over all tobacco products, including e-cigarettes. Altria, in a letter to the FDA dated October 10, 2013, stated that there are "compelling reasons" to extend appropriate regulatory authority over all tobacco products, including those tobacco-derived nicotine products such as e-cigarettes, and that Altria supports such action by the FDA.

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

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

The FDA reported in November 2011 that it issued approximately 1,200 warning letters to retailers in 15 states for violating Federal tobacco regulations since the FDA's Center for Tobacco Products began conducting retail inspections under the FSPTCA. Most of the letters were issued for selling tobacco products to minors. The FDA also reported that it had contracted with 37 states and the District of Columbia to conduct compliance checks in at least 20% of the stores in each state to ensure that the retailers are acting in compliance with the FDA's regulations concerning the sale of tobacco products.

FSPTCA Litigation. In August 2009, a group of tobacco manufacturers (including Reynolds Tobacco and Lorillard) and a tobacco retailer filed a complaint against the United States of America in the United States District Court for the Western District of Kentucky, *Commonwealth Brands, Inc. v. U.S.*, 678 F.Supp.2d 512, in which they asserted that various provisions of the FSPTCA violate their free speech rights under the First Amendment, constitute an unlawful taking under the Fifth Amendment, and are an infringement on their Fifth Amendment due process rights. Plaintiffs sought a preliminary injunction and a judgment declaring the challenged provisions unconstitutional. Both plaintiffs and the government filed motions for summary judgment and on November 5, 2009, the district court denied certain plaintiffs' motion for preliminary injunction as to the modified risk tobacco products provision of the FSPTCA and in January 2010 granted partial summary judgment to plaintiffs on their claims that the ban on color and graphics in advertising and the ban on statements implying that tobacco products are safer due to FDA regulation violated their First Amendment speech rights. The district court granted partial summary judgment to the government on all other claims. Both parties appealed from the district court's order and on March 19, 2012, the United States Court of Appeals for the Sixth Circuit affirmed the district court's decision upholding the FSPTCA's restrictions on the marketing of modified-risk tobacco products, the FSPTCA's bans on event sponsorship, branding non-tobacco merchandise, and free sampling, and the requirement that tobacco manufacturers reserve significant packaging space for textual health warnings. The Sixth Circuit further affirmed the district court's grant of summary judgment to plaintiffs on the FSPTCA's restriction of tobacco advertising to black and white text, as well as the district court's decision to uphold the constitutionality of the color graphic and non-graphic warning label requirement. The Sixth Circuit reversed the district court's determination that the FSPTCA's restriction on statements regarding the relative safety of tobacco products based on FDA regulation is unconstitutional and its determination that the FSPTCA's ban on tobacco continuity programs is permissible under the First Amendment. On May 31, 2012, the Sixth Circuit denied the plaintiffs' motion for rehearing en banc. On October 30, 2012, the plaintiffs filed a petition for writ of certiorari with the U.S. Supreme Court. The government declined to seek a petition for certiorari to the U.S. Supreme Court. The government did not appeal the part of the Court of Appeals ruling striking the FSPTCA's restriction of tobacco advertising to black and white text. On April 22, 2013, the U.S. Supreme Court denied plaintiffs' petition for certiorari.

In February 2011, Lorillard, along with Reynolds Tobacco, filed a lawsuit in the U.S. District Court for the District of Columbia, *Lorillard, Inc. v. U.S. Food and Drug Administration*, against the FDA challenging the composition of the TPSAC because of the FDA's appointment of certain voting members with significant financial conflicts of interest. Lorillard believes these members are financially biased because they regularly testify as expert witnesses against tobacco-product manufacturers, and because they are paid consultants for pharmaceutical companies that develop and market smoking-cessation products. The suit similarly challenges the presence of certain conflicted individuals on the Constituents Subcommittee of the TPSAC. The complaint sought a judgment (i) declaring that, among other things, the appointment of the conflicted individuals to the TPSAC (and its Constituents Subcommittee) was arbitrary, capricious, an abuse of discretion, and otherwise not in compliance with the law because it prevented the TPSAC from preparing a report that was unbiased and untainted by conflicts of interest, and (ii) enjoining the FDA from, among other things, relying on the TPSAC's report. The FDA filed a motion to dismiss this action, and on August 1, 2012, the court denied the FDA's motion to dismiss. The FDA filed its answer to the second amended complaint on October 12, 2012, and the case proceeded before the U.S. District Court for the District of Columbia. On April 25, 2013, the court granted plaintiffs' unopposed motion for leave to file the third amended complaint, and plaintiffs filed same. The FDA filed its answer to plaintiff's third amended complaint on May 9, 2013. On June 21, 2013, the FDA filed a motion for summary judgment against Lorillard. The parties completed the briefing for summary judgment motions on September 20, 2013 and expected a hearing on the summary judgment motions in the fourth quarter of 2013. A stay to accommodate the government furlough in October 2013 may delay the hearing.

On August 16, 2011, five tobacco companies (including OPMs Reynolds Tobacco and Lorillard as well as Commonwealth Brands, Inc., Liggett Group LLC, and Santa Fe Natural Tobacco Company, Inc.) filed a complaint against the FDA in the U.S. District Court for the District of Columbia, *R.J. Reynolds Tobacco Co. v. U.S. Food and Drug Administration*, challenging the FDA's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The tobacco companies sought a declaratory judgment that the FDA's final rule violates the First Amendment and the Administrative Procedure Act (the "**APA**"), and declarative and injunctive relief that the new textual and graphic warnings will not become effective until 15 months after the FDA issues regulations "that are permissible under the United States Constitution and federal laws." The plaintiffs allege that the FDA's final rule regarding textual and graphic warnings requires them "to become a mouthpiece for the Government's emotionally-charged anti-smoking message." The plaintiffs also contend that the FDA's warnings are unjustified and unduly burdensome, as they do not further any compelling governmental purpose and are "unlikely to have any material impact on consumer understanding of smoking risks, consumer intentions regarding smoking, or actual consumer smoking decisions." The FDA's final rule, according to the plaintiffs, "violates the First Amendment under any standard of review." In addition, the plaintiffs argue that the FDA acted arbitrarily and capriciously "by attempting to justify the Rule...on grounds that were illogical, contradictory, and without support in the regulatory record, and by employing different standards of analysis to comments supporting the rule than to comments opposing the rule." As a result, the plaintiffs allege that the FDA's final rule "contravenes core requirements" of the APA. Furthermore, the Plaintiffs assert that the FDA has not issued a legally valid rule and, therefore, the 15-month effective date for the new textual and graphic warnings cannot come into effect until the FDA complies accordingly. On September 9, 2011, the FDA asked the court to reject the plaintiffs' request for a preliminary injunction against the labeling regulation. On November 7, 2011, the U.S. District Court granted the plaintiffs' request to postpone the September 22, 2012 deadline for the regulations to take effect while the court reviews the rule's constitutionality. The FDA appealed the ruling. In December 2011, 24 state attorneys general filed a friend of the court brief with the U.S. Court of Appeals in support of the FDA's challenge of the ruling. Plaintiffs also moved in the district court for summary judgment in their favor. The FDA opposed plaintiffs' motion and has cross moved for summary judgment in its favor. The district court granted a motion to expedite consideration of the cross summary judgment motions. Oral argument on those motions was held on February 1, 2012, at which the U.S. District Court stated that the government had failed to show how graphic images met legal precedents requiring federally-imposed labeling to be factual and uncontroversial, and said the federal rule that requires such warnings may violate the free speech rights of tobacco companies. On February 29, 2012, the district court granted the plaintiffs' motion for summary judgment and entered an order permanently enjoining the FDA, until 15 months following the issuance of new regulations implementing Section 201(a) of the FSPTCA that are substantively and procedurally valid and permissible under the United States Constitution and federal law, from enforcing against plaintiffs the new textual and graphic warnings required by Section 201 (a) of the FSPTCA. The district court ruled that the mandatory graphic warnings violated the First Amendment by unconstitutionally compelling speech, and that the FDA had failed to carry both its burden of demonstrating a compelling interest for its rule requiring the textual and graphic warning labels and its burden of demonstrating that the rule is narrowly tailored to achieve a constitutionally permissible form of compelled commercial speech. The FDA filed an appeal with the U.S. Court of Appeals for the District of Columbia Circuit on March 4, 2012, and moved the appellate court to consolidate this appeal with the FDA's appeal of the preliminary injunction decision. The Court of Appeals granted the FDA's motion and heard argument on both appeals on April 10, 2012. On August 24, 2012, the Court of Appeals affirmed the district court's decision invalidating the graphic warning rule. On October 9, 2012, the FDA filed a motion for rehearing en banc with the Court of Appeals, and on December 5, 2012, the Court of Appeals denied the FDA's petition for a rehearing en banc. The FDA, on December 5, 2012, issued a notice announcing its intention to collect information from consumers to determine the effectiveness of graphic warning labels, in apparent response to the Court of Appeal's August 2012 affirmation of the invalidation of the graphic warning rule, in which it cited the absence of evidence that the chosen labels furthered FDA's stated goal of encouraging cessation and discouraging initiation of smoking. On March 19, 2013, the FDA announced that it would not file a petition for a writ of certiorari with the U.S. Supreme Court, but instead would undertake research to support a new rulemaking on different warning labels consistent with the FSPTCA. The FDA has not provided a timeline for the revised labels.

Other Federal Regulation. In October 2011, the FDA and the National Institutes of Health (the "**NIH**") announced a joint national study called the "Tobacco Control Act National Longitudinal Study of Tobacco Users" to monitor and assess the behavioral and health impacts of new government tobacco regulations by following 40,000 users of tobacco products and those who are 12 and over who are at risk of using tobacco products. The study is being coordinated by researchers at the NIH's National Institute on Drug Abuse and the FDA's Center for Tobacco Products. According to the NIH, data is expected to be collected between 2013 and 2016. The results of the study will be used to guide the FDA in targeting effective actions to reduce the effects of smoking on public health.

In November 2011, the FDA issued two requests for proposals for an integrated anti-smoking campaign that targets teenagers, with a combined budget of up to $600 million over five years. The first request for proposal related to an up to $390 million campaign to prevent tobacco use among teenagers thirteen to seventeen years old. After a year-long review, the FDA in September 2012 selected six agencies to support this anti-smoking educational effort. The FDA's new campaign will strive to inform teens about the benefits of a tobacco-free lifestyle via science-based messages. The second request for proposals was a solicitation for agencies that qualify as small businesses relating to a $210 million campaign to reduce tobacco use among a "minority youth" audience of intermittent smokers in the same age range. The FDA has not announced any developments regarding this campaign.

In March 2012, the CDC announced a 12-week graphic advertising campaign intended to shock smokers into quitting with stories of people damaged by tobacco products. It has been reported that the $54 million campaign is the largest and starkest anti-smoking push by the CDC and its first national advertising effort. The campaign's goal was to convince 500,000 people to try quitting smoking and 50,000 to quit long-term. The CDC reported in August 2012 that its graphic ad campaign has been successful and that the CDC is planning more ads for 2013. The CDC's fiscal year 2013 budget request of $197,117,000 includes an increase of $6.040 million from the prior fiscal year for tobacco prevention and control. The CDC plans to use this increase in resources to expand the reach of a national tobacco education campaign and its tobacco cessation quitline capacity support.

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

Tobacco Quota Payments. A federal law enacted in October 2004 repealed the federal supply management program for tobacco growers and compensated tobacco quota holders and growers with payments to be funded by an assessment on tobacco manufacturers and importers. Cigarette manufacturers and importers are responsible for paying 91.6% of a $10.14 billion payment to tobacco quota holders and growers over a ten-year period that will expire in 2014. The law provides that payments will be based on shipments for domestic consumption.

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

Legislation introduced by Senator Tom Harkin on January 22, 2013, the Healthy Lifestyles and Prevention America Act (or the HeLP America Act), would, among other things, increase the Federal excise tax on cigarettes from $1.01 to $2.01 per pack, on roll-your-own tobacco from $24.78 to $49.55 per pound, on snuff from $1.51 to $26.79 per pound and on chewing tobacco from approximately $0.50 to $10.72 per pound, and set the Federal excise taxes on smokeless tobacco sold in discrete single-use units at $100.50 per 1,000 units (which would make the excise taxes on smokeless tobacco products comparable to those on cigarettes). Legislation introduced by Senator Richard Durbin on January 31, 2013, the Tobacco Tax Equity Act, would similarly equalize Federal excise tax rates on all tobacco products, including pipe tobacco, cigars and smokeless tobacco, so that the tax rates on such products would approximate those of cigarettes. Similar bills have not been introduced in the U.S. House of Representatives. On April 10, 2013, President Obama released a proposed budget which, if approved by the U.S. Congress, would increase the federal excise tax: on a pack of cigarettes from $1.01 to $1.95; for snuff from $1.51 per pound to $2.93 per pound; and for chewing tobacco from $0.5033 per pound to $0.98 per pound.

All of the states, the District of Columbia, Puerto Rico, Guam and the Northern Mariana Islands currently impose cigarette taxes, which in 2012 ranged from $0.17 per pack in Missouri to $4.35 per pack in New York. Since January 1, 2002, 47 states, the District of Columbia and several U.S. territories have raised their cigarette taxes, many of them more than once. According to a report by the American Lung Association, in 2009, 14 states turned to cigarette taxes to increase revenue in response to record state deficits. As reported by Reynolds American and the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues ("**SLATI**"), six states passed cigarette excise tax increases during 2010, two states (Connecticut and Vermont) passed cigarette excise tax increases during 2011, and in 2012, Illinois and Rhode Island enacted legislation to increase their cigarette excise taxes. According to the IHS Global Report, in July 2013 Minnesota increased its cigarette excise tax by $1.60 per pack. Massachusetts raised its excise tax by $1.00 per pack, effective July 31, 2013, bringing its tax to $3.51 per pack, the second highest in the country after New York. New Hampshire's cigarette tax increased by $0.10 on August 1, 2013 due to legislation enacted in 2011. Puerto Rico has also enacted legislation to increase their taxes in 2013. The legislatures in Florida, Maryland, New Hampshire, Oregon and Rhode Island are also considering cigarette excise tax increases. In addition, the Texas state legislature passed a cigarette tax increase in 2013. According to SLATI, the current nationwide average state cigarette tax is $1.51 per pack. Lorillard reports that for the nine months ended September 30, 2013, combined state and local excise taxes ranged from $0.17 to $5.85 per pack. According to Reynolds American, as of September 30, 2013 and December 31, 2012, the weighted average state cigarette excise tax per pack, calculated on a 12-month rolling average basis, was approximately $1.30 and $1.26, respectively. Philip Morris reports that between the end of 1998 (the year in which the MSA was executed) and October 21, 2013, the weighted-average state and certain local cigarette excise taxes increased from $0.36 to $1.47 per pack. It is expected that states will continue to raise excise taxes on cigarettes in 2013 and future years. Philip Morris reports that, as of October 21, 2013, Massachusetts, Minnesota, Oregon and Puerto Rico had enacted legislation to increase their cigarette taxes during 2013. Forty-nine states and the District of Columbia also subject smokeless tobacco to excise taxes, and the Commonwealth of Pennsylvania, the singular exception, is considering such a tax during its 2013 legislative session, according to Reynolds American. In May 2013, Minnesota approved an increase in its excise tax on smokeless tobacco to take effect on January 1, 2014.

In 2004, Michigan imposed an equity assessment on NPMs selling cigarettes in the state. The purpose of the equity assessment is to fund enforcement and administration of Michigan's Qualifying Statute and Complementary Legislation. The assessment is required to be prepaid by March 1 of each year for all cigarettes that are anticipated to be sold in Michigan in the current calendar year. For each NPM, the prepayment amount is equal to the greater of (i) $10,000 or (2) the number of cigarettes that the Department of Treasury reasonably determines that the NPM will sell in Michigan in the current calendar year multiplied by 17.5 mills. According to Reynolds American's SEC filings, Alaska, Minnesota, Mississippi and Utah also impose equity assessments on tobacco manufacturers not participating in the MSA. For example, an extra $0.35 and $0.25, respectively, is added to each pack of cigarettes sold by an NPM in Utah and Alaska, in addition to other applicable taxes on tobacco. See "BONDHOLDERS' RISKS — Potential Payment Decreases Under the Terms of the MSA".

In June 2013, Texas (a Previously Settled State) enacted legislation to apply cigarette taxes ($0.55 per pack) for future health costs to tobacco manufacturers that did not join the Texas' State Settlement Agreement. The tax took effect on September 1, 2013. In November 2013, in *Texas Small Tobacco Coalition. v. Combs*, No. D-1-GN-13-002414 (Tex. Dist. Ct., Travis Cnty.), a district court judge ruled that the tax violated the Equal and Uniform Taxation clause of the Texas Constitution. This decision has since been appealed by the Texas Comptroller of Public Accounts on November 13, 2013.

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

The FSPTCA substantially expanded federal tobacco regulation, but state regulation of tobacco is not necessarily preempted by federal law in this instance. Importantly, the FSPTCA specifically allows states and localities to impose restrictions on the time, place and manner, but not content, of advertising and promotion of tobacco products. The FSPTCA also eliminated the prior federal preemption of state regulation that, in certain circumstances, had been upheld by the U.S. Supreme Court.

In addition to the FSPTCA disclosure requirements and marketing and labeling restrictions, several states have enacted or proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes to state health authorities. According to SLATI, as of March 1, 2013, six states require tobacco product disclosure information: Massachusetts and Texas require tobacco manufacturers to disclose any added constituent of tobacco products other than tobacco, water and reconstituted tobacco sheet made wholly from tobacco; Massachusetts, Texas and Utah require disclosure of the nicotine yield for each brand of cigarettes; Minnesota and Utah require tobacco manufacturers to disclose the presence of ammonia, any compound of ammonia, arsenic, cadmium, formaldehyde or lead in their unburned or burned states; New

Hampshire requires its state Department of Health and Human Services to obtain from the Massachusetts Department of Public Health a list of additives for each brand of tobacco products sold; and Connecticut required its Commissioner of Public Health to issue regulations concerning how the commissioner will obtain nicotine yield ratings for each brand of tobacco product.

In 2003, New York was the first state to pass legislation requiring the introduction of cigarettes with a lower likelihood of starting a fire. Cigarette manufacturers responded by designing cigarettes that would extinguish quicker when left unattended. Since then, according to SLATI, fire-safety standards for cigarettes identical to those of New York are in effect in all 50 states and the District of Columbia.

According to the American Nonsmokers' Rights Foundation ("**ANRF**"), as of October 1, 2013, 27 states and territories have laws that require 100% smoke-free non-hospitality workplaces and restaurants and bars: Arizona, Delaware, the District of Columbia, Hawaii, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, New Jersey, New York, North Dakota, Ohio, Oregon, Puerto Rico, Rhode Island, South Dakota, the U.S. Virgin Islands, Utah, Vermont, Washington and Wisconsin. According to ANRF, as of October 1, 2013, only 15 states and territories do not have laws that require either 100% smoke-free non-hospitality workplaces or restaurants or bars (being Alabama, Alaska, Arkansas, Georgia, Guam, Kentucky, Mississippi, Missouri, Oklahoma, South Carolina, Tennessee, Texas, Virginia, West Virginia and Wyoming). Restrictions in Arizona, Hawaii, Illinois, New Mexico, North Dakota, Oregon and Washington are stronger than those in other states as they include a ban on outdoor smoking within at least 10 feet of the entrances of restaurants and other public places. ANRF also tracks clean indoor air ordinances by local governments throughout the U.S. As of October 1, 2013, there were 1,078 municipalities with local laws that require 100% smoke-free non-hospitality workplaces or restaurants or bars. Most states without a statewide smoking ban have some local municipalities that have enacted smoking regulations. It is expected that these restrictions will continue to proliferate.

Smoking bans have also extended outdoors. According to ANRF, as of October 1, 2013:

- Puerto Rico prohibits smoking on beaches, Maine prohibits smoking on beaches in its state parks, and 178 municipalities specified that all city beaches and/or specifically named city beaches are smokefree, and in January 2014 a smoking ban will go in effect on Hawaii's beaches;

- Iowa, New York, Wisconsin, Guam and the U.S. Virgin Islands prohibit smoking in outdoor public transit waiting areas, and there are 313 municipalities with smokefree outdoor public transit waiting area laws; however, on October 8, 2013 in *NYC C.L.A.S.H. Inc. v. New York State Office of Parks, Recreation & Historic Preservation et al*, No. 2218-13 (N.Y. Sup. Ct., Albany County) the New York Supreme Court for Albany County invalidated a New York regulation that banned smoking in certain outdoor areas and in State parks;

- Hawaii, Maine, Michigan, Washington and Puerto Rico laws prohibit smoking in outdoor dining and bar patios, Iowa prohibits smoking in outdoor dining areas, and 266 municipalities have enacted laws for 100% smokefree outdoor dining, while 126 municipalities have enacted laws both for 100% smokefree outdoor dining and bar patios; and

- Oklahoma and Puerto Rico prohibit smoking in all parks, and 875 municipalities specified that all city parks and/or specifically named city parks are smokefree.

Smoking bans have also been enacted for smaller governmental and private entities. According to the ANRF, as of October 1, 2013, there are at least 1,178 100% smokefree university and college campuses with no exemptions, including dormitory housing, and of these, 793 have a 100% tobacco-free policy. In January 2012, the president of the University of California system requested the entire University of California system to become smoke-free by 2014. ANRF reports that, as of July 8, 2013, complete smoking bans, indoor and outdoor, have also been implemented on the campuses of four national and at least 3,777 local and/or state health providers. In addition, ANRF reports that all federal correctional facilities are completely smoke-free (indoor and outdoor), as well as those in 21 states plus Puerto Rico. Twenty-eight other states allow smoking in correctional facilities but only in outdoors areas. Finally, ANRF reports that as of October 1, 2013, four states and 84 municipalities have laws requiring that all hotel and motel rooms be 100% smokefree.

According to the IHS Global Report, in March 2013 California Assembly Bill 746 was introduced, which would prohibit smoking in, and within 20 feet of entrances of, condominiums, duplexes and apartment units throughout that state. A similar bill has also been introduced in Massachusetts.

In June 2006, the Office of the Surgeon General released a report, "The Health Consequences of Involuntary Exposure to Tobacco Smoke". It is a comprehensive review of health effects of involuntary exposure to tobacco smoke. It concludes definitively that secondhand smoke causes disease and adverse respiratory effects. It also concludes that policies creating completely smoke-free environments are the most economical and efficient approaches to providing protection to non-smokers. On September 18, 2007, the Office of the Surgeon General released the report, "Children and Secondhand Smoke Exposure", which concludes that many children are exposed to secondhand smoke in the home and that establishing a completely smoke-free home is the only way to eliminate secondhand smoke exposure in that setting. The Surgeon General also addressed the health risks of second-hand smoke in its 2010 report entitled "How Tobacco Smoke Can Cause Disease: The Biology and Behavioral Basis for Smoking-Attributable Disease." These reports are expected to strengthen arguments in favor of further smoking restrictions across the country. Further, the California Environmental Protection Agency Air Resources Board declared environmental tobacco smoke to be a toxic air contaminant in 2006.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace and providing incentives to employees who do not smoke, including charging higher health insurance premiums to employees who smoke, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans. According to the IHS Global Report, New York City's first non-smoking apartment building opened in 2009, and many landlords and condominium associations in California and New York City have also established smoke-free apartment policies, including Related Companies, which manages 40,000 rental units and recently announced a ban on smoking for all new tenants.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the U.S. that had ratified the treaty prior to November 30, 2004 (there is no deadline for ratification). According to the World Health Organization, as of June 2013, 177 countries were party to the FCTC. In November 2012, parties to the FCTC adopted the Protocol to Eliminate Illicit Trade in Tobacco Products, which opened for signature in January 2013.

Civil Litigation

Overview

Legal proceedings or claims covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against the tobacco industry. Several types of claims are raised in these proceedings including, but not limited to, claims for product liability, consumer protection, antitrust, and reimbursement. Litigation is subject to many uncertainties and it is possible that there could be material adverse developments in pending or future cases. Damages claimed in some tobacco-related and other litigation are or can be significant and, in certain cases, range in the billions of dollars. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could materially adversely affect the business of the PMs and the market for or prices of securities such as the Series 2013A Bonds payable from tobacco settlement payments made under the MSA. Lorillard's parent company reported in its Form 10-Q filed with the SEC for the nine month period ended September 30, 2013 that, as of October 17, 2013, 7,795 product liability cases are pending against cigarette manufacturers in the United States. Many of these cases are "Engle Progeny

Cases", described below (although many arose from one Florida federal court in 2009 severing the claims of approximately 4,400 Engle Progeny plaintiffs). Reynolds American reports in its Form 10-Q filed with the SEC for the nine month period ending September 30, 2013 that 5,187 Engle Progeny cases are pending against Reynolds Tobacco or its affiliates or indemnitees as of September 30, 2013, and Lorillard, Inc. reports in its Form 10-Q filed with the SEC for the nine month period ended September 30, 2013 that 4,237 Engle Progeny cases are pending against Lorillard or Lorillard, Inc. as of October 17, 2013.

Altria, Philip Morris's parent company, reported in its Form 10-Q filed with the SEC for the nine month period ended September 30, 2013, that after exhausting all appeals in cases resulting in adverse verdicts associated with tobacco-related litigation, Philip Morris has paid in the aggregate judgments (and related costs and fees) totaling approximately $258 million and interest totaling approximately $142 million as of October 21, 2013. In its Form 10-K filed with the SEC for the calendar year 2012, Altria further reported that it recorded pre-tax charges related to certain tobacco and health judgments in the amounts of $4 million, $98 million and $16 million (excluding accrued interest of $1 million, $64 million and $5 million), for the calendar years 2012, 2011 and 2010, respectively. Reynolds American reported in its Form 10-K filed with the SEC for the calendar year 2012 that for calendar years 2010, 2011 and 2012, it had paid approximately $118 million related to unfavorable smoking and health litigation judgments.

Plaintiffs assert a broad range of legal theories in these cases, including, among others, theories of negligence, fraud, misrepresentation, strict liability in tort, design defect, breach of warranty, enterprise liability (including claims asserted under RICO), civil conspiracy, intentional infliction of harm, injunctive relief, indemnity, restitution, unjust enrichment, public nuisance, unfair trade practices, claims based on antitrust laws and state consumer protection acts, and claims based on failure to warn of the harmful or addictive nature of tobacco products.

The MSA does not release the PMs from liability in individual plaintiffs' cases or in class action lawsuits. Plaintiffs in most of the cases seek unspecified amounts of compensatory damages and punitive damages that may range into the billions of dollars. Plaintiffs in some of the cases have sought treble damages, statutory damages, disgorgement of profits, equitable and injunctive relief, and medical monitoring, among other damages.

The list below specifies categories of tobacco-related cases pending against the tobacco industry. A summary description of each type of case follows the list.

Type of Case

Conventional Product Liability Cases
Engle Progeny Cases
West Virginia Individual Personal Injury Cases
Flight Attendant Cases
Class Action Cases
Reimbursement Cases
Tobacco-Related Antitrust Cases

Conventional Product Liability Cases. "**Conventional Product Liability Cases**" are brought by individuals who allege cancer or other health effects caused by smoking cigarettes, by using smokeless tobacco products, by addiction to tobacco, or by exposure to environmental tobacco smoke.

Engle Progeny Cases. "**Engle Progeny Cases**" are brought by individuals who purport to be members of the decertified *Engle* class. These cases are pending in a number of Florida courts. The time period for filing Engle Progeny Cases expired in January 2008 and no additional cases may be filed. Some of the Engle Progeny cases were filed on behalf of multiple class members. Some of the courts hearing the cases filed by multiple class members severed these suits into separate individual cases. It is possible the remaining suits filed by multiple class members may also be severed into separate individual cases.

West Virginia Individual Personal Injury Cases. In a 1999 administrative order, the West Virginia Supreme Court of Appeals transferred to a single West Virginia court a group of cases brought by individuals who allege cancer or other health effects caused by smoking cigarettes, smoking cigars, or using smokeless tobacco products (the "**West Virginia Cases**"). The plaintiffs' claims alleging injury from smoking cigarettes have been consolidated for trial. On May 15, 2013, a jury returned a verdict for tobacco company defendants with the sole exception of a defective design claim regarding cigarette filters. The plaintiffs' claims alleging injury from the use of other tobacco products have been severed from the consolidated cigarette claims and have not been consolidated for trial. The time for filing a case that could be consolidated for trial with the West Virginia Cases expired in 2000.

Flight Attendant Cases. "**Flight Attendant Cases**" are brought by non-smoking flight attendants alleging injury from exposure to environmental smoke in the cabins of aircraft. Plaintiffs in these cases may not seek punitive damages for injuries that arose prior to January 15, 1997. The time for filing Flight Attendant Cases expired in 2000 and no additional cases in this category may be filed.

Class Action Cases. "**Class Action Cases**" are purported to be brought on behalf of large numbers of individuals for damages allegedly caused by smoking, including "lights" Class Action Cases and Class Action Cases that seek court-supervised medical monitoring programs.

Reimbursement Cases. "**Reimbursement Cases**" are brought by or on behalf of entities seeking equitable relief and reimbursement of expenses incurred in providing health care to individuals who allegedly were injured by smoking. Plaintiffs in these cases have included the U.S. federal government, U.S. state and local governments, foreign governmental entities, hospitals or hospital districts, American Indian tribes, labor unions, private companies and private citizens. Included in this category is the suit filed by the federal government, *United States of America v. Philip Morris USA, Inc., et al*. (the "**DOJ Case**"), that sought to recover profits earned by the defendants and other equitable relief.

Tobacco-Related Antitrust Cases. In 2000 and 2001, a number of cases were brought against cigarette manufacturers alleging that defendants conspired to set the price of cigarettes in violation of federal and state antitrust and unfair business practices statutes ("**Tobacco-Related Antitrust Cases**"). Plaintiffs sought class certification on behalf of persons who purchased cigarettes directly or indirectly from one or more of the defendant cigarette manufacturers.

Conventional Product Liability Cases

According to Lorillard, since January 1, 2010, verdicts have been returned in nine Conventional Product Liability Cases against cigarette manufacturers. In one such case, *Evans v. Lorillard Tobacco Co.,* (Superior Court, Suffolk County, Massachusetts), the jury awarded in December 2010 $50 million in compensatory damages to the estate of a deceased smoker, $21 million in damages to the deceased smoker's son, and $81 million in punitive damages. In September 2011, the court granted in part Lorillard's motion to reduce the jury's damages awards and reduced the verdicts to the deceased smoker to $25 million and to the deceased smoker's son to $10 million. The court did not reduce the punitive damages verdict, and it denied the other motions Lorillard filed following trial that contested the jury's verdict. In September 2011, the court also issued an order that addressed the single claim that was not submitted to the jury. While the court made certain findings that were favorable to the plaintiffs, it did not award additional damages to the plaintiffs on this final claim. The court has denied the various motions filed by Lorillard following the entry of the order on the claim that was not submitted to the jury. In September 2011, the court entered a judgment that reflected the jury's damages awards and the court's reductions following trial. The judgment awarded plaintiffs interest on each of the three damages awards at the rate of 12% per year from the date the case was filed in 2004. Interest on the three awards will continue to accrue until either the judgment is paid or is vacated on appeal. In November 2011, the court granted in part plaintiffs' counsel's application for attorneys' fees and costs and has awarded approximately $2.4 million in fees and approximately $225,000 in costs. Lorillard has noticed an appeal from the final judgment to the Massachusetts Appeals Court. In March 2012, plaintiffs' application for direct appellate review was granted, transferring the appeal to the Massachusetts Supreme Judicial Court. On June 11, 2013, the Massachusetts Supreme Judicial Court allowed the $35 million in compensatory damages but vacated the punitive damages of $81 million, and ordered a new trial on that part of the case. Lorillard filed a petition for rehearing, which was denied on July 26, 2013.

According to Lorillard, juries found in favor of the plaintiffs and awarded compensatory damages in three of the other nine Conventional Product Liability Case trial verdicts rendered since January 1, 2010. In one of these three trials, the jury also awarded $4.0 million in punitive damages.

Defendants appealed the verdicts in two of the nine trials, and those appeals remain pending. In one case, according to Lorillard, the plaintiff was awarded $25 million in punitive damages in a retrial ordered by an appellate court in which the jury was permitted to consider only the amount of punitive damages to award. Defendants have appealed that verdict, which was affirmed on appeal in July 2013. In the other case, *Schwarz v. Philip Morris Inc.*, (Circuit Court, Multnomah County, Oregon), the jury awarded $168,500 in compensatory damages and $150 million in punitive damages in March 2002 to plaintiffs. In May 2002, the trial court reduced the punitive damages award to $100 million. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict, vacated the award of punitive damages and remanded the case to the trial court for a new trial limited to the determination of the amount of punitive damages, if any. In June 2006, the plaintiff petitioned the Oregon Supreme Court to review the portion of the court of appeals' decision reversing and remanding the case for a new trial on punitive damages. In June 2010, the Oregon Supreme Court affirmed the court of appeals' decision and remanded the case to the trial court for a new trial limited to the question of punitive damages. In February 2012, the jury awarded plaintiffs $25 million in punitive damages. In March 2012, Philip Morris filed motions to set aside the verdict, for a new trial or, in the alternative, for a remittitur. The trial court denied these motions in May 2012, and on September 4, 2012, Philip Morris filed a notice of appeal from the trial court's judgment with the Oregon Court of Appeals. In its Form 10-Q filed with the SEC for the nine month period ended September 30, 2013, Altria, Philip Morris's parent company, reported no developments in this case.

Juries found in favor of the defendants in the five other Conventional Product Liability Cases. Two of these five cases have concluded because the plaintiffs did not pursue appeals. The plaintiff in the third case noticed an appeal, and in February 2013 the appellate Court affirmed the verdict. In the fourth case, *Hunte v. Philip Morris USA*, the court granted in December 2012 a post trial motion for a new trial filed by the plaintiff, but withdrew the order at Philip Morris's motion for reconsideration. The plaintiff filed a petition for review of this decision with the Alaska Supreme Court, which denied the petition on April 30, 2013. The plaintiff in the fifth case has filed a notice for a new trial which was denied in August 2013. This case is currently on appeal.

In rulings addressing cases tried in earlier years, some appellate courts have reversed verdicts returned in favor of the plaintiffs while other judgments that awarded damages to smokers have been affirmed on appeal. Manufacturers have exhausted their appeals and have been required to pay damages to plaintiffs in 13 individual cases since 2001. Punitive damages were paid to the smokers in 6 of these cases. Lorillard reports that, as of October 17, 2013, there was one Conventional Product Liability Cases are scheduled for trial in 2013. Some cases are scheduled for trial in 2014.

Engle Progeny Cases

The case of *Engle v. R.J. Reynolds Tobacco Co., et al.* (Circuit Court, Dade County, Florida, filed May 5, 1994) ("***Engle***") was certified in 1996 as a class action on behalf of Florida residents, and survivors of Florida residents, who were injured or died from medical conditions allegedly caused by addiction to smoking, and a multi-phase trial resulted in verdicts in favor of the class. During the three-phase trial, a Florida jury awarded compensatory damages to three individuals and approximately $145 billion in punitive damages to the certified class. In *Engle v. Liggett Group, Inc.*, 945 So.2d 1246 (Fla. 2006), the Florida Supreme Court vacated the punitive damages award, determined that the case could not proceed further as a class action and ordered decertification of the class. The Florida Supreme Court also reinstated the compensatory damages awards to two of the three individuals whose claims were heard during the first phase of the *Engle* trial. These two awards totaled approximately $7 million, and according to Lorillard both verdicts were paid in February 2008.

The Florida Supreme Court's 2006 ruling also permitted *Engle* class members to file individual actions, including claims for punitive damages. The court further held that these individuals are entitled to rely on a number of the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. These findings included that smoking cigarettes causes a number of diseases; that cigarettes are addictive or dependence-producing; and that the defendants were negligent, breached express and implied warranties, placed cigarettes on the market that were defective and unreasonably dangerous, and concealed or conspired to conceal the risks of smoking. The time period for filing Engle Progeny Cases expired in January 2008 and no additional cases may be filed. In 2009, the Florida Supreme Court rejected a petition that sought to extend the time for purported class members to file an additional lawsuit.

Engle Progeny Cases are pending in various Florida state and federal courts. Some of the Engle Progeny Cases were filed on behalf of multiple plaintiffs. Various courts have entered orders severing the cases filed by multiple plaintiffs into separate actions. In 2009, one Florida federal court entered orders that severed the claims of approximately 4,400 Engle Progeny plaintiffs, initially asserted in a small number of multi-plaintiff actions, into separate lawsuits. In some cases, spouses or children of alleged former class members have also brought derivative claims. In 2011, approximately 500 cases that were among the 4,400 cases severed into separate lawsuits in 2009, filed by family members of alleged former class members, were combined with the cases filed by the smoker from which the family members' claims purportedly derived. In August 2012, the United States District Court for the Middle District of Florida ordered the parties to submit approximately 600 Engle Progeny Cases (*In re: Engle Progeny Cases* Case No. 3:09-CV-10000- TJC-JBT) to mediation. These cases were scheduled to be mediated in groups starting in November 2012 through May 2013. According to Lorillard, the first group of mediations has concluded. On January 30, 2013, the court issued an order changing the mediation process. Instead of conducting individual plaintiff mediations, the court ordered the parties to participate in a mediation process for the federal Engle Progeny Cases globally. Defendants filed a motion for reconsideration of this mediation order. On March 4, 2013, the Court entered a new order providing that: (1) plaintiffs will participate in a confidential mediation session without the defendants by March 15, 2013; (2) defendants will participate along with a high-level corporate officer from each defendant in a confidential mediation session without the plaintiffs by April 15, 2013; and (3) each side will disclose to the mediators a confidential offer for global resolution of the federal Engle Progeny Cases. The mediators conducted the ordered mediation sessions. On April 9, 2013, the mediators issued a report stating that "there are practical and procedural impediments which act to prevent a meaningful discussion of settlements at this time," and that the mediators were prepared to discuss the mediation process further with the Court at the Court's convenience. On April 22, 2013, the Court met with only the mediators to discuss in further detail the mediation process. On July 29, 2013, the district court issued an order transferring, for case management purposes, all of the Middle District of Florida Engle Progeny Cases to a judge presiding in the District of Massachusetts. The district court directed that the cases will remain in the Middle District of Florida and that such judge will be designated a judge of that district for purposes of managing the cases.

On December 14, 2012, plaintiffs' counsel filed a motion to remand the majority of the federal Engle Progeny Cases to state court. On January 25, 2013, the United States District Court for the Middle District of Florida denied the motion. Plaintiffs petitioned the United States Court of Appeals for the Eleventh Circuit for permission to appeal the district court's order denying the motion to remand. On April 2, 2013, the United States Court of Appeals for the Eleventh Circuit granted the petition for permission to appeal and simultaneously affirmed the District Court's order denying remand.

Lorillard reports that since January 2010 and through October 17, 2013, the United States District Court for the Middle District of Florida has dismissed a total of approximately 3,224 cases. In some instances, the plaintiffs whose cases were dismissed also were pursuing cases pending in other courts. In other instances, the attorneys who represented the plaintiffs asked the court to enter dismissal orders because they were no longer able to contact their clients. In September 2012, the court dismissed approximately 589 cases for failure to comply with court deadlines and granted a motion that dismissed 211 additional cases for a variety of reasons. In November 2012, the court granted a motion by defendants and dismissed an additional 36 cases as barred by the statute of limitations. In January 2013, the court granted a motion by defendants and dismissed approximately 520 cases in which the plaintiffs were deceased at the time their personal injury lawsuits were filed. Plaintiffs appealed the dismissals to the United States Court of Appeal for the Eleventh Circuit, and the appeal remains pending. In June 2013, the Court dismissed an additional approximately 440 cases for a variety of reasons. Plaintiffs have appealed the dismissal of approximately 70 of these cases, in which the plaintiffs were deceased at the time their personal injury lawsuits were filed or where the cases were barred by the statute of limitations. The Court granted plaintiffs' motion to consolidate the appeals from the January and June 2013 orders dismissing these groups of federal cases. Other courts, including state courts, have entered orders dismissing additional cases.

Reynolds American reports in its Form 10-Q filed with the SEC for the nine month period ending September 30, 2013 that as of September 30, 2013, 1,961 Engle Progeny Cases were pending in federal court and 3,226 cases were pending in state court, together including approximately 6,344 plaintiffs.

Various intermediate state and federal Florida appellate courts have issued rulings that address the scope of the preclusive effect of the findings from the first phase of the *Engle* trial, including whether those findings relieve plaintiffs from the burden of proving certain legal elements of their claims. In July 2010, the United States Court of Appeals for the Eleventh Circuit in *Brown v. R. J. Reynolds Tobacco Co.*, 611 F.3d 1324 (2010) ("*Bernice Brown*"), vacated the decision of the trial court, finding that it was premature to address the extent of any preclusive effect of the findings of the first phase of the *Engle* trial until the scope of the factual issues decided in first phase of the *Engle* trial was determined by the trial court. In two other cases, *Duke v. R.J. Reynolds Tobacco Co.* and *Walker v. R.J. Reynolds Tobacco Co.*, the due process issue is on appeal in the United States Court of Appeals for the Eleventh Circuit. On May 8, 2012, a group of plaintiffs firms submitted an amicus brief in both cases contending that finding for the tobacco companies, and undoing the over 100 verdicts decided under the Florida Supreme Court's 2006 decision, would be unfair to their clients. On September 6, 2013, the United States Court of Appeals for the Eleventh Circuit ruled that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. R.J. Reynolds filed a petition for panel rehearing or a rehearing en banc before the Eleventh Circuit on October 7, 2013. On October 31, 2013 the Eleventh Circuit again ruled that the use of phase I *Engle* findings does not violate a tobacco manufacturer's due process rights.

In December 2010, the Florida First District Court of Appeal in *R.J. Reynolds Tobacco Co. v. Martin*, 53 So.3d 1060 (2010) refused to adopt the Eleventh Circuit's ruling in *Brown*, finding that the trial court correctly construed the Florida Supreme Court's 2006 *Engle* decision and had properly instructed the jury on the preclusive effect of certain of the *Engle* jury's findings. In September 2011, the Florida Fourth District Court of Appeal in *R.J. Reynolds Tobacco Co. v. Brown*, 70 So.3d 707 (2011) ("*Jimmie Lee Brown"*) had a different interpretation of the effect of the 2006 *Engle* decision on plaintiff's claims than both the *Bernice Brown* and *Martin* courts, holding that while the conduct elements of strict liability and negligence claims were preclusively established, the remaining elements of the underlying claims must be proven in the second phase of trial. In May 2013, however, the Florida Supreme Court accepted discretionary jurisdiction in *Jimmie Lee Brown* and the case will be submitted without oral argument. A decision is pending. In December 2011, the U.S. District Court for the Middle District of Florida, in *Waggoner v. R.J. Reynolds Tobacco Co.*, 835 F.Supp.2d 1244 (2011), held that the first phase of the *Engle* trial may be given the preclusive effect afforded them by the 2006 Florida Supreme Court decision, as well as the *Martin* and *Jimmie Lee Brown* decisions without violating the Due Process Clause. In *Philip Morris v. Douglas* (No. 12-617), the Florida Supreme Court ruled on March 14, 2013 that a tobacco manufacturer's due process rights are not violated by relying upon the findings of the first phase of the *Engle* trial. In order to prevail on either strict liability or negligence claims, the Court found that an *Engle* plaintiff must establish (1) membership in the *Engle* class; (2) that addiction to smoking the *Engle* defendants' cigarettes containing nicotine was a legal cause of the injuries the plaintiff alleged; and (3) damages. Defendants filed a petition for review of the Florida Supreme Court's decision in *Douglas* with the U.S. Supreme Court on August 9, 2013 which the court denied on October 7, 2013.

Various courts, including appellate courts, have issued rulings that have addressed the conduct of the cases prior to trial. One intermediate state appellate court ruled in 2011 that plaintiffs are permitted to assert a claim against a cigarette manufacturer even if the smoker did not smoke a brand sold by that manufacturer. Defendants' petition for review of this decision by the Florida Supreme Court was denied in August 2012. In March 2012, another intermediate state appellate court agreed with the 2011 ruling and reversed dismissals in a group of cases. Defendants in these cases also sought review by the Florida Supreme Court. The Florida Supreme Court had announced that it would defer decision on whether to accept review of these cases until it decided whether to review the 2011 decision. In June and July 2013, the Florida Supreme Court denied defendants' petitions for review of the intermediate appellate court's decision in these cases. These rulings may limit the ability of the defendants to be dismissed from cases in which smokers did not use a cigarette manufactured by such defendant. In October 2012, the Florida First District Court of Appeal in Soffer v. R.J. Reynolds Tobacco Co. affirmed the trial court's ruling in full, awarding compensatory damages and no punitive damages. On the direct appeal, the court held that only intentional torts could support a punitive damages claim and held that the Engle Progeny plaintiffs may not seek punitive damages for negligence or strict liability because the original *Engle* class did not seek punitive damages for those claims. The Florida First District Court of Appeal certified the question to the Florida Supreme Court as one of great public importance. On the cross appeal, the court rejected the defendant's arguments about the use of the *Engle* findings and the statute of limitations. The defendant filed a motion for rehearing or for certification to the Florida Supreme Court and the plaintiff filed a motion for rehearing or rehearing en banc. In January 2013, the Florida First District Court of Appeal granted rehearing on the defendant's cross appeal to clarify that the trial court's application of *Engle* findings did not violate the defendant's due process rights. Otherwise, rehearing, rehearing en banc and certification were denied. The defendant and the plaintiff have both filed notices to invoke the discretionary jurisdiction of the Florida Supreme Court. Decisions are pending. In June 2013, in *Capone v.*

Philip Morris, the Florida Supreme Court reversed an intermediate state appellate court and held that a plaintiff's representative may continue to litigate an existing lawsuit after the original plaintiff has died. In October 2013, a Florida appeals court ruled that individual plaintiffs in *Engle* progeny suits can sue tobacco companies for individual and punitive damages on the nonintentional tort claims of strict liability and negligence.

According to Lorillard, tobacco manufacturing defendants face various other legal issues in connection with the Engle Progeny Cases that could materially affect the outcome of the Engle Progeny Cases. These legal issues include, but are not limited to, the application of the statute of limitations and statute of repose, the constitutionality of a cap on the amount of a bond necessary to obtain an automatic stay of a post-trial judgment, and whether a plaintiff's representative may continue an existing lawsuit or file a new lawsuit after the original plaintiff has died. Lorillard reports that various intermediate Florida appellate courts and Florida federal courts have issued rulings on these issues.

Lorillard reports that as of October 17, 2013, verdicts had been returned in fourteen Engle Progeny Cases in which Lorillard was a defendant and 92 Engle Progeny Cases in which neither Lorillard nor Lorillard Inc. was a defendant at trial. Lorillard was a defendant in one of the fourteen Engle Progeny Cases at the time of verdict. Juries awarded compensatory damages to the plaintiffs in eleven of these cases (and in three of these eleven cases, juries also awarded punitive damages), and in another case, the court entered an order following trial that awarded plaintiff compensatory damages. According to Lorillard, of the 92 Engle Progeny Cases in which neither Lorillard nor Lorillard Inc. was a defendant at trial, juries awarded compensatory damages and punitive damages in 30 of the trials; the 30 punitive damages awards have totaled approximately $707 million and have ranged from $20,000 to $244 million. In 28 of the trials, juries' awards were limited to compensatory damages. In the 34 remaining trials, juries found in favor of the defendants. Post-trial motions challenging the verdicts in some cases and appeals from final judgments in some cases are pending before various Florida circuit and intermediate appellate courts. Lorillard reports in its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013 that as of October 17, 2013, one verdict in favor of the defendants and three verdicts in favor of the plaintiff have been reversed on appeal and returned to the trial court for a new trial on all issues, and in nine cases, the appellate courts have ruled that the issue of damages awarded must be revisited by the trial court. Motions for rehearing of these appellate court rulings are pending in some cases. According to Altria, as of October 21, 2013, 47 Engle Progeny Cases involving Philip Morris have resulted in verdicts since the Florida Supreme Court's *Engle* decision, 24 of which were returned in favor of plaintiffs and 23 of which were returned in favor of Philip Morris. In one of the Engle Progeny Cases in which all 3 OPMs are defendants, *Calloway v. R.J. Reynolds Tobacco Company, et al.* (Circuit Court, Seventeenth Judicial Circuit, Broward County, Florida), the jury awarded plaintiff and a daughter of the decedent a total of $20,500,000 in compensatory damages. The jury apportioned 20.5% of the fault for the smoker's injuries to the smoker, 27% to R.J. Reynolds, 25% to Philip Morris, 18% to Lorillard, and 9.5% to Liggett. The jury awarded a total punitive damages award from the defendants of $54,850,000. In August 2012, the court granted a post-trial motion by the defendants and lowered the compensatory damages award to $16,100,000. The court also ruled that the jury's finding on the plaintiff's percentage of comparative fault would not be applied to reduce the compensatory damage award because the jury found in favor of the plaintiff on her claims alleging intentional conduct. In August 2012, the court entered final judgment against defendants in the amount of $16,100,000 in compensatory damages and $54,850,000 in punitive damages, plus the statutory rate of interest, which is currently 4.75%. In September 2012, the defendants filed a notice of appeal to the Florida Fourth District Court of Appeal, and Reynolds Tobacco posted a supersedeas bond in the amount of $1.5 million. The plaintiff filed a notice of cross-appeal. Briefing with the Florida Fourth District Court of Appeal was underway as of the date hereof.

In another Engle Progeny case, *Naugle v. Philip Morris*, a jury returned a verdict in November 2009 in favor of the plaintiff and against Philip Morris. The jury awarded approximately $56.6 million in compensatory damages and $244 million in punitive damages, allocating 90% of the fault to Philip Morris. In August 2010, the trial court entered an amended final judgment of approximately $12.3 million in compensatory damages and approximately $24.5 million in punitive damages. In June 2012, the Fourth District Court of Appeal affirmed the amended final judgment, and in July 2012, Philip Morris filed a motion for rehearing. On December 12, 2012, the Fourth District Court of Appeal withdrew its prior decision, reversed the verdict as to compensatory and punitive damages and returned the case to the trial court for a new trial on the question of damages. On December 26, 2012, the plaintiff filed a motion for rehearing *en banc* or for certification to the Florida Supreme Court, which was denied on January 25, 2013. The jurisdiction of the Florida Supreme Court was invoked through the filing of a Notice to Invoke Discretionary Jurisdiction in February 2013. The Fourth District Court of Appeal issued its mandate in

March 2013. On May 17, 2013, the Florida Supreme Court consolidated the parties' petitions and ordered the parties to show cause as to why the Florida Supreme Court's decision in *Philip Morris USA, Inc v. Douglas* was not controlling and the court should not decline jurisdiction. On June 3, 2013, the parties filed responses to the court's order to show cause. Upon retrial on the question of damages, on October 16, 2013, the new jury awarded approximately $3.7 million in compensatory damages and $7.5 million in punitive damages.

Reynolds Tobacco reports that as of June 30, 2012, outstanding jury verdicts in favor of the Engle Progeny plaintiffs in Engle Progeny Cases had been entered against Reynolds Tobacco in the aggregate amount of $111,040,200 in compensatory damages (as adjusted) and in the aggregate amount of $151,715,000 in punitive damages, for a total of $262,755,200. Reynolds Tobacco reports that all of such verdicts are at various stages in the appellate process.

Various Engle Progeny Cases are discussed in detail in the SEC filings of the parent companies of Lorillard, Philip Morris and Reynolds Tobacco.

In June 2009, Florida amended the security requirements for a stay of execution of any judgment during the pendency of appeal in Engle Progeny Cases. The amended statute provides for the amount of security for individual Engle Progeny Cases to vary within prescribed limits based on the number of adverse judgments that are pending on appeal at a given time. The required security decreases as the number of appeals increases to ensure that the total security posted or deposited does not exceed $200 million in the aggregate. This amended statute applies to all judgments entered on or after June 16, 2009. The plaintiffs in some cases challenged the constitutionality of the amended statute. These motions were denied, withdrawn or declared moot. In January 2012, the Florida Supreme Court agreed to review one of the orders denying a challenge to the amended statute. In August 2012, the Florida Supreme Court dismissed the appeal as moot because the defendant had satisfied the judgment..

A number of Engle Progeny Cases have been placed on courts' 2013/2014 trial calendars; according to Reynolds American, there are 49 set for trial through September 30, 2014. Altria reported in its Form 10-Q filed with the SEC for the nine-month period ended in September 30, 2013 that as of October 21 2013, 2 Engle Progeny Cases against Philip Morris were scheduled for trial through the end of 2013. Trial schedules are subject to change. It is not possible to predict whether some courts will implement procedures that consolidate multiple Engle Progeny Cases for trial.

On October 23, 2013, Vector Group Ltd. announced that it and Liggett reached a comprehensive settlement resolving substantially all of the individual *Engle* progeny tobacco litigation cases pending against them. Under the settlement, which does not require court approval, more than 4,900 of the approximately 5,300 individual *Engle* plaintiffs will be dismissing their claims against Vector Group and Liggett. Vector Group Ltd. expects to incur an after-tax charge of $53 million in the third quarter of 2013 related to the settlement agreement. Pursuant to the terms of the agreement, Liggett will pay a total of $110 million (or present value, net of income taxes, of $53 million), with approximately $61 million ($38 million, net of income taxes) to be paid in a lump sum, and the balance of approximately $49 million (or a present value, net of income taxes, of $15 million) to be paid over 15 years. The settlement is expected to be finalized by January 23, 2014 and is contingent upon delivery of the required settlement documents by plaintiffs' attorneys.

West Virginia Cases

In September 2000, there were approximately 1,250 West Virginia Cases. Plaintiffs in most of the cases alleged injuries from smoking cigarettes, and the claims alleging injury from smoking cigarettes have been consolidated for a multi-phase trial. Approximately 645 West Virginia Cases have been dismissed in their entirety; however, some or all of the dismissals could be contested in subsequent appeals.

The West Virginia Cases pending are brought in a single West Virginia court by individuals who allege cancer or other health effects caused by smoking cigarettes, smoking cigars, or using smokeless tobacco products. More than 700 West Virginia Cases were consolidated for a multiphase trial, which began April 22, 2013 and concluded May 13, 2013. The order that consolidated the cases for trial, among other things, also limited the consolidation to those cases that were filed by September 2000. No additional West Virginia Cases may be consolidated for trial with this group. On May 15, 2013, the jury returned a verdict finding for the defendant tobacco companies on claims of failure to warn, negligence and fraudulent concealment but for the plaintiff smokers on the claim that manufacturers are liable for the defective design of ventilated filter cigarettes. No punitive damages were awarded. Plaintiffs and defendants both filed post-trial motions on July 15, 2013. On August 13, 2013, the trial court denied all post-trial motions. The trial court has yet to enter final judgment..

The court has severed from the West Virginia Cases those claims alleging injury from the use of tobacco products other than cigarettes, including smokeless tobacco and cigars (the "**Severed West Virginia Claims**"). The Severed West Virginia Claims involve 30 plaintiffs. Twenty-eight of these plaintiffs have asserted both claims alleging that their injuries were caused by smoking cigarettes as well as claims alleging that their injuries were caused by using other tobacco products. The former claims were included in the consolidated trial of the West Virginia Cases, while the latter claims are among the Severed West Virginia Claims. Two plaintiffs have asserted only claims alleging that injuries were caused by using tobacco products other than cigarettes, and no part of their cases was included in the consolidated trial of the West Virginia Cases (the "**Severed West Virginia Cases**"). According to Lorillard, as of October 17, 2013, the Severed West Virginia Claims and the Severed West Virginia Cases were not subject to a trial plan. None of the Severed West Virginia Claims or the Severed West Virginia Cases was scheduled for trial as of October 17, 2013.

Flight Attendant Cases

Four cigarette manufacturers are the defendants in the pending Flight Attendant Cases. These suits were filed as a result of a settlement agreement by the parties in *Broin v. Philip Morris Companies, Inc., et al.* (Circuit Court, Miami-Dade County, Florida, filed October 31, 1991), a class action brought on behalf of flight attendants claiming injury as a result of exposure to environmental tobacco smoke. The settlement agreement, among other things, permitted the plaintiff class members to file these individual suits. These individuals may not seek punitive damages for injuries that arose prior to January 15, 1997. The period for filing Flight Attendant Cases expired in 2000 and no additional cases in this category may be filed.

The judges who have presided over the cases that have been tried have relied upon an order entered in October 2000 by the Circuit Court of Miami-Dade County, Florida. The October 2000 order has been construed by these judges as holding that the flight attendants are not required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages. The court further ruled that the trials of these suits are to address whether the plaintiffs' alleged injuries were caused by their exposure to environmental tobacco smoke and, if so, the amount of damages to be awarded.

Defendants have prevailed in seven of the eight cases in which verdicts have been returned. In one of the seven cases in which a defense verdict was returned, the court granted plaintiff's motion for a new trial and, following appeal, the case has been returned to the trial court for a new trial. The six remaining cases in which defense verdicts were returned are concluded. In the single trial decided for the plaintiff, *French v. Philip Morris Incorporated, et al.*, the jury awarded $5.5 million in damages. The court, however, reduced this award to $500,000. This verdict, as reduced by the trial court, was affirmed on appeal and the defendants have paid the award. According to Lorillard, as of October 17, 2013, none of the Flight Attendant Cases were scheduled for trial; however, trial dates are subject to change.

Class Action Cases

In most of the class action cases, plaintiffs seek class certification on behalf of groups of cigarette smokers, or the estates of deceased cigarette smokers, who reside in the state in which the case is filed. According to Lorillard, cigarette manufacturers have defeated motions for class certification in a number of cases. Motions for class certification have also been ruled upon in some of the "lights" cases or in other types of class actions. In some of these cases, courts have denied class certification to the plaintiffs, while classes have been certified in other matters.

The Scott Case. In one of the class actions, *Scott v. The American Tobacco Company, et al* (District Court, Orleans Parish, Louisiana, filed May 24, 1996), a class was certified on behalf of certain cigarette smokers resident in the State of Louisiana who desired to participate in medical monitoring or smoking cessation programs and who began smoking prior to September 1, 1988, or who began smoking prior to May 24, 1996 and alleged that defendants undermined compliance with the warnings on cigarette packages. In *Scott*, trial was heard in two phases and at the conclusion of the first phase in July 2003, the jury rejected medical monitoring, the primary relief requested by plaintiffs, and returned sufficient findings in favor of the class to proceed to a Phase II trial on plaintiffs' request for a statewide smoking cessation program. Phase II of the trial, which concluded in May 2004, resulted in an award of $591 million to fund cessation programs for Louisiana smokers. In February 2007, the Louisiana Court of Appeal reduced the amount of the award by approximately $328 million; struck an award of prejudgment interest, which totaled approximately $440 million as of December 31, 2006; and limited class membership to individuals who began smoking by September 1, 1988, and whose claims accrued by September 1, 1988. The case was returned to the trial court, which subsequently entered an amended final judgment that ordered the defendants to pay approximately $264 million to fund a ten year, court-supervised smoking cessation program for the members of the certified class. The Louisiana Court of Appeal, Fourth Circuit, issued a decision in April 2010 that modified the trial court's 2008 amended final judgment, reducing the judgment amount to approximately $242 million to fund the court-supervised smoking cessation program. Both the Louisiana Supreme Court and the U.S. Supreme Court declined to review the case. In August 2011, following the exhaustion of all appeals, the defendants paid a total of approximately $280 million to satisfy the final judgment and the interest that was due. In May 2012, the parties reached a settlement on the amount of fees and costs to be awarded to plaintiffs' counsel. Plaintiffs agreed that any recovery of fees and costs would come from the court-supervised fund, not the defendants, and indicated they would seek approximately $114 million from the fund. In exchange, defendants agreed to waive 50% of their right to a refund of any unspent money in the fund after the 10-year program is completed. The agreement is not contingent on the trial court's granting plaintiffs' request for additional costs and fees. In December 2012, the court ratified and approved the agreement.

The New York Court of Appeals on May 30, 2013, agreed to consider the following certified questions that it received from the United States Circuit Court of Appeals for the Second Circuit in a medical monitoring class action, *Caronia v. Philip Morris USA*, that is pending in the U.S. District Court for the Eastern District of New York: (1) under New York law, may a current or former longtime heavy smoker who has not been diagnosed with a smoking-related disease, and who is not under investigation by a physician for such a suspected disease, pursue an independent equitable cause of action for medical monitoring for such a disease; (2) and if so, what are the elements of that cause of action; and (3) what is the applicable statute of limitations, and when does that cause of action accrue. With regard to *Caronia* and other medical monitoring class action suits, evolving medical standards and practices could have an impact on the defense of medical monitoring claims. For example, the first publication of the findings of the National Cancer Institute's National Lung Screening Trial in June 2011 reported a 20% reduction in lung cancer deaths among certain long-term smokers receiving Low Dose CT Scanning for lung cancer. Since then, various public health organizations have begun to develop new lung cancer screening guidelines. Also, a number of hospitals have advertised the availability of screening programs. Other studies in this area are ongoing.

Other Class Action Cases. In another Class Action Case, *Brown v. The American Tobacco Company, Inc., et al.* (Superior Court, San Diego County, California, filed June 10, 1997), the California Supreme Court in 2009 vacated an order that had previously decertified a class and returned *Brown* to the trial court for further activity. The class in *Brown* is composed of residents of California who smoked at least one of defendants' cigarettes between June 10, 1993 and April 23, 2001 and who were exposed to defendants' marketing and advertising activities in California. The trial court has permitted plaintiffs to assert claims based on the alleged misrepresentation, concealment and fraudulent marketing of "light" or "ultra-light" cigarettes. In May 2012, the court issued rulings that decertified the class on false statements concerning additives, nicotine manipulation and conspiracy to mislead concerning health risks of smoking. However, the court found that the class action could proceed as to the "light" claims, but that only one of the currently named plaintiffs was suitable to represent the class. In September 2012, the court entered an order that dismissed Lorillard, Reynolds Tobacco and all other defendants except Philip Morris from this case. On October 18, 2012, the Court of Appeal denied the defendants' petition to issue a writ of mandate. Trial began April 15, 2013. On June 3, 2013, Philip Morris filed a motion to decertify the class. The trial concluded on July 10, 2013 and the court took the matter under consideration. On September 24, 2013, the court issued a final Statement of Decision, in which the court found that Philip Morris violated California law, but that plaintiffs had not established a basis for relief. On this basis, the court granted judgment for Philip Morris. The court also denied Philip Morris's motion to decertify the class. On October 15, 2013, the court entered final judgment in favor of Philip Morris.

"Lights" Class Action Cases. According to Lorillard, there are approximately 16 Class Action Cases in which plaintiffs' claims are based on the allegedly fraudulent marketing of "light" or "ultra-light" cigarettes. Classes have been certified in some of these cases. In one of the "lights" Class Action Cases, *Good v. Altria Group, Inc., et al*., the U.S. Supreme Court ruled in December 2008 that neither the Federal Cigarette Labeling and Advertising Act nor the Federal Trade Commission's regulation of cigarettes' tar and nicotine disclosures preempts (or bars) certain of plaintiffs' claims. Although the Court rejected the argument that the Federal Trade Commission's actions were so extensive with respect to the descriptors that the state law claims were barred as a matter of federal law, the Court's decision was limited: it did not address the ultimate merits of plaintiffs' claim, the viability of the action as a class action, or other state law issues. The case was returned to the federal court in Maine and consolidated with other federal cases in a multidistrict litigation proceeding, discussed below. In June 2011, the plaintiffs voluntarily dismissed the case without prejudice after the district court denied plaintiffs' motion for class certification, concluding the litigation.

Since the December 2008 United States Supreme Court decision in *Good*, and through July 22, 2013, according to Philip Morris, 26 purported "Lights" class actions were served upon Philip Morris and, in certain cases, Altria. These cases were filed in 14 states, the U.S. Virgin Islands and the District of Columbia. All of these cases either were filed in federal court or were removed to federal court by Philip Morris and were transferred and consolidated by the Judicial Panel on Multidistrict Litigation ("**JPMDL**") before the United States District Court for the District of Maine for pretrial proceedings. In November 2010, the district court denied plaintiffs' motion for class certification in four cases, covering the jurisdictions of California, the District of Columbia, Illinois and Maine. These jurisdictions were selected by the parties as sample cases, with two selected by plaintiffs and two selected by defendants. Plaintiffs sought appellate review of this decision but, in February 2011, the United States Court of Appeals for the First Circuit denied plaintiffs' petition for leave to appeal. Later that year, plaintiffs in 13 cases voluntarily dismissed without prejudice their cases. In April 2012, the JPMDL remanded the remaining four cases back to the federal district courts in which the suits originated. In one of those cases, *Phillips vs. Altria Group, Inc.*, which is now pending in the United States District Court for the Northern District of Ohio, defendants filed in June 2012 a motion for partial judgment on the pleadings on plaintiffs' class action consumer sales practices claims and a motion for judgment on the pleadings on plaintiffs' state deceptive trade practices claims. On March 21, 2013, the Court granted defendants' motions and accordingly dismissed plaintiffs' class action consumer sales practices and deceptive trade practices claims with prejudice. On April 18, 2013, defendants filed a motion for judgment on the pleadings on the class component of plaintiffs' common law fraud and unjust enrichment claims. A hearing on plaintiff's motion for class certification is currently set for October 30, 2013.

According to Philip Morris, in addition to the district court for the District of Maine proceeding, 15 courts in 16 "Lights" cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or have entered judgment in favor of Philip Morris.

On June 19, 2013, the Oregon Court of Appeals in *Pearson et al. v. Philip Morris Inc.* et al. reversed a Multnomah County Circuit judge's October 2005 decision that had granted summary judgment to Philip Morris USA and dismissed a lawsuit filed against Philip Morris USA in 2002 by two Marlboro Lights smokers. In that case the Court of Appeals ruled that plaintiffs' claims were not preempted by federal law as the circuit court had concluded and were not subject to dismissal on that basis. The Court of Appeals also ruled that the circuit court had erred in not allowing the case to proceed as a class-action suit on behalf of an alleged 100,000 Oregon smokers. In this suit which has been remanded to the circuit court for further proceedings, plaintiffs allege, among other things, that Philip Morris USA violated the Oregon Unlawful Trade Practices Act by misrepresenting the tar and nicotine characteristics of Marlboro Lights and that, as result of such misrepresentations, plaintiffs had suffered economic losses. On July 17, 2013, Philip Morris filed a petition for reconsideration with the Oregon Court of Appeals, which was denied on August 23, 2013. On October 28, 2013 Phillip Morris filed a perfected (amended) petition for review with the Oregon Supreme Court.

The Price Case. In *Price, et al v. Philip Morris Inc*. (Circuit Court, Madison County, Illinois, filed February 10, 2000) the trial judge found in favor of the plaintiff class and awarded $7.1 billion in compensatory damages and $3 billion in punitive damages against Philip Morris. In December 2005, the Illinois Supreme Court issued its judgment reversing the trial court's judgment in favor of the plaintiffs and directing the trial court to dismiss the case. In December 2006, the defendant's motion to dismiss and for entry of final judgment was granted, and the case was dismissed with prejudice. In December 2008, plaintiffs filed with the trial court a petition for relief from the final judgment and sought to vacate the 2005 Illinois Supreme Court judgment, contending that the U.S. Supreme Court's December 2008 decision in *Good* demonstrated that the Illinois Supreme Court's decision was "inaccurate". In February 2009, the trial court granted Philip Morris's motion to dismiss plaintiffs' petition. In March 2009, the plaintiffs filed a notice of appeal with the Illinois Appellate Court, Fifth Judicial District. In February 2011, the Illinois Appellate Court, Fifth Judicial District reversed the trial court's dismissal of plaintiffs' petition and remanded for further proceedings, and on September 28, 2011, the Illinois Supreme Court denied Philip Morris' petition for leave to appeal that ruling. As a result, the case returned to the trial court for proceedings on whether the court should grant the plaintiffs' petition to reopen the prior judgment. In February 2012, plaintiffs filed an amended petition, which Philip Morris opposed. Subsequently, in responding to Philip Morris's opposition to the amended petition, plaintiffs asked the trial court to reinstate the original judgment. On December 12, 2012, the trial court denied the plaintiffs' request to reopen the prior judgment, and the plaintiffs filed a notice of appeal to the Fifth District Appellate Court on January 8, 2013. On January 23, 2013 Philip Morris filed a motion requesting that the Illinois State Supreme Court directly hear plaintiffs' appeal. On February 15, 2013, the Illinois State Supreme Court denied Philip Morris' motion for direct appeal. Oral argument on plaintiffs' appeal to the Fifth Judicial District was heard on October 23, 2013.

In another case, *Larsen v. Philip Morris Inc.* (formerly *Craft v. Philip Morris Inc.*), a Missouri Court of Appeals in August 2005 affirmed a class certification order for current and former smokers of Marlboro Lights. (The class period is 1995 through 2003.) In June 2011, Philip Morris filed various summary judgment motions challenging the plaintiffs' claims. In August 2011, the trial court granted Philip Morris's motion for partial summary judgment, ruling that plaintiffs could not present a damages claim based on allegations that Marlboro Lights are more dangerous than Marlboro Reds, and denied Philip Morris's remaining summary judgment motions. Trial began in September 2011, and in October 2011 the trial court declared a mistrial after the jury failed to reach a verdict. The court has scheduled a new trial to begin in January 2014.

In early 2013, the U.S. District Court for Massachusetts in *Donovan v. Philip Morris* finalized the certified class and approved the notice plan for certain Massachusetts plaintiffs potentially affected by smoking Marlboro cigarettes. Plaintiffs seek compensation for medical monitoring of incipient and not yet detected or diagnosed cancers. In September 2010, the First Circuit U.S. Court of Appeals denied defendant Philip Morris' petition for interlocutory review of class certification. As a remedy, plaintiffs have proposed a 28-year medical monitoring program with an approximate cost of $190 million. In June 2011, plaintiffs filed various motions for summary judgment and to strike affirmative defenses, which the district court denied in March 2012 without prejudice. In October 2011, Philip Morris filed a motion for class decertification, which was denied in March 2012. In February 2013, the district court amended the class definition to extend to individuals who satisfy the class membership criteria through February 26, 2013, and to exclude any individual who was not a Massachusetts resident as of February 26, 2013. A trial date has not yet been set.

In September 2013, a California Superior Court judge in *Brown v. The American Tobacco Co., Inc.* ruled in favor of defendant PM USA and rejected the class plaintiffs' claims for recovery of a portion of the money paid by California smokers who purchased Marlboro Lights between 1998 and 2001. The plaintiffs claimed that defendant PM USA violated California's Unfair Competition Law and False Advertising Law by using the terms "Lights" and "Lowered Tar and Nicotine" on cigarette packages. In this ruling the court concluded that, based on the totality of the evidence presented, plaintiffs were not entitled to any restitution of the payments they made for defendant's cigarettes. The Court also ruled that plaintiffs' request for injunctive relief was moot because "the evidence established that the descriptors on which the Plaintiffs base their case have been removed and, because of changes in the law, these descriptors can never be used again."

An Arkansas state circuit court, the Circuit Court of Pulaski County, approved class certification in a Marlboro Lights lawsuit, Wayne Miner et al v. Philip Morris Cos. Inc., on October 22, 2013. Plaintiffs initially filed the lawsuit against Philip Morris, which is part of Altria Group, in 2003, accusing the company of deceptive marketing practices in violation of the Arkansas Deceptive Business Practices Act. Plaintiffs allege Philip Morris violated the law by advertising Marlboro Lights as a safer alternative to regular cigarettes. Philip Morris has stated it will appeal the class-action designation. Pulaski County Circuit Judge Tim Fox approved the class-action status, which could result in one of the largest plaintiffs' classes in Arkansas history.

Reimbursement Cases

Reimbursement Cases are brought by or on behalf of entities seeking equitable relief and reimbursement of expenses incurred in providing health care to individuals who allegedly were injured by smoking. Plaintiffs in these cases have included the U.S. federal government, U.S. state and local governments, foreign governmental entities, hospitals or hospital districts, American Indian tribes, labor unions, private companies and private citizens.

The DOJ Case. In August 2006, the U.S. District Court for the District of Columbia issued its final judgment and remedial order in the federal government's reimbursement suit, *United States of America v. Philip Morris*, which final judgment and remedial order concluded a bench trial that began in September 2004. The court determined in its final judgment and remedial order that the defendants violated certain provisions of the RICO statute, that there was a likelihood of present and future RICO violations, and that equitable relief was warranted. The government was not awarded monetary damages. The equitable relief included permanent injunctions that prohibit the defendants from engaging in any act of racketeering, as defined under RICO; from making any material false or deceptive statements concerning cigarettes; from making any express or implied statement about health on cigarette packaging or promotional materials (these prohibitions include a ban on using such descriptors as "low tar," "light," "ultra-light," "mild" or "natural"); from making any statements that "low tar," "light," "ultra-light," "mild" or "natural" or low-nicotine cigarettes may result in a reduced risk of disease; and from participating in the management or control of certain entities or their successors. The final judgment and remedial order also requires the defendants to make corrective statements on their websites, in certain media, in point-of-sale advertisements, and on cigarette package "inserts" (as described below). The final judgment and remedial order also requires defendants to make disclosures of disaggregated marketing data to the government, and to make document disclosures on a website and in a physical depository, and also prohibits each defendant that manufactures cigarettes from selling any of its cigarette brands or certain elements of its business unless certain conditions are met.

Following trial, the final judgment and remedial order was stayed because the defendants, the government and several interveners noticed appeals to the Circuit Court of Appeals for the District of Columbia. In May 2009, a three judge panel upheld substantially all of the District Court's final judgment and remedial order. In September 2009, the Court of Appeals denied defendants' rehearing petitions as well as their motion to vacate those statements in the appellate ruling that address defendants' marketing of "low tar" or "lights" cigarettes, to vacate those parts of the trial court's judgment on that issue, and to remand the case with instructions to deny as moot the government's allegations and requested relief regarding "lights" cigarettes. In June 2010, the U.S. Supreme Court denied all of the petitions for review of the case. The case was returned to the trial court for implementation of the Court of Appeals' directions in its 2009 ruling and for entry of an amended final judgment. In March 2011, defendants filed a motion to vacate the court's factual findings and remedial order on alternative grounds, and on June 1, 2011, the trial court denied defendants' motion. Defendants filed a notice of appeal, and in July 2012 the appellate court affirmed the District Court's ruling, permitting the case to proceed. In response to the government's motion requesting clarification, the trial court held in April 2011 that the defendants must provide a broad range of data for the ten-year period beginning July 29, 2010, and that the Department of Justice may share that data with other governmental agencies, subject to the confidentiality requirements previously imposed by the trial court. The defendants noticed an appeal from this order to the U.S. Court of Appeals for the District of Columbia Circuit. In July 2012, the appellate court dismissed the appeal for lack of jurisdiction, and the defendants have not sought further review of that decision.

On November 27, 2012 the U.S. District Court for the District of Columbia issued an order specifying the text of the corrective statements that the defendants must make on their websites and through other media. The court ordered that the corrective statements include statements to the effect that a federal court has ruled that the tobacco companies deliberately deceived the American public about the health effects of smoking and secondhand smoke and the addictiveness of smoking and nicotine, and deliberately deceived the American public by falsely selling and advertising low tar and light cigarettes as less harmful than regular cigarettes and by designing cigarettes to enhance the delivery of nicotine. In addition, the court ordered that the corrective statements contain statements including, among other things, that smoking kills on average 1,200 Americans every day, results in various detrimental health conditions and is highly addictive, that low tar and light cigarettes are not less harmful than regular cigarettes and cause some of the same detrimental health conditions that regular cigarettes cause, that tobacco companies intentionally designed cigarettes to make them more addictive, and that secondhand smoke causes lung cancer and coronary heart disease in adults who do not smoke. The court further ordered that the parties are to engage in discussions with the court, regarding implementation of the corrective statements. As of October 17, 2013, those discussions were still ongoing. In January 30, 2013, defendants appealed to the U.S. Court of Appeals for the District of Columbia Circuit the district court's November 2012 order on the text of the corrective statements. Defendants also filed a motion to hold the appeal in abeyance pending the completion of related proceedings in the district court regarding the implementation of the corrective statements. On February 15, 2013, the Court of Appeals granted the defendants' motion to hold the case in abeyance pending the District Court's resolution of corrective statement implementation issues. The mediation process on implementation issues is ongoing. The District Court has not entered an amended final judgment. Reynolds American has stated in its Form 10-K filed with the SEC for the calendar year 2012 that if the corrective statements remedy is implemented, Reynolds Tobacco would incur significant compliance costs and there could be an adverse effect on product sales.

Tobacco-Related Antitrust Cases

Indirect Purchaser Suits. Approximately 30 antitrust suits were filed in 2000 and 2001 on behalf of putative classes of consumers in various state courts against cigarette manufacturers. The suits all alleged that the defendants entered into agreements to fix the wholesale prices of cigarettes in violation of state antitrust laws which permit indirect purchasers, such as retailers and consumers, to sue under price fixing or consumer fraud statutes. More than 20 states permit such suits. Four indirect purchaser suits, in New York, Florida, New Mexico and Michigan, thereafter were dismissed by courts in those states. The actions in all other states, except for Kansas, were either voluntarily dismissed or dismissed by the courts.

In the Kansas case, *Smith v. Philip Morris Cos., Inc*., the District Court of Seward County, Kansas certified a class of Kansas indirect purchasers in 2002. In July 2006, the court issued an order confirming that fact discovery was closed, with the exception of privilege issues that the court determined, based on a court special master's report, justified further fact discovery. In October 2007, the court denied all of the defendants' privilege claims, and the Kansas Supreme Court thereafter denied a petition seeking to overturn that ruling. On March 23, 2012, The District Court of Seward County granted the defendants' motions for summary judgment dismissing the Kansas suit. Plaintiff's motion for reconsideration was denied. On July 18, 2012, plaintiff filed a notice of appeal to the Court of Appeals for the State of Kansas, and in August 2012 the defendants cross-appealed the trial court's class certification decision. Oral argument is set for December 11, 2013.

For a discussion of *VIBO* and other litigation involving claims of antitrust violations, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT—Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

Other Litigation

By way of example only, and not as an exclusive or complete list, the following are additional types of tobacco-related litigation which the tobacco industry is also the target of: (a) asbestos contribution cases, where asbestos manufacturers and related parties seek contribution or reimbursement where asbestos claims were allegedly caused in whole or in part by cigarette smoking, (b) patent infringement claims, (c) "ignition propensity cases" where wrongful death actions contend fires caused by cigarettes led to other individuals' deaths, (d) "filter cases" which mostly have been filed against Lorillard for alleged exposure to asbestos fibers there were incorporated into filter material used in one brand of cigarettes manufactured by Lorillard over 50 years ago, (e) claims related to smokeless tobacco products, (f) ERISA claims, and (g) employment litigation claims.

Defenses

The PMs believe that they have valid defenses to the cases pending against them as well as valid bases for appeal should any adverse verdicts be returned against them. While PMs have indicated their intent to defend vigorously all tobacco products liability litigation, it is not possible to predict the outcome of any litigation. Litigation is subject to many uncertainties. Plaintiffs have prevailed in several cases, as noted herein, and it is possible that one or more of the pending actions could be decided unfavorably as to the PMs or the other defendants. According to Altria's Form 10-Q filed with the SEC for the nine-month period ended September 30, 2013, as of October 21, 2013, 2 Engle Progeny Cases against Philip Morris were scheduled for trial through the end of 2013 and no individual smoking and health cases against Philip Morris were scheduled for trial through the end of 2013. The PMs may enter into discussions in an attempt to settle particular cases if the PMs believe it is appropriate to do so.

Some plaintiffs have been awarded damages from cigarette manufacturers at trial. While some of these awards have been overturned or reduced, other damages awards have been paid after the manufacturers have exhausted their appeals. These awards and other litigation activities against cigarette manufacturers and health issues related to tobacco products also continue to receive media attention. It is possible, for example, that the 2006 verdict in *United States of America v. Philip Morris*, which made many adverse findings regarding the conduct of the defendants, could form the basis of allegations by other plaintiffs or additional judicial findings against cigarette manufacturers. In addition, the U.S. Supreme Court ruling in *Good v. Altria* could result in further "lights" litigation. Any such developments could have material adverse effects on the ability of the PMs to prevail in smoking and health litigation and could influence the filing of new suits against the PMs.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the examination or analysis by the Corporation of the court records of the cases mentioned or of any other court records. It is based on SEC filings by the OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2013 Bonds are referred to the reports filed with the SEC by the OPMs and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filings, Reynolds American has stated that the possibility of material losses related to tobacco litigation is more than remote, but that generally, it is not possible to predict the outcome of the litigation or reasonably estimate the amount or range of any possible loss. This OPM has disclosed that notwithstanding the quality of defenses available to it and its affiliates in tobacco-related litigation matters, it is possible that its consolidated results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending or future litigation matters or difficulties in obtaining the bonds required to stay execution of judgments on appeal. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could materially adversely affect the business of the PMs and the market for or prices of securities such as the Series 2013 Bonds payable from tobacco settlement payments made under the MSA.

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APPENDIX H

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 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.

[With respect to the Series A Indenture] "**Beneficiaries**" means Bondholders, the owner of the Residual Certificate and, to the extent specified in the related Series Supplement or other Supplemental Indenture, the party or parties to Swap Contracts, Ancillary Contracts and Subordinate Indebtedness.

[With respect to the Series B Indenture] "Beneficiaries" means Bondholders, the owner of the 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.

[With respect to the Series A Indenture] "**Bond Purchase Agreement**" means collectively the Bond Purchase Agreements by and between the Corporation and the underwriters of the applicable series of the Series A Bonds, relating to the sale of the Series A Bonds, in such form as the parties thereto shall agree.

[With respect to the Series B Indenture] "**Bond Purchase Agreement**" means collectively the Bond Purchase Agreements by and between the Corporation and the underwriters of the applicable series of the Series B Bonds, relating to the sale of the Series B 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 the applicable obligations issued as summarized in the caption herein entitled "THE INDENTURE – Bonds of the Corporation."

“**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.

“**Closing Date**” with respect to the Series A Indenture means June 19, 2003 and with respect to the Series B Indenture means December 2, 2003.

“**Code**” or “**Tax Code**” means the Internal Revenue Code of 1986, as amended.

“**Collateral**” means the Series A Collateral or the Series B Collateral, as applicable with respect to the Series A Indenture and the Series B Indenture, respectively.”

“**Complementary Legislation**” means sections 480-b, 481(1)(c) and 1846(a-1) of the Tax Law of the State.

[With respect to the Series A Indenture] “**Contingency Contract**” means (i) with respect to the Series A Bonds, that certain Tobacco Settlement Financing Corporation Contingency Contract, dated as of June 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.

[With respect to the Series B Indenture] “Contingency Contract” means: (i) with respect to the Series B 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, 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 Distribution Date, to the extent so characterized 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, (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 (FHNLB) 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) solely 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.

"**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 Reserve Account and any other debt service reserves, (5) fees and costs for Ancillary Contracts, 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.

"**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.

[With respect to the Series A Indenture] "**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, 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 Contingency 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 Series A Indenture.

[With respect to the Series B Indenture] "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 Contingency Contract, costs incurred to preserve the tax-exempt status of any Tax-Exempt Bonds, costs related to the enforcement rights with respect to the Series B Indenture, the MSA, the Sale Agreement, the Qualifying Statute, the Complementary Legislation or the Bonds and all other Operating Expenses so identified in the Series B 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.

[With respect to the Series A Indenture] "**Outstanding**" means, with respect to bonds, all Bonds issued under the Series A Indenture, excluding: (i) Series A Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against a principal payment; (ii) Series A Bonds that have been paid; (iii) Bonds that have become due and for the payment of which money has been duly provided; (iv) Bonds for which (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.

[With respect to the Series B Indenture] "Outstanding" means with respect to bonds, all Bonds issued under the Series B 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 Series B 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 Series B 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 Series B 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.

[With respect to the Series A Indenture] "**Permitted Indebtedness**" means (i) Bonds, (ii) borrowings to pay Operating Expenses as described in the Indenture, (iii) bonds or other obligations payable solely from Unsold Settlement Payments, (iv) Subordinate Indebtedness, and (v) 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.

[With respect to the Series B Indenture] "Permitted Indebtedness" means: (i) Bonds, (ii) borrowings to pay Operating Expenses as described in the Series B Indenture, (iii) bonds or other obligations payable solely from Previously Purchased and Pledged Settlement Payments and Unsold Settlement Payments, (iv) indebtedness secured by specified assets of the Corporation not subject to the lien of the Series B 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.

[With respect to the Series A Indenture] "**Pledged Settlement Payments**" means the "pledged tobacco revenues," as defined in the Act, being such portion of the State's Share constituting tobacco settlement payments sold to the Corporation pursuant to Section 4 of the Act and pursuant to the Series A Sale Agreement, and assigned and pledged pursuant to Section 2.01, consisting of (i) fifty percent (50%) of the annual payments and strategic contribution fund payments (as such terms are defined in the MSA), and of all adjustments to prior payments, 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 the Closing Date in the Disputed Payments Account as defined in the Escrow Agreement under the MSA), and (ii) 50% of all Lump Sum Payments (other than the payment of funds to the State to resolve claims relating to amounts held as of the Closing Date in the Disputed Payments Account as defined in the Escrow Agreement under the MSA) received at any time commencing with the Closing Date.

[With respect to the Series B Indenture] "**Pledged Settlement Payments**" means the "pledged tobacco revenues," as defined in the Act, being such portion of the State's Share constituting tobacco settlement payments sold to the Corporation pursuant to Section 4 of the Act and pursuant to the Series B Sale Agreement, and assigned and pledged pursuant to Section 2.01, consisting of (i) fifty percent (50%) of the annual payments and strategic contribution fund payments (as such terms are defined in the MSA), and of all adjustments to prior payments, received on and after January 1, 2004, and (ii) 50% of all Lump Sum Payments received at any time commencing with the Closing Date, less, with respect to either (i) or (ii) above, the Unsold Settlement Payments.

"**Portion of the State's Share**" means fifty percent (50%) of the State's Share (other than the payment of funds to the State to resolve claims relating to amounts held as of the Closing Date in the Disputed Payments Account as defined in the Escrow Agreement under the MSA).

"**Previously Purchased and Pledged Settlement Payments**" means, the "Pledged Settlement Payments" as defined in the Series A Sale Agreement, which were purchased by the Corporation pursuant thereto, consisting of (i) fifty percent (50%) of annual payments and strategic contribution fund payments (as such terms are defined in the MSA), and of all adjustments to prior payments, 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 the Closing Date of the Series 2003A Bonds in the Disputed Payments Account as defined in the Escrow Agreement under the MSA) and (ii) fifty percent (50%) of any lump sum payment (other than the payment of funds to the State to resolve claims relating to amounts held as of the date of initial delivery of the Series 2003A Bonds in the Disputed Payments Account as defined in the Escrow Agreement under the MSA) received at any time commencing with the date of initial delivery of the Series 2003A Bonds from a Participating Manufacturer which results in, or is due to, a release of that Participating Manufacturer from all or a portion of such payment obligations due on and after January 1, 2004 under the MSA.

"**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; 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 A Collateral"** has the meaning as set forth herein under the caption "THE INDENTURES – Security and Pledge – Series A Indenture."

"**Series B Collateral"** has the meaning as set forth herein under the caption "THE INDENTURES – Security and Pledge – Series B Indenture."

"**Series Supplement**" means a Supplemental Indenture as identified above under the caption: "Bonds of the Corporation."

"**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.

"**Subordinate Indebtedness**" means, with respect to the Series A Indenture, any indebtedness of the Corporation secured by a pledge of the Collateral which conforms to the requirements as summarized above under the caption "Subordinate Indebtedness."

"**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 above under "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, the Contract, the Indenture and the Bond Purchase Agreement.

[With respect to the Series A Indenture] "**Unsold Settlement Payments**" means, as defined in the Series A Sale Agreement, the right, title and interest to the revenue (including but not limited to all payments required to be made under the MSA) that the State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) has a right to receive from time to time under the MSA, other than the Pledged Settlement Payments.

[With respect to the Series B Indenture] "**Unsold Settlement Payments**" means, whenever received by the State, (i) payment of funds to the State to resolve claims relating to amounts held as of the Closing Date of the Series 2003A Bonds in the Disputed Payments Account as defined in the Escrow Agreement under the MSA, and (ii) 50% of the annual payments (as such term is defined in the MSA), and of all adjustments to prior payments, owed to the State under the MSA 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 amount to constitute Pledged Settlement Payments).

THE INDENTURES

The following summary describes certain terms of the Series A Indenture pursuant to which the Series 2013A Bonds will be issued and the Series B Indenture pursuant to which the Series 2013B Bonds will be issued. The terms of the Series A Indenture and the Series B Indenture are very alike. Where provisions summarized under this heading are different in each indenture, the alternate text has been set forth. References to "the Indenture" mean the Series A Indenture or the Series B Indenture, as applicable, references to "the Trustee" mean the Series A Trustee or the Series B Trustee, as applicable, and references to "the Sale Agreement" mean the Series A Sale Agreement or the Series B Sale Agreement, as applicable. The terms "Bond" or "Bonds" should be understood as bonds issued under the applicable Indenture. 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 2013 Bonds. See "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS" or "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS" for further descriptions of certain terms and provisions of the Series A Bonds or Series B Bonds, as applicable.

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

Series A Indenture

Pursuant to the Series A 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, all of the Corporation's right, title and interest, whether now owned or hereafter acquired, in, to and under all of the following property (subject to the next two succeeding sentences) constituting the "Series A Collateral": (a) the

Pledged Revenues (including all Pledged Settlement Payments and payments on Contingency 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 Contingency Contracts, including the representations, warranties and covenants of the State in the Sale Agreement and in Contingency Contracts, 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 Unsold Settlement Payments, (ii) 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, (iii) any right or power reserved to the Corporation pursuant to the Act or other law, (iv) any Defeasance Collateral held by the Trustee for the benefit of Defeased Beneficiaries in accordance with the Defeasance provisions of the Indenture, and (v) as to any Series of Bonds identified in a Series Supplement, any other property or interest explicitly excluded from Series A 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 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 State (or any future assignee or any 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 Unsold Settlement Payments and, likewise, neither the Corporation nor the State (nor any future assignee or 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 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 Series A Collateral is to be pledged and a security interest therein granted by the Corporation to secure the payment of Bonds, Swap Contracts, Ancillary Contracts and Subordinate Indebtedness, 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).

Series B Indenture

Pursuant to the Series B 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, all of the Corporation's right, title and interest, whether now owned or hereafter acquired, in, to and under all of the following property (subject to the next two succeeding sentences) constituting the "**Series B Collateral**": (a) the Pledged Revenues (including all Pledged Settlement Payments and payments on Contingency 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 Contingency Contracts, including the representations, warranties and covenants of the State in the Sale Agreement and in Contingency Contracts, 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, any other property or interest explicitly excluded from Series B 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 and 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 A Trustee (or any future assignee or any future successor of the Series A Trustee) to receive the Previously Purchased and Pledged Settlement Payments and the right of the State 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 A Trustee (nor any future assignee or future successor of the Series A Trustee) nor the State (nor any future assignee or any 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 Series B Collateral is to be pledged and a security interest therein granted by the Corporation 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.

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 duly 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 in 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 with 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 Series A Indenture or the Series B Indenture, as applicable, 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) respectively, the Series A Bonds or Series B Bonds and (2) other Series of Bonds, but solely as 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 2003A Bonds and 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 "SECURITY AND SOURCE OF PAYMENTS FOR THE SERIES 2013A BONDS" and "SECURITY AND SOURCE OF PAYMENTS FOR THE SERIES 2013B BONDS." (Section 3.01)

Series A Indenture Subordinate Indebtedness

Pursuant to the Series A Indenture (but not the Series B Indenture), the Corporation may incur Subordinate Indebtedness, not constituting Bonds under the Series A Indenture for any purpose, pursuant to the terms of any Supplemental Indenture, provided, that (a) payment of principal of and interest on such Subordinate Indebtedness shall be treated under the Series A Indenture as Junior Payments, and (b) failure by the Corporation to pay the principal of or interest on such Subordinate Indebtedness when due shall not constitute an Event of Default under the Series A Indenture so long as there shall be any Series A Bonds Outstanding. (Section 3.05)

Accounts

There is established within the Indenture the Pledged Revenues Account, the 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, redeemed or, with respect to the Series A Indenture, defeased, and not previously so applied or credited. With respect to the Series B Indenture, 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 20 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. Unless otherwise specified in the Indenture or by Series Supplement: (a) if less than all the Outstanding Bonds of like Series and Maturity Date are to be redeemed, the particular Bonds to be redeemed shall be selected by the Trustee by such method as it shall deem fair and appropriate, and which may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination, and (b) the 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.

(f) Notwithstanding any other provision of the Indenture, the obligation to remit the Rebate Requirement to the United States and to comply with all other requirements of the Tax Covenants provisions of the Indenture and the Tax Certificate shall survive the defeasance or payment in full of the Tax-Exempt Bonds. (Section 4.09)

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 2013A BONDS – Series A Flow of Funds" and paragraph (B)(vi) under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS – Series B Flow of Funds" or the preceding sentence of this paragraph to the contrary, between April 15 and the next Distribution Date 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 Debt Service scheduled to be paid on such next 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, Ancillary Contracts and, with respect to Series A Indenture, Subordinate Indebtedness. 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.

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 Sale 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 by 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, pursuant to the requirements of the respective Indenture described herein under paragraph (B)(vi) under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013A BONDS – Series A Flow of Funds" and paragraph (B)(vi) under the caption "SECURITY AND SOURCES OF PAYMENT FOR THE SERIES 2013B BONDS – Series B Flow of Funds", 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 Contingency 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 and Beneficiaries 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 Contingency 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 Contingency Contract, such payment to be received (subject to the terms of the related Contingency Contract) in any event on or before such Distribution Date, and any amounts paid pursuant to such Contingency 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 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, Ancillary Contracts and, with respect to the Series A Indenture, Subordinate Indebtedness, 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 and any other sale agreement with the State, (including the issuance of obligations secured, with respect to the Series A Indenture, by Unsold Settlement Payments or, with respect to the Series B Indenture, 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 A Bonds or Series B Bonds, as applicable, 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 thereby become vested with all the property, rights, powers and duties under the Indenture, without any further act or conveyance and 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

Series A Indenture

Pursuant to the Series A Indenture, the Trustee, on or prior to each Distribution Date for a Series of Bonds, shall deliver to the Holders of such Bonds 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)

Series B Indenture

Pursuant to the Series B Indenture, 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 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.

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 or government authority for the purpose of commencing or sustaining a case against the Corporation under any federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Corporation or 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 by the owner of any Bond will be irrevocable and bind all future record and beneficial owners thereof. (Section 8.01)

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 agreements 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% in principal amount 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 and Governing Law

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) The Indenture shall be construed in accordance with the laws of the State, without reference to its conflict of law provisions, and the obligations, rights and remedies of the parties hereunder shall be determined in accordance with such laws (section 10.05)

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 or, (8) with respect to the Series A Indenture, provide provisions regarding Subordinate Indebtedness, 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), the Indenture and the Sale Agreement. (Section 10.02)

Supplements and Amendments to Contingency Contracts

A Contingency 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 Contingency Contract that may be defective or inconsistent with any other provisions contained in the Indenture or in such Contingency 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 Contingency 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 decrease, with respect to the Series B Indenture without the consent of the Bondholders adversely affected thereby, the amount of any payment to be made under any Contingency 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 Contingency 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 SERIES A SALE AGREEMENT AND SERIES B SALE AGREEMENT

The following summary describes certain terms of each of the Series A Sale Agreement and the Series B 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 Series A Sale Agreement or Series B Sale Agreement, as applicable. The term "Sale Agreement" refers to each individually. References to "Indenture" mean the Series A Indenture or the Series B Indenture, as applicable.

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 2013 Bonds and the applicable Residual Certificate in accordance with and subject to the terms and conditions of the applicable Series.

The Series A Sale Agreement

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 Series A 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 State (or any future assignee or any future purchaser of any portion of the Unsold Settlement Payments) to receive the Unsold 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 Unsold Settlement Payments and, likewise, neither the Corporation 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 Unsold Settlement Payments from the Pledged Settlement Payments. (Section 2.01)

The Series B Sale Agreement

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 Series B 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 (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 to receive Unsold 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 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.

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 Corporation. 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 sale of the portion of the State's Share and 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 sale of the portion of the State's Share and the consummation by the Corporation and 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 A Bonds, (2) seeking to prevent the issuance of the Series A 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 A 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 applicable Residual Certificate, (3) any characterization of the Corporation or its bonds for purposes of accounting, taxation or securities regulation, (4) the pledge of other funds or assets of the Corporation, including the Contingency 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 in accordance with the Indenture 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 the 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 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 pledges and agrees with the Corporation, and the Corporation is authorized to include such pledge 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 Beneficiaries, or (c) in any way impair the rights and remedies of the Beneficiaries 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 Beneficiaries, 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 Beneficiaries. 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 officer 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 applicable Series of the Series 2013 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 applicable Series of the Series 2013 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 such 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 applicable Series of the Series 2013 Bonds shall at any time be used directly or indirectly to acquire securities or obligations the acquisition or holding of which would cause any such 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 applicable Series of the Series 2013 Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code. (Section 4.02)

Residual Certificate, Unsold 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 if the Trustee shall receive, in the case of the Series A Sale Agreement, Unsold Settlement Payments or, in the case of the Series B Sale Agreement, 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 in the case of the Series A Sale Agreement or of the State or the Series A Trustee, in the case of the Series B Sale Agreement. (Section 5.02)

Bonds Not Debt of State

The applicable Series of the Series 2013 Bonds must be issued in the name of the Corporation. Such 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. Such Bonds and any Ancillary Bond Facility must contain a recital on their face or in another prominent place to the effect that, pursuant to the Act, neither any such 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 such 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 Contingency 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 2013A 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 with respect to the Series A Sale Agreement, and with the consent the holders of a majority of principal amount of outstanding Series B Bonds, with respect to the Series B Sale Agreement, 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 I
PROPOSED FORMS OF OPINIONS OF BOND COUNSEL AND CO-BOND COUNSEL

December 12, 2013

Tobacco Settlement Financing Corporation
New York, New York

Members:

As [Bond Counsel][Co-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 $660,090,000 aggregate principal amount of its Asset-Backed Revenue Bonds, Series 2013A (State Contingency Contract Secured) (the "Series 2013A 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 2013A Bonds are authorized and issued pursuant to the Act and a resolution of the Corporation adopted November 7, 2013, and are issued pursuant to an indenture, dated as of June 1, 2003 (the "General Indenture"), and series supplement thereto, dated as of December 1, 2013 (together with the General Indenture, the "Indenture"), each by and between the Corporation and The Bank of New York Mellon, as trustee (the "Trustee"). 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 2013A Bonds and other bonds heretofore issued under the General Indenture, only on the terms and conditions set forth in the General 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 2013A 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 2013A Bonds from gross income under Section 103 of the Code.

The Series 2013A Bonds are secured by a pledge of the Contingency Contract dated as of June 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 Bonds outstanding under the Indenture. We have relied upon the opinion of the Attorney General as to the enforceability of each of the Sale Agreement and the Contract against the State and upon the opinion of Carter Ledyard & Milburn LLP as to the enforceability of the Indenture against the Trustee, each in accordance with its respective terms.

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 Sale Agreement, to perform the duties and obligations of the Corporation under the Indenture, the Contract and the Sale Agreement, and to issue the Series 2013A Bonds.

3. Each of the 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 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 the claim, to Unsold Settlement Payments, of the State or the trustee under the indenture, dated as of December 1, 2003, between the Corporation and The Bank of New York Mellon, as supplemented and amended in accordance with its terms.

6. The Series 2013A 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 2013A 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 2013A Bond be payable out of any funds or assets other than the Collateral pledged therefor.

8. Under existing statutes and court decisions, (i) interest on the Series 2013A Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2013A 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 adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. The original issue discount on the Series 2013A Bonds, if any, that has accrued and is properly allocable to any owner thereof is excluded from gross income for federal income tax purposes to the same extent as other interest on the 2013A Bonds.

9. Under the Act, interest on the Series 2013A Bonds is exempt from personal income taxes imposed by the State and its political subdivisions, including The City of New York.

We express no opinion regarding any other federal or state tax consequences with respect to the Series 2013A Bonds. We render our opinions under existing statutes and court decisions as of the date hereof, and we assume no obligation to update, revise or supplement our opinions after such date to reflect any future action taken or not taken, or any facts or circumstances that may hereafter come to our attention, or any changes in law or interpretation thereof that may hereafter occur, or for any other reason. 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 2013A Bonds, or under state and local tax law. We undertake no responsibility for the accuracy, completeness or fairness of any official statement or other offering materials relating to the Series 2013A Bonds and we express no opinion herein relating thereto.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2013A Bonds, the Indenture and the 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,

December 12, 2013

Tobacco Settlement Financing Corporation
New York, New York

Members:

As [Bond Counsel][Co-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 $565,655,000 aggregate principal amount of its Asset-Backed Revenue Bonds, Series 2013B (State Contingency Contract Secured) (the "Series 2013B 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 2013B Bonds are authorized and issued pursuant to the Act and a resolution of the Corporation adopted November 7, 2013, and are issued pursuant to an indenture, dated as of December 1, 2003, as supplemented by a supplemental indenture dated as of November 1, 2004 (collectively, the "General Indenture"), and a series supplement thereto, dated as of December 1, 2013 (together with the General Indenture, the "Indenture"), each by and between the Corporation and The Bank of New York Mellon, as trustee (the "Trustee"). 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 2013B Bonds and other bonds heretofore issued under the General Indenture, only on the terms and conditions set forth in the General 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 2013B 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 2013B Bonds from gross income under Section 103 of the Code.

The Series 2013B 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 Bonds outstanding under the Indenture. We have relied upon the opinion of the Attorney General as to the enforceability of each of the Sale Agreement and the Contract against the State and upon the opinion of Carter Ledyard & Milburn LLP as to the enforceability of the Indenture against the Trustee, each in accordance with its respective terms.

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 Sale Agreement, to perform the duties and obligations of the Corporation under the Indenture, the Contract and the Sale Agreement, and to issue the Series 2013B Bonds.

3. Each of the 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 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 the claim of the State or the Series 2003A Trustee to Unsold Settlement Payments and to Previously Purchased and Pledged Settlement Payments.

6. The Series 2013B 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 2013B 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 2013B Bond be payable out of any funds or assets other than the Collateral pledged therefor.

8. Under existing statutes and court decisions, (i) interest on the Series 2013B Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Code, and (ii) interest on the Series 2013B 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 adjusted current earnings of certain corporations for purposes of calculating the alternative minimum tax imposed on such corporations. The original issue discount on the Series 2013B Bonds, if any, that has accrued and is properly allocable to any owner thereof is excluded from gross income for federal income tax purposes to the same extent as other interest on the 2013B Bonds.

9. Under the Act, interest on the Series 2013B Bonds is exempt from personal income taxes imposed by the State and its political subdivisions, including The City of New York.

We express no opinion regarding any other federal or state tax consequences with respect to the Series 2013B Bonds. We render our opinions under existing statutes and court decisions as of the date hereof, and we assume no obligation to update, revise or supplement our opinions after such date to reflect any future action taken or not taken, or any facts or circumstances that may hereafter come to our attention, or any changes in law or interpretation thereof that may hereafter occur, or for any other reason. 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 2013B Bonds, or under state and local tax law. We undertake no responsibility for the accuracy, completeness or fairness of any official statement or other offering materials relating to the Series 2013B Bonds and we express no opinion herein relating thereto.

In rendering this opinion, we are advising you that the enforceability of rights and remedies with respect to the Series 2013B Bonds, the Indenture and the 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,

APPENDIX J

BONDS TO BE REFUNDED

Series	Maturity Date	Interest Rate	Par Amount	Call Date	Call Price
2003A-1C	June 1, 2018	4.200%	$12,385,000	12/20/2013	100%
2003A-1C	June 1, 2019	4.250	11,825,000	12/20/2013	100
2003A-1C	June 1, 2019	5.500	81,005,000	12/20/2013	100
2003A-1C	June 1, 2020	4.000	1,570,000	12/20/2013	100
2003A-1C	June 1, 2020	5.250	184,650,000	12/20/2013	100
2003A-1C	June 1, 2021	4.000	7,445,000	12/20/2013	100
2003A-1C	June 1, 2021	5.250	190,715,000	12/20/2013	100
2003A-1C	June 1, 2022	4.125	4,815,000	12/20/2013	100
2003A-1C	June 1, 2022	5.250	205,810,000	12/20/2013	100
2003B-1C	June 1, 2019	5.500	135,500,000	12/20/2013	100
2003B-1C	June 1, 2020	4.700	8,885,000	12/20/2013	100
2003B-1C	June 1, 2020	5.500	177,415,000	12/20/2013	100
2003B-1C	June 1, 2021	5.500	199,690,000	12/20/2013	100
2003B-1C	June 1, 2022	5.500	81,775,000	12/20/2013	100

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