**NEW ISSUE** **BOOK-ENTRY ONLY**

*In the opinion of Kutak Rock LLP, Transaction Counsel, under existing federal and Minnesota laws, regulations, rulings and judicial decisions and assuming the accuracy of certain representations and continuing compliance with certain covenants, interest on the Tax-Exempt Series 2011B Bonds is excludable from gross income for federal income tax purposes and from taxable net income of individuals, estates or trusts for Minnesota income tax purposes; is includable in the income of corporations and financial institutions for purposes of the Minnesota franchise tax; and is not a specific tax preference item for purposes of the federal alternative minimum tax or the Minnesota alternative minimum tax applicable to individuals, estates and trusts, except that such interest must be included in the "adjusted current earnings" of certain corporations for purposes of calculating federal alternative minimum taxable income. The interest to be paid on the Taxable Series 2011A Bonds is includable in gross income of owners thereof for federal income tax purposes, in taxable net income of individuals, trusts and estates for Minnesota income tax purposes, and in the income of corporations and financial institutions for purposes of the Minnesota franchise tax. For a discussion of tax matters see "TAX MATTERS" herein.*

# $756,955,000
# TOBACCO SECURITIZATION AUTHORITY
## Minnesota Tobacco Settlement Revenue Bonds, Series 2011
## Consisting of:

**$74,685,000**
**Minnesota Tobacco Settlement Revenue Bonds,**
**Taxable Series 2011A**

**$682,270,000**
**Minnesota Tobacco Settlement Revenue Bonds,**
**Tax-Exempt Series 2011B**

The Minnesota Tobacco Settlement Revenue Bonds, Series 2011 are comprised of two series – the Taxable Series 2011A Bonds, which are taxable fixed amortization bonds (the "**Taxable Series 2011A Bonds**"), and the Tax-Exempt Series 2011B Bonds, which are tax-exempt fixed amortization bonds (the "**Tax-Exempt Series 2011B Bonds**", and together with the Taxable Series 2011A Bonds, the "**Series 2011 Bonds**").

The Series 2011 Bonds are being issued by the Tobacco Securitization Authority (the "**Authority**"), a body corporate and politic and a public instrumentality of, but having a legal existence independent and separate from, the State of Minnesota (the "**State**"), and established under Minnesota Statutes, Section 16A.98 (as amended from time to time, the "**Act**"). The Series 2011 Bonds are being issued pursuant to the Indenture, dated as of November 1, 2011 (the "**Indenture**"), by and between the Authority and U.S. Bank National Association, as Trustee (the "**Trustee**").

Interest on the outstanding principal amount of the Series 2011 Bonds will be payable on each March 1 and September 1, commencing March 1, 2012. Interest on the Series 2011 Bonds payable on or prior to September 1, 2013 will be capitalized. The Series 2011 Bonds mature on March 1 in the years and in the aggregate principal amounts as set forth on the inside front cover. The Series 2011B Bonds are subject to redemption prior to maturity under certain circumstances as described under "THE SERIES 2011 BONDS" herein. Failure to pay interest when due or the principal of any Series 2011 Bonds when due (including Sinking Fund Installments when due) will constitute an Event of Default under the Indenture.

The Settlement Agreement (the "**Minnesota Agreement**") was entered into by 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 "**Settling Defendants**") and the State in May 1998 (as amended by the Agreement of Amendment to Settlement Agreement, dated as of June 1, 2001, by and among the State and the Settling Defendants), in settlement of certain smoking-related litigation. The Minnesota Agreement is separate and distinct from the Master Settlement Agreement entered into on November 23, 1998 (the "**MSA**"), among the attorneys general of 46 states (not including Minnesota), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**MSA Settling States**") and Philip Morris, Reynolds Tobacco, B&W and Lorillard (collectively, the "**MSA OPMs**"). Pursuant to a purchase and sale agreement, dated as of November 1, 2011 (the "**Sale Agreement**"), between the State and the Authority, the State will sell to the Authority, and the Authority will purchase from the State, (i) all tobacco settlement revenues paid or payable to the State on and after July 1, 2013 and required to be made by the Settling Defendants to the State, and the State's rights to receive such tobacco settlement revenues (consisting of Annual Payments, as defined herein), and (ii) partial and lump sum payments, if any, whenever received, that are allocable to Annual Payments that are payable on or after July 1, 2013 in satisfaction of all or a portion of the Annual Payments, and the State's rights to receive such payments. Such payments are collectively referred to herein as the "**Pledged Settlement Payments**", as more fully described herein. Upon the issuance of the Series 2011 Bonds, the Settling Defendants will be irrevocably instructed by the State to remit all Pledged Settlement Payments directly to the Trustee. The State will use the net sale proceeds of the Series 2011 Bonds to refund certain of the State's General Obligation State Various Purpose Bonds and other payment obligations.

The Series 2011 Bonds are special limited revenue obligations of the Authority and are secured solely by a pledge under the Indenture of (i) the Pledged Settlement Payments and all fees, charges, payments, investment earnings and other income and receipts, and (ii) all amounts and assets on deposit in the Pledged Accounts (defined herein) established under the Indenture, including the Debt Service Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account (the amounts set forth in the clauses (i) and (ii) as more fully described herein are collectively referred to herein as the "**Pledged Revenues**"), and (iii) all other property pledged for the payment of the Series 2011 Bonds under the Indenture. The Indenture provides for the release to the State of all "**Residual Revenues**" consisting of all Pledged Revenues deposited in the Residual Account maintained under the Indenture after prior funding of certain operating expenses and other debt-related payments described in the Indenture.

**Payments with respect to the Series 2011 Bonds are dependent upon receipt of the Pledged Settlement Payments. The Authority has no assets available for the payment of the Series 2011 Bonds other than the Collateral (as defined herein) pledged under the Indenture.**

The amount of Pledged Settlement Payments received is dependent on many factors, including future domestic cigarette consumption, the financial capability of the Settling Defendants, litigation affecting the Settling Defendants and the tobacco industry generally, and federal, state and local regulation affecting the tobacco industry generally. Payments by the Settling Defendants under the Minnesota Agreement are subject to the Inflation Adjustment and the Volume Adjustment, each as described herein, but are not subject to a non-participating manufacturers adjustment (the "**NPM Adjustment**"), as more fully described herein. See "SUMMARY OF THE MINNESOTA AGREEMENT" herein. Bondholders should assume that future Pledged Settlement Payments may be reduced.

See "RISK FACTORS" for a discussion of certain factors that should be considered in connection with an investment in the Series 2011 Bonds.

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**See the Inside Front Cover for Maturities, Principal Amounts, Interest Rates, Prices or Yields, and CUSIPs.**

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**Pursuant to the Act, the State is not liable on the Series 2011 Bonds and the Series 2011 Bonds shall not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the meaning of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No owner of any Series 2011 Bond shall have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Series 2011 Bonds.**

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

*The Series 2011 Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Kutak Rock LLP, Omaha, Nebraska, Transaction Counsel. Certain legal matters will be passed upon for the State by the Attorney General of the State. Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, New York, New York, as Underwriters' Counsel. It is expected that the Series 2011 Bonds will be available for delivery in book-entry only form through The Depository Trust Company in New York, New York, on or about November 29, 2011.*

**Barclays Capital**

**BofA Merrill Lynch** **Jefferies & Company**
**Citi** **Ramirez & Co., Inc.** **RBC Capital Markets**
**U.S. Bancorp** **Wells Fargo Securities**

November 17, 2011

## MATURITIES, PRINCIPAL AMOUNTS, INTEREST RATES, PRICES OR YIELDS, AND CUSIPS

**$756,955,000 Minnesota Tobacco Settlement Revenue Bonds, Series 2011**

**Dated: Date of Delivery**

**Expected Ratings:**

| | |
|---|---|
| **Standard & Poor's:** | A (Series 2011 Bonds maturing March 1, 2014 through March 1, 2022)<br>A- (Series 2011 Bonds maturing March 1, 2023 and thereafter) |
| **Fitch**: | BBB+ |

**$74,685,000 Taxable Series 2011A Serial Bonds**

| Maturity (March 1) | Principal Amount | Interest Rate | Price | CUSIP* (88880CA) |
|---|---|---|---|---|
| 2014 | $36,900,000 | 2.643% | 100% | A1 |
| 2015 | 37,785,000 | 3.093 | 100 | B9 |

**$682,270,000 Tax-Exempt Series 2011B Serial Bonds**

| Maturity (March 1) | Principal Amount | Interest Rate | Yield | CUSIP* (88880CA) |
|---|---|---|---|---|
| 2016 | $25,255,000 | 5.00% | 2.15% | P8 |
| 2016 | 5,000,000 | 3.00 | 2.15 | C7 |
| 2017 | 28,190,000 | 5.00 | 2.63 | Q6 |
| 2017 | 3,500,000 | 4.00 | 2.63 | D5 |
| 2018 | 32,410,000 | 5.00 | 3.07 | E3 |
| 2019 | 30,015,000 | 5.00 | 3.48 | R4 |
| 2019 | 2,925,000 | 3.50 | 3.48 | F0 |
| 2020 | 34,300,000 | 5.00 | 3.78 | G8 |
| 2021 | 32,610,000 | 5.00 | 3.93 | S2 |
| 2021 | 3,175,000 | 4.00 | 3.93 | H6 |
| 2022 | 37,480,000 | 5.00 | 4.15 | J2 |
| 2023 | 38,550,000 | 5.25 | 4.48† | K9 |
| 2024 | 40,720,000 | 5.25 | 4.63† | L7 |
| 2025 | 43,165,000 | 5.25 | 4.76† | M5 |
| 2026 | 39,640,000 | 5.25 | 4.88† | T0 |
| 2026 | 6,075,000 | 4.85 | 4.88 | N3 |

**$279,260,000 5.25% Tax-Exempt Series 2011B Term Bonds due March 1, 2031; Price: 99.50% to Yield 5.291%; CUSIP*: 88880CAU7**

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† Priced at the stated yield to the March 1, 2022 optional redemption date at a redemption price of 100%.

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 AUTHORITY, 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 AUTHORITY, 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 Authority, the State, Global Insight (defined herein) and other sources, all of which are believed to be reliable. The information contained under the caption "SUMMARY OF THE GLOBAL INSIGHT REPORT" and in "APPENDIX B – GLOBAL INSIGHT REPORT" hereto has been included in reliance upon Global Insight as an expert in econometric forecasting. Information concerning the tobacco industry and participants therein has been obtained from certain publicly available information provided by certain participants and certain other sources (see "DOMESTIC TOBACCO INDUSTRY"). The participants in such industry have not provided any information to the Authority 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 Authority has not independently verified the information contained in "DOMESTIC TOBACCO INDUSTRY" and "TAX MATTERS" 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 Authority or the State or the matters covered by the report of Global Insight included as APPENDIX B 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 UNDERTAKING."

This Official Statement contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Pledged Settlement Payments (see "RISK FACTORS", "LEGAL CONSIDERATIONS" and "APPENDIX A – THE MINNESOTA AGREEMENT"), the inclusion in this Official Statement of such forecasts, projections and estimates should not be regarded as a representation by the Authority, the State, Global Insight or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

References in this Official Statement to the Act, the Indenture, the Sale Agreement and the Continuing Disclosure Agreement do not purport to be complete. Refer to the Act, the Indenture, the Sale Agreement, and the Continuing Disclosure Agreement for full and complete details of their provisions. Copies of the Act, the Indenture, the Sale Agreement and the Continuing Disclosure Agreement are on file with the Authority and the 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 Authority. These forward-looking statements speak only as of the date of this Official Statement. The Authority 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 Authority's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

THE SERIES 2011 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 2011 Bonds to potential investors is made only by means of the entire Official Statement. Capitalized terms used in this Summary Statement and not otherwise defined shall have the meanings given such terms in the Indenture and the Sale Agreement. See "APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE" and "APPENDIX E — DEFINITIONS AND SUMMARY OF THE PURCHASE AND SALE AGREEMENT". For definitions of certain terms used herein, see also "APPENDIX G — INDEX OF DEFINED TERMS".

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| **Overview** .......................................... | The Tobacco Securitization Authority (the "**Authority**") is a body corporate and politic and a public instrumentality of, but having a legal existence independent and separate from, the State of Minnesota (the "**State**") and was established under Minnesota Statutes, Section 16A.98 (as the same may be amended, the "**Act**"). The Authority's Minnesota Tobacco Settlement Revenue Bonds, Series 2011 (the "**Series 2011 Bonds**") are comprised of two series – the Taxable Series 2011A Bonds in the principal amount of $74,685,000, which are taxable fixed amortization bonds (the "**Taxable Series 2011A Bonds**"), and the Tax-Exempt Series 2011B Bonds in the principal amount of $682,270,000, which are tax-exempt fixed amortization bonds (the "**Tax-Exempt Series 2011B Bonds**"). The Series 2011 Bonds are being issued pursuant to the Indenture, dated as of November 1, 2011 (the "**Indenture**"), by and between the Authority and U.S. Bank National Association, as Trustee (the "**Trustee**").<br><br>To date, the Settling Defendants (as defined herein) have paid approximately $3.31 billion of tobacco settlement payments required to be made pursuant to the terms of the Settlement Agreement, entered into by the Settling Defendants and the State in May 1998, as amended by the Agreement of Amendment to Settlement Agreement, dated as of June 1, 2001, by and among the State and the Settling Defendants (the "**Minnesota Agreement**"), in settlement of certain smoking-related litigation.<br><br>As used herein, "**Pledged Settlement Payments**" consist of (i) all tobacco settlement revenues paid or payable to the State on and after July 1, 2013, and required to be made, pursuant to the terms of the Minnesota Agreement, by the Settling Defendants to the State, and the State's rights to receive such tobacco settlement revenues (consisting of the Annual Payments as defined below), and (ii) "**Lump Sum Payments**" or "**Partial Lump Sum Payments**," if any, whenever received, that are allocable to Annual Payments that are payable on or after July 1, 2013 in satisfaction of all or a portion of the Annual Payments due under the terms of the Minnesota Agreement, and the State's rights to receive such payments. |

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| | Pursuant to a Purchase and Sale Agreement, dated as of November 1, 2011 (the "**Sale Agreement**"), between the State, as seller, and the Authority, as purchaser, the State will sell to the Authority, and the Authority will purchase, the Pledged Settlement Payments, which the Authority is pledging and assigning under the Indenture as security and as the primary source of payment for the Series 2011 Bonds. The State will irrevocably instruct PricewaterhouseCoopers, as the calculation agent for the Minnesota Agreement (the "**Minnesota Agreement Calculation Agent**"), and the Settling Defendants to remit all Pledged Settlement Payments directly to the Trustee.<br><br>The Series 2011 Bonds are special obligations of the Authority and are secured solely by a pledge of (i) the Pledged Revenues, which include (a) all Pledged Settlement Payments and (b) all amounts and assets on deposit in the Pledged Revenues Account, the Debt Service Account, the Debt Service Reserve Account and the Lump Sum Account (collectively, the "**Pledged Accounts**"), and (ii) all other property pledged for the payment of the Series 2011 Bonds under the Indenture. The Indenture provides for the release to the State of all "**Residual Revenues**" consisting of all Pledged Revenues deposited in the Residual Account maintained under the Indenture after prior funding of certain operating expenses, amounts attributable to debt service on Bonds and replenishment of the Debt Service Reserve Account, and any Junior Payments (as defined in the Indenture), not later than February 15 of each year. Residual Revenues, once deposited in the Residual Account, no longer constitute Pledged Revenues under the Indenture. |
| **Minnesota Agreement.....................** | The Minnesota Agreement was entered into on May 8, 1998, among the Attorney General of the State 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 "**Settling Defendants**"). It was amended in June 2001 to clarify the meaning of the term "net operating profits" as it applies to the calculation of the Volume Adjustment (as defined herein). See "SUMMARY OF THE MINNESOTA AGREEMENT–Volume Adjustment" herein.<br><br>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, which occurred on June 30, 2004. References herein to the "Settling Defendants" mean, 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 Minnesota Agreement resolved cigarette smoking-related litigation between the State and the Settling Defendants and released the Settling Defendants from past and present smoking-related claims by the State, and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the State (including Initial Payments and Annual Payments, as defined herein), and the imposition of certain tobacco advertising and marketing restrictions, among other things. Under the Minnesota Agreement, each Settling Defendant is required to pay an allocable portion of each Annual Payment based on its relative market share of the United States cigarette market (excluding Puerto Rico and roll-your-own cigarettes) during the calendar year. Payments by the Settling Defendants are required to be made directly to the State. The Authority is not a party to the Minnesota Agreement.

The Minnesota Agreement is separate and distinct from the Master Settlement Agreement entered into on November 23, 1998 (the "**MSA**"), among the attorneys general of 46 states (not including Minnesota), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**MSA Settling States**") and Philip Morris, Reynolds Tobacco, B&W and Lorillard (collectively, the "**MSA OPMs**," and together with any tobacco manufacturers that entered into the MSA subsequent to the MSA OPMs, the "**MSA PMs**"). Minnesota is one of four "**Previously Settled States**" (along with Florida, Mississippi and Texas) that settled with the tobacco manufacturers pursuant to their own settlement agreements. There are a number of important differences between the Minnesota Agreement and the MSA. See "SUMMARY OF THE MINNESOTA AGREEMENT" herein.

The MSA provides for numerous adjustments and offsets to payments payable by the MSA PMs to the MSA Settling States that the Minnesota Agreement does not include. Annual Payments due under the Minnesota Agreement are adjusted solely by the Inflation Adjustment and the Volume Adjustment, each as described herein. In addition, while the MSA includes roll-your-own cigarettes in its definition of "cigarette" for purposes of determining cigarette volume and market share, the Minnesota Agreement does not. Unlike the MSA, the Minnesota Agreement does include smokeless tobacco sold by the Settling Defendants for purposes of determining volume and market share. See "SUMMARY OF THE MINNESOTA AGREEMENT" herein.

The Minnesota Agreement is a settlement of litigation between the State and the Settling Defendants only. It does not provide for tobacco companies other than the Settling Defendants to become party to it. Tobacco companies that are not parties to the Minnesota Agreement are referred to herein as "**Non-Participating**

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| | **Manufacturers**” or “**NPMs**”. There are no provisions in the Minnesota Agreement for sales by the NPMs and no adjustments will be made to Pledged Settlement Payments as a result of a loss of market share by the Settling Defendants to the NPMs. Therefore, payments under the Minnesota Agreement are not subject to an NPM Adjustment. See “SUMMARY OF THE MINNESOTA AGREEMENT”. |
| **Sale of Pledged Settlement Payments.........................................** | Pursuant to the Sale Agreement, the Authority will purchase from the State and the State will sell to the Authority, the Pledged Settlement Payments simultaneously with the issuance of the Series 2011 Bonds. The net proceeds of the Series 2011 Bonds and other elements of the purchase price transferred to the State (including the Residual Certificate described below), other than proceeds deposited in the Debt Service Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account, are not pledged to the payment of, nor are they security for, the Series 2011 Bonds.<br><br>The purchase price to be paid by the Authority to the State under the Sale Agreement will consist of: (i) the net proceeds of the Series 2011 Bonds and (ii) a security (the “**Residual Certificate**”), issued by the Authority under the Indenture, which will entitle the State as holder of the Residual Certificate to the Residual Revenues.<br><br>The sale of the Pledged Settlement Payments and the lien created under the Indenture will stay in effect so long as the Series 2011 Bonds remain outstanding. The Act provides that the Authority and its corporate existence will continue until twelve months after all the Authority’s liabilities (which include the Series 2011 Bonds) have been met or otherwise discharged, and upon the termination of the existence of the Authority, all of the Authority’s rights and property will pass to and be vested in the State. |
| **Flow of Pledged Settlement Payments.........................................** | From and after the sale of the Pledged Settlement Payments to the Authority, which sale will occur simultaneously with the issuance of the Series 2011 Bonds, the Settling Defendants and the Minnesota Agreement Calculation Agent will be irrevocably instructed by the State to disburse all Pledged Settlement Payments directly to the Trustee. The Trustee will apply, no later than five business days after receipt of such Pledged Settlement Payments, amounts to fund the payment of fees, operating expenses and debt service on the Series 2011 Bonds and the replenishment of the Debt Service Reserve Account and will, on or before February 15 of each year, deposit the Residual Revenues, if any, in the Residual Account. |
| **Securities Offered ............................** | The Series 2011 Bonds are being issued as fixed amortization bonds. Interest on the outstanding principal amount of the Series 2011 Bonds will be payable on each March 1 and September 1, commencing March 1, 2012. Interest on the Series 2011 Bonds payable on or prior to September 1, 2013 will be capitalized. The |

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| | Series 2011 Bonds mature on March 1 in the years as set forth on the inside front cover. The Taxable Series 2011A Bonds are not subject to redemption prior to maturity except from Extraordinary Prepayments following the occurrence of a Payment Default (as defined herein). The Tax-Exempt Series 2011B Bonds are subject to mandatory redemption (including a mandatory clean-up call, redemption by Sinking Fund Installments applicable to term bonds), optional redemption, and extraordinary optional redemption under certain limited circumstances, each as described herein. Failure to pay interest when due or the principal of any Series 2011 Bonds when due (including Sinking Fund Installments when due) will constitute an Event of Default under the Indenture.<br><br>It is expected that the Series 2011 Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about November 29, 2011 (the "**Closing Date**"). See "APPENDIX F — BOOK-ENTRY ONLY SYSTEM".<br><br>Individual purchases of beneficial ownership interests may be made in the principal amount of $5,000 or any integral multiple thereof (an "**Authorized Denomination**"). Beneficial owners of the Series 2011 Bonds will not receive physical delivery of bond certificates. |
| **Collateral** .......................................... | The Series 2011 Bonds are special limited revenue obligations of the Authority payable solely from and secured solely by a pledge under the Indenture of the "**Collateral**," which consists of (a) the Pledged Revenues (including all Pledged Settlement Payments), (b) all rights to receive the Pledged Revenues and the proceeds of such rights, (c) the Pledged Accounts and assets thereof, 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 Authority under the Sale Agreement including the representations, warranties and covenants of the State therein, and (e) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture. The Collateral does not include the Residual Revenues once deposited in the Residual Account, and certain other reserved rights of the Authority set forth in the Indenture.<br><br>The proceeds of the Series 2011 Bonds, except the amount deposited in the Debt Service Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account, are not pledged to the payment of, and are therefore not available to, the holders of the Series 2011 Bonds. |
| **Pledged Revenues**............................. | "**Pledged Revenues**" means: (i) the Pledged Settlement Payments, (ii) to the extent set forth in the applicable series supplement or supplemental indenture, payments made to the Authority or Trustee |

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| | under Related Contracts (as defined herein), and (iii) all fees, charges, payments, investment earnings and other income and receipts (including the proceeds of the Series 2011 Bonds deposited in the Debt Service Reserve Account and the Capitalized Interest Subaccount) paid or payable to the Authority or the Trustee for the account of the Authority or Beneficiaries (as defined herein), but excluding all Residual Revenues once deposited in the Residual Account. |
| **Bonds not a Debt of the State..........** | Pursuant to the Act, the State is not liable on the Series 2011 Bonds and the Series 2011 Bonds shall not constitute an indebtedness or an obligation of the State or any subdivision thereof, within the meaning of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No owner of any Series 2011 Bond shall have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Series 2011 Bonds. |
| **Payments Pursuant to the Minnesota Agreement......................** | Under the Minnesota Agreement, the Settling Defendants, in the aggregate, are required to pay to the State the amounts below:<br><br>(a) Six initial payments, all of which have been paid (the "**Initial Payments**").<br><br>(b) Annual base payments set forth in the Minnesota Agreement on each December 31 beginning on December 31, 1998 (the "**Applicable Base Payments**"), and continuing in perpetuity. Such Applicable Base Payments, as adjusted by application of the Inflation Adjustment and the Volume Adjustment (subject to final adjustment within thirty days of the date of payment), are referred to herein as the "**Annual Payments**." The Annual Payments due in 1998 through 2010 have already been paid.<br><br>The following chart sets forth the Applicable Base Payments due to the State from the Settling Defendants in each year: |

| Year | Amount | Year | Amount |
|---|---|---|---|
| **1998** | **$102,000,000** | **2001** | **$165,750,000** |
| **1999** | **114,750,000** | **2002** | **165,750,000** |
| **2000** | **127,500,000** | **2003** | **204,000,000** |
| | | **thereafter** | **204,000,000** |

Under the Minnesota Agreement, the Applicable Base Payments due are subject to (a) an upward adjustment in an amount equal to the greater of (i) 3% or (ii) the year over year percentage increase in the actual Consumer Price Index for All Urban Consumers (the "**CPI**") in November of the applicable year as published by the Bureau of Labor Statistics (the "**Inflation Adjustment**"), and (b) a reduction for decreased domestic cigarette sales, which in practice have been measured by shipments (as more fully described herein,

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| | the "**Volume Adjustment**"). The Annual Payments do not reflect application of an NPM Adjustment as there is no provision for any such adjustment in the Minnesota Agreement. The Inflation Adjustment and the Volume Adjustment have occurred, will continue to occur and may be material. See "SUMMARY OF THE MINNESOTA AGREEMENT—Annual Payments", "—Inflation Adjustment", "—Volume Adjustment" and "RISK FACTORS" herein.<br><br>Under the Minnesota Agreement, each Settling Defendant is required to pay an allocable portion of each Annual Payment based on its respective market share (based on sales, which in practice have been measured by shipments) of the United States cigarette market during the calendar year. |
| **Industry Overview** .......................... | The three Settling Defendants – Philip Morris, Reynolds American and Lorillard – are the largest manufacturers of cigarettes in the United States (based on 2010 domestic market share). The market for cigarettes is highly competitive and is characterized by brand recognition. See "DOMESTIC TOBACCO INDUSTRY". |
| **Cigarette Volume** ............................ | 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 304 billion cigarettes in 2010, as reported by the National Association of Attorneys General ("**NAAG**"). The NAAG data includes roll-your-own tobacco (measured at 0.0325 ounces per cigarette conversion rate). A "Cigarette" as defined in the Minnesota Agreement does not include roll-your-own tobacco. According to Global Insight, adjusting the NAAG data to remove roll-your-own-tobacco results in estimated shipments in 2010 of 301 billion cigarettes. |
| **Interest** ............................................... | Interest on the outstanding principal amount of the Series 2011 Bonds will be payable on each March 1 and September 1, commencing March 1, 2012 (each, a "**Distribution Date**"). Interest on the Series 2011 Bonds payable on or prior to September 1, 2013 will be capitalized.<br><br>Interest on the Series 2011 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. The Debt Service Reserve Account is available to pay current interest on the Series 2011 Bonds when due to the extent Pledged Revenues are insufficient for such purpose. |
| **Optional Redemption of the Series 2011 Bonds** .......................... | The Taxable Series 2011A Bonds are not subject to optional redemption prior to maturity.<br><br>The Tax-Exempt Series 2011B Bonds maturing on or after March 1, 2023 are subject to redemption, on any date on and after March 1, 2022, at the option of the Authority, from any source including the |

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| | proceeds of Refunding Bonds or other refunding obligations, at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date. |
| **Mandatory Redemption by Sinking Fund Installments............** | The Tax-Exempt Series 2011B Term Bonds due March 1, 2031 are subject to mandatory redemption on and after March 1, 2027, at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Sinking Fund Installments in the respective amounts and on each of the dates set forth herein under "THE SERIES 2011 BONDS – Sinking Fund Installments". |
| **Extraordinary Optional Redemption ....................................** | The Tax-Exempt Series 2011B Bonds are subject to extraordinary optional redemption by the Authority at any time on or prior to December 1, 2012, in whole, at a redemption price equal to the Extraordinary Redemption Price (hereinafter defined) plus accrued and unpaid interest to the redemption date but only from the net proceeds of Tobacco Appropriation Bonds (as defined in the Act) and amounts and assets on deposit in the Pledged Accounts. The Extraordinary Redemption Price will be determined by an independent accounting firm, investment banking firm or financial advisor retained by the State at the State's expense and such redemption price shall be conclusive and binding on the owners of the Tax-Exempt Series 2011B Bonds.<br><br>"**Extraordinary Redemption Price**" means for each Tax-Exempt Series 2011B Bond, the greater of the Minimum Price and the price of such bond as of the extraordinary optional redemption date determined assuming all of the relevant terms of such bond at a yield equal to the sum of the Relevant MMD Yield and the Relevant Spread.<br><br>"**Relevant MMD Yield**" means for each Tax-Exempt Series 2011B Bond, the yield on Thompson Reuters' Municipal Market Data General Obligation AAA Index ("**MMD**" ) corresponding to the maturity date of such Tax-Exempt Series 2011B Bond will be used. The MMD yield selected will be that known to be effective as of 10:00 a.m. (New York City time) on the Yield Determination Date. If any such yield is not reported as of such time or the yield reported as of such time is not ascertainable, a nationally-recognized municipal AAA bond index will be substituted.<br><br>"**Yield Determination Date**" means any business day not more than 60 calendar days prior to the redemption date.<br><br>"**Minimum Price**" and "**Relevant Spread**" means for each Tax-Exempt Series 2011B Bond the following: |

| Maturity | Coupon | Minimum Price | Relevant Spread |
|---|---|---|---|
| 2016 | 3.00% | 102.652% | 0.752% |
| 2016 | 5.00 | 108.896 | 0.752 |
| 2017 | 4.00 | 105.471 | 0.960 |
| 2017 | 5.00 | 109.467 | 0.960 |
| 2018 | 5.00 | 109.287 | 1.120 |
| 2019 | 3.50 | 100.107 | 1.240 |
| 2019 | 5.00 | 108.466 | 1.240 |
| 2020 | 5.00 | 107.667 | 1.280 |
| 2021 | 4.00 | 100.484 | 1.280 |
| 2021 | 5.00 | 107.471 | 1.280 |
| 2022 | 5.00 | 106.467 | 1.336 |
| 2023 | 5.25 | 105.771 | 1.480 |
| 2024 | 5.25 | 104.614 | 1.480 |
| 2025 | 5.25 | 103.624 | 1.480 |
| 2026 | 4.85 | 99.702 | 1.480 |
| 2026 | 5.25 | 102.720 | 1.480 |
| 2031 | 5.25 | 99.515 | 1.433 |

**Partial Lump Sum Payments and Lump Sum Payments.............** The Indenture provides that Partial Lump Sum Payments (as defined herein) are to be deposited in the Lump Sum Account and shall be transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments of and interest on the Bonds (as defined herein) then outstanding on the respective Distribution Dates covered by such Partial Lump Sum Payments. The Indenture provides that any Lump Sum Payments (as defined herein) shall be placed into a defeasance escrow to pay or redeem the Bonds then outstanding, pro rata by principal amount among maturities and within a maturity, in an aggregate principal amount equal to the amount of such Lump Sum Payments.

**Extraordinary Prepayments...........** Following the occurrence of a Payment Default (as defined herein), the Bonds then outstanding are subject to redemption, on each Distribution Date thereafter, pro rata among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Bonds then outstanding to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to payment of Operating Expenses not in excess of the Operating Cap, and to funding attributable to interest on such Bonds), from amounts on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

**Mandatory Clean-up Call...............** The Taxable Series 2011A Bonds are not subject to a mandatory clean-up call prior to maturity. The Tax-Exempt Series 2011B Bonds are subject to mandatory redemption on any Distribution

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| | Date at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date, in the event liquidation of the aggregate amount on deposit in the Pledged Accounts (other than amounts set aside for the payment of Tax-Exempt Series 2011B Bonds) is greater than the principal amount of and accrued interest (if any) on the Tax-Exempt Series 2011B Bonds after the application of Pledged Revenues in accordance with the Indenture on such Distribution Date. |
| **Debt Service Reserve Account........** | Upon the Closing Date of the Series 2011 Bonds, a liquidity reserve account (the "**Debt Service Reserve Account**") will be funded at its required level of $73,553,424 (the "**Debt Service Reserve Requirement**"), which level is required to be maintained through required deposits of Pledged Revenues for so long as any Series 2011 Bonds remain Outstanding. However, the Indenture does not require a ratable increase in the Debt Service Reserve Requirement, or any further funding of the Debt Service Reserve Requirement, in connection with the issuance of Refunding Bonds.<br><br>Prior to a Payment Default, amounts on deposit in the Debt Service Reserve Account will be available to pay the principal of and interest on the Series 2011 Bonds when due, to the extent Pledged Revenues are insufficient for such purpose. After an Event of Default, money in the Debt Service Reserve Account will be available to pay the principal of and interest on the Series 2011 Bonds pursuant to Extraordinary Prepayments.<br><br>Unless a Payment Default has occurred, amounts withdrawn from the Debt Service Reserve Account will be replenished from Pledged Revenues as described herein.<br><br>If an Event of Default has not occurred, money in the Debt Service Reserve Account may be applied to the redemption of outstanding bonds, under the circumstances described under the caption "THE SERIES 2011 BONDS — Mandatory Clean-Up Call". |
| **Distributions.....................................** | The Trustee will deposit all Pledged Revenues in the Pledged Revenues Account and distribute them in accordance with the "– Application of Pledged Revenues" set forth under the caption "SECURITY FOR THE SERIES 2011 BONDS". |
| **Event of Default ...............................** | If an Event of Default (as defined herein) occurs, the Trustee may, and upon written request of the holders of 25% in principal amount of the Bonds then outstanding shall, in its own name by action or proceeding in accordance with the law: (a) enforce all rights of the holders and require the Authority 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, (b) sue upon such Bonds, (c) require the Authority to account as if it were the trustee of an express trust for the holders of such Bonds and (d) enjoin any acts |

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| | or things which may be unlawful or in violation of the rights of the holders of such Bonds. Failure to pay interest when due or the principal of any Bonds (including by Sinking Fund Installment) when due will constitute an Event of Default under the Indenture (a "**Payment Default**"). Upon a Payment Default, the Bonds shall not be subject to acceleration of the maturity of principal, but shall be subject to pro rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter. For a description of Events of Default under the Indenture, see "APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE – *Events of Default*". |
| **Refunding Bonds..............................** | One or more additional series of bonds (the "**Refunding Bonds**") may be issued by the Authority solely for refunding purposes (each, a "**Series**"). In accordance with the Act, no such Refunding Bonds may mature more than thirty years after the date of issuance. The Series 2011 Bonds and any Refunding Bonds issued under the Indenture are collectively referred to herein as the "**Bonds**". See "THE SERIES 2011 BONDS - Refunding Bonds". |
| **Covenants of the State and the Authority ..........................................** | Pursuant to the Act, the State has covenanted in the Sale Agreement that, among other things, it will (i) irrevocably direct, through the Commissioner of Management and Budget, the transfer of all Pledged Settlement Payments directly to the Trustee as the assignee of the Authority, (ii) diligently enforce its right to collect all moneys due from the Settling Defendants pursuant to the Minnesota Agreement, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General (provided, that remedies available to the Authority and the owners of the Bonds for any breach of these agreements of the State shall be limited to injunctive relief and that the State will be deemed to have diligently enforced this covenant so long as there is no judicial determination by a court of competent jurisdiction in the State that the State has failed to diligently enforce the covenant), (iii) in any materially adverse way, neither amend the Minnesota Agreement or take any other action that would (a) impair the Authority's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Bondholders, or (c) 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 Sale Agreement or the Indenture will be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the State to amend, modify or repeal or otherwise alter statutes imposing or relating to the taxes) and (iv) not amend, supersede or repeal the Minnesota Agreement or the Act, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments |

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| | of, the Authority or the Bondholders. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, the Indenture, the Bonds or the Act shall be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the Minnesota Agreement or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the Minnesota Agreement.<br><br>The Authority has covenanted in the Indenture that, among other things, it will (a) 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, (b) (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 registered owners of the Bonds ("**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 Indenture, the Act or the Sale Agreement or the performance by any party thereunder and (iv) cause the Trustee to enforce the Sale Agreement and (c) diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral. In accordance with the Act, the Indenture provides that the Authority has no authority to file a voluntary petition under, or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may from time to time be in effect and neither any public officer nor any organization, entity, or other person shall authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute as may from time to time be in effect.<br><br>The Authority and the State have each covenanted not to impair the exclusion of interest on the Tax-Exempt Series 2011B Bonds from gross income for federal income tax purposes. See "APPENDIX D — DEFINITIONS AND SUMMARY OF THE INDENTURE" for a summary of the covenants made by the Authority and "APPENDIX E — DEFINITIONS AND SUMMARY OF THE PURCHASE AND SALE AGREEMENT" for a summary of the covenants made by the State. |
| **Ratings** ............................................ | Standard & Poor's Ratings Services, a Division of The McGraw-Hill Companies, Inc. ("**S&P**"), is expected to assign the ratings of "A" to the Series 2011 Bonds maturing on March 1, 2014 through March 1, 2022 and "A-" to the Series 2011 Bonds maturing on March 1, 2023 and thereafter, and Fitch Ratings ("**Fitch**") is |

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| | expected to assign the rating of "BBB+ to the Series 2011 Bonds. Each of Fitch and S&P are referred to herein as a "**Rating Agency**". Such ratings reflect only the views of such organizations, and explanations of the significance of such ratings may be obtained only from such organizations. The Authority makes no representation as to the appropriateness of the ratings. The ratings for the Series 2011 Bonds address (i) the payment of interest on the Series 2011 Bonds when due, and (ii) the payment of principal of the Series 2011 Bonds on any Sinking Fund Installment dates and on their respective maturity dates. The principal amounts, Sinking Fund Installment dates and maturity dates of the Series 2011 Bonds were structured to produce cash flow stress test performance necessary for the Authority to achieve the targeted credit ratings. A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to downward revision or withdrawal at any time. Any such downward revision or withdrawal of such ratings may have an adverse effect on the market price of the Series 2011 Bonds. See "RATINGS". |
| **Risk Factors**...................................... | Reference is made to "RISK FACTORS" for a description of certain considerations relevant to an investment in the Series 2011 Bonds. |
| **Legal Considerations**....................... | Reference is made to "LEGAL CONSIDERATIONS" for a description of certain legal issues relevant to an investment in the Series 2011 Bonds. |
| **Tax Matters**...................................... | In the opinion of Kutak Rock LLP, Transaction Counsel, under existing federal and Minnesota laws, regulations, rulings and judicial decisions, the interest to be paid on the Taxable Series 2011A Bonds is includable in gross income of owners thereof for federal income tax purposes, in taxable net income of individuals, trusts and estates for Minnesota income tax purposes, and in the income of corporations and financial institutions for purposes of the Minnesota franchise tax. Assuming the accuracy of certain representations and continuing compliance with certain covenants, interest on the Tax-Exempt Series 2011B Bonds is excludable from gross income for federal income tax purposes and from taxable net income of individuals, estates or trusts for Minnesota income tax purposes; is includable in the income of corporations and financial institutions for purposes of the Minnesota franchise tax; and is not a specific tax preference item for purposes of the federal alternative minimum tax or the Minnesota alternative minimum tax applicable to individuals, estates and trusts, except that such interest must be included in the "adjusted current earnings" of certain corporations for purposes of calculating federal alternative minimum taxable income. For a discussion of tax matters see "TAX MATTERS" herein. |

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| **ERISA** | Fiduciaries and other persons investing "plan assets" of employee benefit or other plans subject to the Employees Retirement Income Security Act of 1974, as amended ("**ERISA**") or Section 4975 of the Internal Revenue Code of 1986, as amended (each, a "**Plan**") should consider the fiduciary investment standards and prohibited transaction rules of ERISA and Section 4975 of the Code before authorizing an investment of "plan assets" of any Plan in the Taxable Series 2011A Bonds. Subject to these considerations, the Taxable Series 2011A Bonds are eligible for purchase by persons investing assets of a Plan. See "ERISA CONSIDERATIONS". |
| **Availability of Documents** | Included herein are brief summaries of certain documents, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. Copies of the Indenture and the Sale Agreement may be obtained by written request from the Trustee at Mailstation EP-MN-WS3C, 60 Livingston Avenue, St. Paul, Minnesota 55107, Attention: Corporate Trust Services. Any statements in this Official Statement involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Official Statement is not to be construed as a contract or agreement among the Authority, the State and the Bondholders. |

**$756,955,000**

**Tobacco Securitization Authority**
**Minnesota Tobacco Settlement Revenue Bonds, Series 2011**

*This Official Statement sets forth information concerning the issuance by the Tobacco Securitization Authority (the "**Authority**") of its $74,685,000 Minnesota Tobacco Settlement Revenue Bonds, Taxable Series 2011A (the "**Taxable Series 2011A Bonds**") and $682,270,000 Minnesota Tobacco Settlement Revenue Bonds, Tax-Exempt Series 2011B (the "**Tax-Exempt Series 2011B Bonds**," and together with the Taxable Series 2011A Bonds, the "**Series 2011 Bonds**"), pursuant to the Indenture. Defined terms used herein not otherwise defined below shall have the meanings set forth therefore in the Summary Statement and as referenced in Appendix G.*

## THE SERIES 2011 BONDS

The following summary describes certain terms of the Series 2011 Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2011 Bonds. Copies of the Indenture may be obtained upon written request to the Trustee.

The Series 2011 Bonds will initially be represented by one or more bond certificates registered in the name of The Depository Trust Company, New York, New York ("**DTC**"), or its nominee. DTC will act as securities depository for the Series 2011 Bonds. Individual purchases of beneficial ownership interests in the Series 2011 Bonds may be made for principal amounts of $5,000 or any integral multiple thereof (an "**Authorized Denomination**"). Except under the limited circumstances described herein, no Beneficial Owner (as defined herein) of the Series 2011 Bonds will be entitled to receive a physical certificate representing its ownership interest in such Bonds. See "APPENDIX F — BOOK-ENTRY ONLY SYSTEM".

For each Distribution Date, payments will be made to registered owners of the Series 2011 Bonds (the "**Holders**") as of the last Business Day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs (the "**Record Date**"). The Trustee and the Authority may establish special record dates for the determination of the Holders for various purposes of the Indenture, including giving consent or direction to the Trustee.

**Sources and Uses of Funds**

Estimated sources and uses of funds are as follows:

| **Sources of Funds** | **Series 2011A** | **Series 2011B** | **Total** |
|---|---|---|---|
| Principal Amount of Series 2011 Bonds | $74,685,000 | $682,270,000 | $756,955,000 |
| Plus: Net Premium | - | 27,199,678 | 27,199,678 |
| Total Sources | $74,685,000 | $709,469,678 | $784,154,678 |
| **Uses of Funds*** | | | |
| Proceeds Distributed to State | - | $640,000,000 | $640,000,000 |
| Deposit to Debt Service Reserve Account | $ 9,007,699 | 64,545,725 | 73,553,424 |
| Costs of Issuance† | 455,064 | 4,743,001 | 5,198,065 |
| Capitalized Operating Expenses | 19,049 | 180,951 | 200,000 |
| Deposit to Capitalized Interest Subaccount | 65,203,189 | - | 65,203,189 |
| Total Uses | $74,685,000 | $709,469,678 | $784,154,678 |

* Totals may not add due to rounding.

† Costs of issuance include underwriters' discount, Global Insight fees, legal fees, rating agency fees, verification agent fees, printing costs and certain other expenses related to the issuance of the Series 2011 Bonds.

**Payments of Interest**

Interest on the outstanding principal amount of the Series 2011 Bonds will be payable on each March 1 and September 1, commencing March 1, 2012 until the Maturity Date or earlier redemption of such Series 2011 Bond. Interest on the Series 2011 Bonds payable on or prior to September 1, 2013 will be capitalized. Interest on Series 2011 Bonds will accrue from the Closing Date, or from the most recent Distribution Date on which interest has been paid, to but excluding the subsequent Distribution Date on which interest is payable. Interest on the Series 2011 Bonds will be computed on the basis of a 360-day year consisting of twelve 30-day months. Amounts on deposit in the Debt Service Reserve Account and the Capitalized Interest Subaccount of the Debt Service Account are available to make payments of interest on the Series 2011 Bonds. If on any Distribution Date there are insufficient funds to pay all interest then due on the Series 2011 Bonds, this will constitute a Payment Default under the Indenture, and the Bonds shall be subject to pro rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter.

**Payments of Principal**

The Series 2011 Bonds are issued as fixed amortization bonds. The Series 2011 Bonds are subject to mandatory redemption (including by Sinking Fund Installments with respect to term bonds), optional redemption and extraordinary optional redemption under certain limited circumstances prior to maturity as described below. A failure to pay principal of a Bond pursuant to Sinking Fund Installments or on its Maturity Date will constitute a Payment Default under the Indenture, and the Bonds shall be subject to pro rata redemption among maturities from Extraordinary Prepayments on each Distribution Date thereafter.

Except to the extent redemption of Series 2011 Bonds is to be by pro rata selection, including within a maturity, if less than all of the Series 2011 Bonds of any maturity are to be redeemed, the Holders of the Series 2011 Bonds of such maturity will be paid as described under the caption "– Partial Redemptions" below.

**Optional Redemption**

The Taxable Series 2011A Bonds are not subject to optional redemption prior to maturity.

The Tax-Exempt Series 2011B Bonds maturing on and after March 1, 2023 are subject to redemption, on any date on and after March 1, 2022, at the option of the Authority, from any source including the proceeds of Refunding Bonds or other refunding obligations, at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date.

**Mandatory Redemption of Sinking Fund Installments**

The Tax-Exempt Series 2011B Term Bonds due March 1, 2031 are subject to mandatory redemption, at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Sinking Fund Installments in the respective amounts and on each of the dates (including the final payment at maturity) set forth below:

| Maturity (March 1) | Sinking Fund Installment |
|---|---|
| 2027 | $ 49,310,000 |
| 2028 | 52,385,000 |
| 2029 | 55,660,000 |
| 2030 | 59,155,000 |
| 2031† | 62,750,000 |

† Final maturity

**Extraordinary Optional Redemption**

The Tax-Exempt Series 2011B Bonds are subject to extraordinary optional redemption by the Authority at any time on or prior to December 1, 2012, in whole, at a redemption price equal to the Extraordinary Redemption Price (hereinafter defined) plus accrued and unpaid interest to the redemption date but only from the net proceeds of Tobacco Appropriation Bonds (as defined in the Act) and amounts and assets on deposit in the Pledged Accounts. The Extraordinary Redemption Price will be determined by an independent accounting firm, investment banking firm or financial advisor retained by the State at the State's expense and such redemption price shall be conclusive and binding on the owners of the Tax-Exempt Series 2011B Bonds.

"**Extraordinary Redemption Price**" means for each Tax-Exempt Series 2011B Bond, the greater of the Minimum Price and the price of such bond as of the extraordinary optional redemption date determined assuming all of the relevant terms of such bond at a yield equal to the sum of the Relevant MMD Yield and the Relevant Spread.

"**Relevant MMD Yield**" means for each Tax-Exempt Series 2011B Bond, the yield on Thompson Reuters' Municipal Market Data General Obligation AAA Index ("**MMD**") corresponding to the maturity date of such Tax-Exempt Series 2011B Bond will be used. The MMD yield selected will be that known to be effective as of 10:00 a.m. (New York City time) on the Yield Determination Date. If any such yield is not reported as of such time or the yield reported as of such time is not ascertainable, a nationally-recognized municipal AAA bond index will be substituted.

"**Yield Determination Date**" means any business day not more than 60 calendar days prior to the redemption date.

"**Minimum Price**" and "**Relevant Spread**" means for each Tax-Exempt Series 2011B Bond the following:

| Maturity | Coupon | Minimum Price | Relevant Spread |
|---|---|---|---|
| 2016 | 3.00% | 102.652% | 0.752% |
| 2016 | 5.00 | 108.896 | 0.752 |
| 2017 | 4.00 | 105.471 | 0.960 |
| 2017 | 5.00 | 109.467 | 0.960 |
| 2018 | 5.00 | 109.287 | 1.120 |
| 2019 | 3.50 | 100.107 | 1.240 |
| 2019 | 5.00 | 108.466 | 1.240 |
| 2020 | 5.00 | 107.667 | 1.280 |
| 2021 | 4.00 | 100.484 | 1.280 |
| 2021 | 5.00 | 107.471 | 1.280 |
| 2022 | 5.00 | 106.467 | 1.336 |
| 2023 | 5.25 | 105.771 | 1.480 |
| 2024 | 5.25 | 104.614 | 1.480 |
| 2025 | 5.25 | 103.624 | 1.480 |
| 2026 | 4.85 | 99.702 | 1.480 |
| 2026 | 5.25 | 102.720 | 1.480 |
| 2031 | 5.25 | 99.515 | 1.433 |

**Mandatory Clean-Up Call**

The Taxable Series 2011A Bonds are not subject to a Mandatory Clean-Up Call.

The Tax-Exempt Series 2011B Bonds are subject to mandatory redemption on any Distribution Date, at a redemption price equal to 100% of the principal amount of Tax-Exempt Series 2011B Bonds to be redeemed, plus interest accrued thereon to the redemption date, in the event liquidation of the aggregate amount on deposit in the Pledged Revenues Account, the Debt Service Account, the Debt Service Reserve Account and the Lump Sum Account (collectively, the "**Pledged Accounts**") (other than amounts set aside for the payment of Bonds) is greater than the principal amount of and accrued interest (if any) on the Tax-Exempt Series 2011B after the application of Pledged Revenues in accordance with the Indenture on such Distribution Date.

**Extraordinary Prepayments**

Following the occurrence of a Payment Default, the Bonds then outstanding are subject to mandatory redemption, on each Distribution Date, pro rata as to principal amount among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Bonds then outstanding to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to Operating Expenses not in excess of the Operating Cap as set forth in the Indenture and after funding amounts attributable to interest on the Bonds), from funds on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

**Partial Redemptions**

Unless otherwise subject to redemption selection pro rata within a maturity, if less than all of the Tax-Exempt Series 2011B Bonds of a maturity are to be redeemed, the particular Tax-Exempt Series 2011B Bonds within such maturity to be redeemed will be selected by the Trustee by such method as the Trustee deems fair and appropriate, and which may provide for the selection for redemption of portions (equal to any Authorized Denominations) of the principal of Tax-Exempt Series 2011B Bonds of a denomination larger than the minimum Authorized Denomination.

So long as Cede & Co. is the registered owner of the Series 2011 Bonds, as nominee of DTC, all notices of redemption, including partial redemptions, will go only to DTC. In the case of a partial redemption of the Series 2011 Bonds, DTC will determine the amount of the interest of each Direct Participant (as defined by DTC) to be redeemed.

**Notice of Redemption**

When a Series 2011 Bond is to be redeemed prior to its stated Maturity Date, the Trustee will give notice in the name of the Authority, which notice will identify the Series 2011 Bond to be redeemed, state the date fixed for redemption, and state that such Series 2011 Bond will be redeemed at the Corporate Trust Office of the Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Series 2011 Bond to be redeemed the redemption price thereof, together with interest accrued to the date fixed for redemption, and that money therefore having been deposited with the Trustee or Paying Agent on or prior to the redemption date, from and after such date, interest on the Series 2011 Bonds to be redeemed will cease to accrue.

The Trustee will give at least 20 days' notice (or such shorter period permitted by DTC so long as DTC remains the registered Bondholder) by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions under the Indenture, to the registered owners of any Series 2011 Bonds that are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Holders of Series 2011 Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice of such Holder, will not affect the redemption of any Series 2011 Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by written notice to the Trustee by the Authority no later than five days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons as notice of such redemption was given as described above.

**Refunding Bonds**

The Authority may authorize, issue, sell and deliver Bonds under the Indenture from time to time in such principal amounts as the Authority may determine but solely to refund Series 2011 Bonds, by exchange, purchase, redemption or payment, and establish such escrows therefore as it may determine ("**Refunding Bonds**"). In accordance with the Act, no such Refunding Bonds may mature more than thirty years after the date of their issuance.

**Events of Default and Remedies**

Under the Indenture, any one of the following events is an "**Event of Default**":

(a) principal or Sinking Fund Installments of or interest on any Bond has not been paid, when due (a "**Payment Default**");

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

(c) the State fails to observe or perform its covenants in the Indenture or the Sale Agreement, which failure is not remedied within 60 days after written notice thereof is given to the Authority and the State by the Trustee or to the Authority and the Trustee by the Bondholders of at least 25% in principal amount of the Bonds then Outstanding; or

(d) 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 Authority and, if instituted against the Authority, are not dismissed within 60 days after such institution.

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

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

(ii) sue upon such Bonds;

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

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

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

Upon a Payment Default 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 must give written notice thereof to the Authority. The Trustee is required to proceed for the benefit of the Bondholders in accordance with the written direction of a Majority in Interest of the Outstanding Bonds.

Notwithstanding the foregoing, the Act provides that injunctive relief shall be the sole remedy available to the Trustee for any breach of the pledge and agreement of the State to diligently enforce its right to collect all money due from the Settling Defendants pursuant to the Minnesota Agreement.

Upon a Payment Default, the Bonds, including the Series 2011 Bonds, are subject to redemption, on each Distribution Date, pro rata by principal amount among maturities and within a maturity, at a redemption price equal to 100% of the principal amount of Bonds to be redeemed, plus interest accrued thereon to the redemption date, from Extraordinary Prepayments derived from amounts on deposit in the Pledged Revenues Account (after application to Operating Expenses not in excess of the Operating Cap as set forth in the Indenture and after funding amounts attributable to interest on the Bonds), from funds on deposit in the Debt Service Reserve Account, and from Partial Lump Sum Payments in the Lump Sum Account.

## SECURITY FOR THE SERIES 2011 BONDS

### Pledge of Collateral

Under the Indenture, the Series 2011 Bonds are secured by a pledge and assignment of the Authority's right, title and interest in:

(a) the Pledged Revenues (including all Pledged Settlement Payments),

(b) all rights to receive the Pledged Revenues and the proceeds of such rights,

(c) the Pledged Accounts and assets thereof (including Related Contracts), including money, contract rights, general intangibles or other personal property, held by the Trustee under the Indenture,

(d) all rights and interest of the Authority under the Sale Agreement including the representations, warranties and covenants of the State therein, and

(e) any and all other property of every kind and nature from time to time, by delivery or by writing of any kind, conveyed, pledged, assigned or transferred as and for additional security under the Indenture (collectively, the "**Collateral**").

Except as specifically provided in the Indenture, this assignment and pledge does not include: (i) the Residual Revenues (upon deposit in the Residual Account), (ii) amounts received by the State pursuant to the Minnesota Agreement before July 1, 2013 (except for any Lump Sum Payments or Partial Lump Sum Payments allocable to payments that are payable on or after July 1, 2013) (iii) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Beneficiaries, (iv) any right or power reserved to the Authority 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 Indenture, and (vi) as to any Series of Bonds, any other property or interest explicitly excluded from Collateral pursuant to the terms of the related Series Supplement. The Residual Revenues, and the proceeds of the Series 2011 Bonds, other than the amount deposited in the Debt Service Reserve Account and the Capitalized Interest Subaccount of 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.

For the purposes of the Indenture, the "**Residual Revenues**" consist of the Pledged Revenues deposited in the Residual Account no later than February 15 of each year after payment in full of, in each case due and to become due in the current and next Fiscal Year ("**Fiscal Year**" being defined as the twelve (12) month period commencing July 1 of each year and ending on June 30 of the succeeding year), amounts allocated under the Indenture for each Distribution Date, (1) (a) the Trustee fees and expenses and (b) Operating Expenses (subject to the Operating Cap); (2) interest due on Bonds; (3) principal and Sinking Fund Installments due on Bonds; (4) amounts required to replenish the Debt Service Reserve Account until the amount on deposit therein equals the Debt Service Reserve Requirement; and (5) Junior Payments.

The pledge of the Collateral will stay in effect so long as the Series 2011 Bonds remain outstanding. The Act provides that the Authority and its corporate existence will continue until twelve months after all the Authority's liabilities (which include the Series 2011 Bonds) have been met or otherwise discharged, and upon the termination of the existence of the Authority, all of the Authority's rights and property will pass to and be vested in the State.

**Accounts**

All of the following accounts will be established under the Series Indenture and held by the Trustee for the benefit of the holders of the Bonds. All money on deposit in the following accounts may be invested in Eligible Investments.

*Pledged Revenues Account.* All Pledged Settlement Payments received by the Trustee shall immediately be deposited in segregated trust account designated the "**Pledged Revenues Account**". Within five business days following each deposit of Pledged Settlement Payments to the Pledged Revenues Account, funds in the Pledged Revenues Account will be transferred to various other accounts under the Indenture, in accordance with the priorities described below under "—Application of Pledged Revenues".

*Debt Service Account.* The Trustee will deposit into the "**Debt Service Account**" amounts transferred from the Pledged Revenues Account in respect of interest on and principal of the Bonds. The Trustee will make payments on the Bonds from the Debt Service Account in accordance with the priority of payments as described below under "Application of Pledged Revenues". Proceeds of the Series 2011 Bonds for the payment of interest due on or prior to September 1, 2013 will be deposited in the Capitalized Interest Subaccount within the Debt Service Account.

*Debt Service Reserve Account.* On the Closing Date of the Series 2011 Bonds, the Debt Service Reserve Account will be funded at its required level of $73,553,424 (the "**Debt Service Reserve Requirement**"), which level is required to be maintained for so long as any Series 2011 Bonds remain Outstanding. However, the Indenture does not require a ratable increase in the Debt Service Reserve Requirement, or any further funding of the Debt Service Reserve Requirement, in connection with the issuance of Refunding Bonds. Unless a Payment Default has occurred, amounts withdrawn from the Debt Service Reserve Account will be replenished from Pledged Revenues as described herein. On any Distribution Date, unless a Payment Default has occurred and is continuing, any amount remaining in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement will be transferred to the Pledged Revenues Account and applied in accordance with the Indenture. See "SUMMARY OF

ANNUAL PAYMENT CALCULATION METHODOLOGY AND STRUCTURING ASSUMPTIONS—Structuring Assumptions—*Debt Service Reserve Account*" herein.

Each of the following accounts will be established under the Indenture and held by the Trustee. None of these accounts is a Pledged Account, and amounts on deposit therein are not available to pay principal of and interest on the Series 2011 Bonds.

*Costs of Issuance Account*. Upon issuance of the Series 2011 Bonds, the amount of proceeds thereof specified for payment of costs of issuance will be deposited in the "**Costs of Issuance Account**" for payment of such costs of issuance. Any money or investments held in the Costs of Issuance Account for more than 180 days shall be transferred to the Capitalized Interest Subaccount of the Debt Service Account or, if the moneys held in the Capitalized Interest Subaccount shall have been fully disbursed, to the Debt Service Account for application on the next Distribution Date.

*Operating Account*. The Trustee will hold the "**Operating Account**" into which the Trustee will deposit amounts transferred from the Pledged Revenues Account as set forth in the Officer's Certificate as Operating Expenses and from which Operating Expenses will be paid in accordance with the priority of payments as described below under "Application of Pledged Revenues".

*Rebate Account*. The Trustee will hold the "**Rebate Account**" into which the Trustee will deposit amounts to the extent required to satisfy the Rebate Requirement with respect to the Tax-Exempt Series 2011B Bonds (as defined, computed and provided to the Trustee in accordance with the Tax Certificate), for payment to the United States Treasury. Neither the Authority nor any Bondholder will have any rights in or claim to such money in the Rebate Account.

*Residual Account*. The Trustee will hold the "**Residual Account**" into which the Trustee will deposit the Residual Revenues, which are those Pledged Revenues 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 "Application of Pledged Revenues". Amounts on deposit in the Residual Account will be delivered to the holder of the Residual Certificate as described below.

**Application of Pledged Revenues**

Unless otherwise specified in the Indenture, the Trustee will deposit all Pledged Settlement Payments received by it in the Pledged Revenues Account.

A. No later than five (5) Business Days following each deposit of Pledged Settlement Payments to the Pledged Revenues Account (but in no event later than the next Distribution Date and subject to clause (vii) below), the Trustee will withdraw Pledged Revenues on deposit in the Pledged Revenues Account and transfer such amounts as follows and in the following order of priority; provided, however, that investment earnings on amounts in the funds and accounts (other than the Debt Service Reserve Account, investment earnings on which shall be retained therein until the amounts on deposit therein are at least equal to the Debt Service Reserve Requirement, and on the fifth Business Day preceding each Distribution Date amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement may, at the direction of the Authority, be deposited directly to the Debt Service Account) will be deposited directly to the Debt Service Account; and provided, further, that upon the occurrence of a Payment Default, Pledged Revenues shall be transferred as set forth in clauses (i), (ii), (iv) and (vi) below and then all remaining Pledged Revenues shall be applied to make Extraordinary Prepayments as described in clause (C) below.

(i) to the Operating Subaccount, the amount required to pay (A) Trustee fees and expenses (including reasonable attorneys' fees, if applicable) reasonably expected to be due during the next Fiscal Year and (B) an amount specified by an Officer's Certificate for operating and administrative expenses incurred by the Authority ("**Operating Expenses**") (provided that such amounts paid pursuant to this clause (i) shall not exceed the "**Operating Cap**" (defined as $100,000.00 in the year ending June 30, 2014 inflated annually in each following Fiscal Year in accordance with the Indenture) and Operating Expenses shall not include any termination payments or loss amounts on Related Contracts);

(ii) to the Debt Service Account an amount sufficient to cause the amount therein (together with the amount, if any, then on deposit in the Capitalized Interest Subaccount allocable to the next succeeding Distribution Date, any Partial Lump Sum Payment to be applied to the payment of interest allocable to the next succeeding Distribution Date, and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next Distribution Date), to equal interest (including interest at the stated rate on the principal of outstanding bonds, and on overdue interest, if any) due on the next succeeding Distribution Date;

(iii) to the Debt Service Account, exclusive of the amounts deposited therein pursuant to clause (ii) above, an amount sufficient to cause the amount on deposit therein (together with any Partial Lump Sum Payment to be applied to the payment of principal or Sinking Fund Installments on the next succeeding March 1 and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next succeeding March 1 to the extent not counted for purposes of clause (ii) above), to equal the principal and Sinking Fund Installments due on the next succeeding March 1;

(iv) to the Debt Service Account, exclusive of the amount on deposit therein under clauses (ii) and (iii) above, an amount sufficient to cause the amount on deposit therein (together with any Partial Lump Sum Payment to be applied to the payment of interest on the second succeeding Distribution Date and the amount, if any, then on deposit in the Capitalized Interest Subaccount allocable to the second succeeding Distribution Date and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the second succeeding Distribution Date to the extent not counted for purposes of clause (ii) or (iii) above), to equal interest (including interest at the stated rate on the principal of Outstanding Series 2011 Bonds, and on overdue interest, if any) due on the second succeeding Distribution Date;

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

(vi) in the amounts and to the accounts established by the Series Indenture for (i) termination payments and loss amounts on related bond facilities, (ii) amounts due under related bond facilities and not payable as debt service, (iii) operating expenses, including litigation expenses, if any, incurred by the Authority, incurred in the previous Fiscal Year in excess of the applicable Operating Cap or reasonably expected to be incurred in the current or next succeeding Fiscal Years in excess of the applicable Operating Cap for such Fiscal Years, (iv) principal and interest on any Subordinated Bonds issued hereunder and (v) any other Junior Payments so identified in or by reference to the Indenture or any Series Indenture (the "**Junior Payments**"); and

(vii) no later than February 15 of each year, to the Residual Account, the Residual Revenues.

On the first (1st) Business Day of the calendar month preceding a month in which a Distribution Date occurs, the Trustee will compare (i) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (other than amounts set aside for the payment of Bonds) to (ii) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts described below on such Distribution Date, and if the amount in clause (i) is greater than the amount described in clause (ii) as of such Distribution Date, then the Authority will direct the Trustee to liquidate the investments in the Pledged Accounts and will withdraw from the Pledged Accounts an amount sufficient to, and shall, retire the Bonds in full on such Distribution Date.

B. Unless a Payment Default shall have occurred, 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 Operating Subaccount, to the parties entitled thereto, to pay the expenses of Authority described in clause (i) of the definition of Operating Expenses, in the amount specified in an Officer's Certificate of the Authority;

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

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

(iv) from the funds and accounts therefore, to make Junior Payments.

C. Promptly, and in no event more than five (5) Business Days after the deposit of such funds in the Residual Account, the Residual Revenues shall be transferred to the registered owner of the Residual Certificate.

Upon the occurrence of a Payment Default, the Trustee shall transfer Pledged Revenues in accordance with the priorities and purposes set forth in clauses (A)(i), (ii) and (iv) above and then, together with all funds on deposit in the Debt Service Reserve Account and all Partial Lump Sum Payments in the Lump Sum Account, shall apply any remaining funds to redeem Bonds on each Distribution Date, pro rata as to principal amount among maturities and within a maturity, without regard to Authorized Denominations, at the redemption price of 100% of the Outstanding principal amount thereof plus accrued interest to the date of redemption.

**Covenants of the Authority and the State**

*Protection of Title; Non-Impairment Covenant*. Pursuant to the Act, the Authority has included in the Indenture for the benefit of the Bondholders the pledge and agreement of the State contained in the Sale Agreement that the State shall (i) irrevocably direct, through the Commissioner of Management and

Budget, the transfer of all Pledged Settlement Payments directly to the Trustee as the assignee of the Authority, (ii) diligently enforce its right to collect all moneys due from the Settling Defendants pursuant to the Minnesota Agreement, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General (provided, that remedies available to the Authority and the owners of the Series 2011 Bonds for any breach of these agreements of the State shall be limited to injunctive relief and that the State will be deemed to have diligently enforced this covenant so long as there is no judicial determination by a court of competent jurisdiction in the State that the State has failed to diligently enforce the covenant), (iii) in any materially adverse way, neither amend the Minnesota Agreement or take any other action that would (a) impair the Authority's right to receive Pledged Settlement Payments, or (b) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Bondholders, or (c) impair the rights and remedies of the Bondholders or the security for the Series 2011 Bonds until the Series 2011 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 Sale Agreement or the Indenture will be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, and taxation and regulation of the sale of cigarettes or the like or to restrict the right of the state to amend, modify or repeal or otherwise alter statutes imposing or relating to the taxes) and (iv) not amend, supersede or repeal the Minnesota Agreement or the Act, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Bondholders. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, in the Indenture, in the Bonds or in the Act shall be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the Minnesota Agreement or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the Minnesota Agreement.

*No Bankruptcy of the Authority*. In accordance with the Act, the Authority shall have no authority to file a voluntary petition under, or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may, from time to time, be in effect and neither any public officer nor any organization, entity, or other person shall authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute as may, from time to time, be in effect.

*Tax Covenant*. The State agrees in the Sale Agreement that it 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 Authority on Tax-Exempt Bonds shall be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the State shall at any time be used directly or indirectly to acquire securities, obligations or investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations issued thereunder and in furtherance of such covenant shall execute and comply with the tax certificate provided by Transaction Counsel.

*Further Actions*. Upon request of the Authority 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. Upon request of the State or the Trustee, the Authority will execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes of the Sale Agreement.

## SUMMARY OF THE MINNESOTA AGREEMENT

*The following includes a brief summary of certain provisions of the Minnesota Agreement. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the Minnesota Agreement, as amended, which is attached hereto as Appendix A.*

### General

The Minnesota Agreement is settlement of litigation originally between the State and the then-existing four largest United States cigarette manufacturers, Philip Morris, Reynolds Tobacco, Lorillard and B&W (collectively, the "**Settling Defendants**") and was entered into between the Attorney General of the State and the Settling Defendants on May 8, 1998, as amended by the Agreement of Amendment to Settlement Agreement, dated as of June 1, 2001, by and among the State and the Settling Defendants. On January 5, 2004, Reynolds American Inc. 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, which occurred on June 30, 2004. References herein to the "Settling Defendants" mean, 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 obligations of the Settling Defendants are several and not joint. Blue Cross Blue Shield of Minnesota, which was also a party to the litigation, settled separately with the Settling Defendants. The State had previously settled with Liggett Group, Inc. ("**Liggett**") in exchange for Liggett's cooperation with respect to the release of documents related to the tobacco industry litigation. Liggett makes annual payments to the State of $100,000 in perpetuity, which are not included in the Pledged Settlement Payments. The Minnesota Agreement does not provide for other tobacco companies to become parties to the Minnesota Agreement. The settlement represents the resolution of a large potential financial liability of the Settling Defendants for smoking-related injuries, the costs of which have been borne and will likely continue to be borne by cigarette consumers. Pursuant to the Minnesota Agreement, the State agreed to settle all its past, present and future smoking-related claims against the Settling Defendants in exchange for agreements and undertakings by the Settling Defendants concerning a number of issues. These issues include, among others, making payments to the State, abiding by more stringent advertising restrictions, funding educational programs, ensuring public access to court documents and files and requiring disclosure of certain payments to lobbyists, all in accordance with the terms and conditions set forth in the Minnesota Agreement. Distributors of Settling Defendants' products are also covered by the settlement of such claims to the same extent as the Settling Defendants.

### Voluntary Agreement of the Parties

The Minnesota Agreement was entered into by the State and the Settling Defendants with the understanding that the U.S. Congress might enact legislation in the future addressing some or all of the issues addressed in the Minnesota Agreement. The Settling Defendants and their assigns, affiliates, agents and successors waived any right to challenge the Minnesota Agreement or the Consent Judgment, directly or through third parties, on the ground that any term of the Minnesota Agreement is unconstitutional, outside the power or jurisdiction of the court, preempted by or in conflict with any current or future federal legislation, except where non-economic terms of future federal legislation are irreconcilable.

**Scope of Release**

Under the Minnesota Agreement, the Settling Defendants and the other Released Parties (defined below) are released from:

- claims based on past conduct relating to the subject matter of the Minnesota Agreement which could have been asserted or could be asserted now or in the future; and

- monetary claims based on future conduct, directly or indirectly based on, arising out of or in any way relating to the use of or exposure to Tobacco Products (defined below) manufactured in the ordinary course of business, including future claims for reimbursement of healthcare costs allegedly associated with the use of or exposure to Tobacco Products.

The release is binding upon the State and any of its past, present and future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement, whether directly, indirectly, representatively, derivatively or in any other capacity.

The release inures to the benefit of each of the Settling Defendants and their past and present parents, subsidiaries (whether of not wholly-owned) and affiliates, and the respective divisions, organizational units, officers, directors, employees, representatives, insurers, suppliers, agents, attorneys and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing) (collectively, the "**Released Parties**").

**Overview of Payments by the Settling Defendants**

The Minnesota Agreement requires that the Settling Defendants make two types of payments, Initial Payments and Annual Payments, as well as certain court-administered payments. See "– Initial Payments" and "– Annual Payments" below. The base amount of these payments (with the exception of the up front Initial Payments) are subject to certain adjustments, which could be material. See "– Inflation Adjustment" and "– Volume Adjustment" below. Thus far, the Settling Defendants have made all of the Initial Payments and the Annual Payments for 1998 through 2010. See "– Payments Made to Date" below.

Payments required to be made by the Settling Defendants are calculated by reference to the Settling Defendants' respective share of sales of cigarettes (which in practice have been measured by shipments) by unit for consumption in the United States (excluding Puerto Rico). Payments to be made by the Settling Defendants are recalculated each year, based on the Market Share (as defined below) of each individual Settling Defendant for the prior year. Pursuant to the Minnesota Agreement, payments made pursuant to the Minnesota Agreement are made to an account designated in writing by the State. Upon the sale of the Pledged Settlement Payments to the Authority pursuant to the Sale Agreement, the State will direct the Settling Defendants and PricewaterhouseCoopers LLP, as the Calculation Agent with respect to the Minnesota Agreement (the "**Minnesota Agreement Calculation Agent**") to deposit all payments to the Pledged Revenues Account.

The Minnesota Agreement Calculation Agent or its predecessor has, among other things, calculated and determined the amount of all payments owed pursuant to the Minnesota Agreement, including the adjustments thereto (and all resulting carry-forwards if any), and the allocation of such payments and adjustments among the Settling Defendants and among the State. *This information is not* *publicly available and the Minnesota Agreement Calculation Agent has agreed to maintain the confidentiality of all such information, except that the Minnesota Agreement Calculation Agent may provide such information to the Settling Defendants and the State as set forth in the Minnesota Agreement.*

In addition to the Initial Payments and the Annual Payments, the Minnesota Agreement also provided for certain payments from the Settling Defendants that were deposited in accounts administered, as ordered by the Second Judicial District (Ramsey County), by the Minnesota Partnership for Action Against Tobacco. The Settling Defendants paid $102 million due in December 1998, which was deposited in the cessation account to be used to provide cessation opportunities to Minnesota smokers, and each Settling Defendant paid pro rata in proportion to its Market Share, its share of $10 million each year from June 1998 through June 2007, which was deposited into a national research account to be used for research to eliminate tobacco use by children and for program implementation, evaluation, and other tobacco control purposes.

**Initial Payments**

In September 1998, the Settling Defendants collectively made an up front Initial Payment of $240.0 million to the State. In January 1999, the Settling Defendants collectively made an up front Initial Payment of $220.8 million. These Initial Payments were not subject to the Inflation Adjustment or the Volume Adjustment (as defined herein). The Initial Payments due in the years 1998 through 2003, and the amounts paid by the Settling Defendants, after application of the adjustments, are set forth below under "Payments Made to Date".

**Annual Payments**

The Settling Defendants are required to make Annual Payments on each December 31 in perpetuity, subject to final adjustment within thirty days. The Settling Defendants made the first eleven Annual Payments due December 31 in each of the years 1998 through 2010. The scheduled amounts (before the adjustments discussed below) of each Annual Payment are referred to herein as the "**Applicable Base Payments**"; such amounts, and the amounts paid by the Settling Defendants, after application of the adjustments, are set forth below under "Payments Made to Date".

The respective portion of each Applicable Base Payment allocable to each Settling Defendant is calculated by multiplying the Applicable Base Payment by the Settling Defendant's Market Share during the calendar year ending on the date on which the payment is due. The Applicable Base Payments will be increased by the Inflation Adjustment (defined below), and adjusted by the Volume Adjustment (defined below), beginning with the Annual Payment due on December 31, 1999.

"**Market Share**" is defined as a Settling Defendant's respective share of sales (which in practice have been measured by shipments) of cigarettes by unit for consumption in the United States (excluding Puerto Rico) during (i) with respect to Annual Payments, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made, and (ii) with respect to all other payments made pursuant to the Minnesota Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

The term "**cigarette**" is defined in the Minnesota Agreement to mean any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (ii) 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 (iii) 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 (i) of this definition. Roll-your-own cigarettes are not included in the definition of "cigarette" in the Minnesota Agreement.

The Applicable Base Payments are subject to two adjustments applied in the following order:

- the Inflation Adjustment and
- the Volume Adjustment.

The application of the Volume Adjustment has in the past resulted in a material reduction of the Annual Payments made to the State by the Settling Defendants from the Applicable Base Payments set forth in the Minnesota Agreement, and may continue to do so in the future.

**Inflation Adjustment**

The base amounts of the Initial Payments, beginning with the Initial Payment due on or before January 3, 2000, and the Annual Payments are increased each year to account for inflation. The increase in each year will be the greater of 3% or the year over year percentage increase in the actual Consumer Price Index for All Urban Consumers (the "**CPI**") in November of the applicable year as published by the Bureau of Labor Statistics (the "**Inflation Adjustment**"). The inflation adjustment percentages are compounded annually on a cumulative basis beginning in 1998 and were first applied in 1999.

**Volume Adjustment**

The Initial Payments, beginning with the Initial Payment due on or before January 3, 2000, were, and each of the Applicable Base Payments is, increased or decreased by an adjustment which accounts for fluctuations in the number of cigarettes and smokeless tobacco products, which are defined in the Minnesota Agreement as any powder that consists of cut, ground, powdered or leaf tobacco that contains nicotine and is intended to be placed in the oral cavity, and is referred to together with cigarettes as "**Tobacco Products**" sold by the Settling Defendants in or to the United States (the "**Volume Adjustment**"). The smokeless tobacco products covered by the Minnesota Agreement include only those produced by the Settling Defendants. Those products represent a small fraction of the total U.S. smokeless market and currently do not have a material impact on the amount of Annual Payments that are payable to the State pursuant to the Minnesota Agreement. See "SUMMARY OF THE GLOBAL INSIGHT REPORT" herein.

If the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in any given year (the "**Actual Volume**") is greater than the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in 1997 (the "**Base Volume**") (471,247,947,000), the Applicable Base Payment allocable to the Settling Defendants is the amount of such Applicable Base Payment 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 Applicable Base Payment shall be reduced by subtracting from it the amount equal to such Applicable Base Payment multiplied both by 98% and by the result of (i) one minus (ii) the ratio of the Actual Volume to the Base Volume.

If, however, the aggregate net operating profits of the Settling Defendants from sales of Tobacco Products (as reported to the SEC for such year) in the United States during the year (the "**Actual Net Operating Profit**") is greater than $3,115,100,000, as adjusted for inflation in accordance with the

Inflation Adjustment (the "**Base Net Operating Profit**"), all or a portion of the volume reduction is added back. The amount by which the Applicable Base Payment is reduced if Actual Volume is less than Base Volume shall be reduced by 2.55% of 25% of such increase in profits. Any increase in the Applicable Base Payment due pursuant to this paragraph will be payable within 120 days after the date that the Applicable Base Payment was required to be made.

**No NPM Adjustment under the Minnesota Agreement**

Unlike the MSA, the Minnesota Agreement does not contain any provision for a reduction in Annual Payments from the Settling Defendants in the event that the Settling Defendants incur losses in market share to NPMs during a calendar year as a result of the Settling Defendants' participation in the Minnesota Agreement. The MSA contains provisions for an "**NPM Adjustment**", which is based upon market share increases, measured by domestic sales of cigarettes by manufacturers which are not a party to the MSA, and operates to reduce the payments due from the manufacturers that are parties to the MSA (the "**MSA PMs**") in the event that the MSA PMs incur losses in market share to manufacturers who are not parties to the MSA (the "**MSA NPMs**") during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment: (1) the aggregate market share of the MSA PMs in any year must fall more than 2% below the aggregate market share held by those same MSA 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 MSA enforcement statutes. An NPM Adjustment is applied to certain payments under the MSA for the subsequent year, and the decrease in total funds available as a result of an NPM Adjustment is then allocated on a pro rata basis among those MSA Settling States that have been found (i) to not diligently enforce their enforcement statutes, or (ii) to have enacted enforcement statutes that are declared invalid or unenforceable by a court of competent jurisdiction. The MSA PMs have claimed an NPM Adjustment in each year since payment year 2006, and such claims have been disputed by the MSA Settling States. The MSA Settling States and one or more of the MSA PMs are currently or have disputed the calculations of their payments under the MSA totaling over $7.1 billion for the sales years 2003 through 2010, including, with respect to payments due in April 2006 through April 2011, moneys withheld outright, deposited in a disputed payments account, or moneys paid to the MSA Settling States but with the MSA PM asserting a reservation of right to dispute such amount paid. The resolution of these disputes may occur either through arbitration or possibly the judicial process, and could lead to a significant reduction in payments to the MSA Settling States. There are no provisions in the Minnesota Agreement for sales by the NPMs and no adjustments will be made to Pledged Settlement Payments as a result of a loss of market share by the Settling Defendants to the NPMs.

**Payments Made to Date**

As required, the Settling Defendants have made all of the Initial Payments and have made Annual Payments from 1998 through 2010 and certain other amounts pursuant to the Minnesota Agreement totaling approximately $3.31 billion to date. Amounts received prior to July 1, 2013 (except for any Lump Sum Payments or Partial Lump Sum Payments received prior to July 1, 2013 allocable to payments that are payable on or after July 1, 2013) are not pledged to the payment of the Series 2011 Bonds. Under the Minnesota Agreement, the computation of Initial Payments and Annual Payments by the Minnesota Agreement Calculation Agent is confidential and may not be used for purposes other than those stated in the Minnesota Agreement.

| | Unadjusted Minnesota Agreement Applicable Base Payment | State's Actual Receipts* |
|---|---|---|
| **Up-Front Initial Payment**† | $240,000,000 | $240,000,000 |
| **1999 Initial Payment**† | 220,800,000 | 220,800,000 |
| **2000 Initial Payment** | 242,550,000 | 221,784,750 |
| **2001 Initial Payment** | 242,550,000 | 220,885,523 |
| **2002 Initial Payment** | 242,550,000 | 215,007,990 |
| **2003 Initial Payment** | 121,550,000 | 107,669,822 |
| **1998 Annual Payment**† | 102,000,000 | 102,000,000 |
| **1999 Annual Payment** | 114,750,000 | 104,925,995 |
| **2000 Annual Payment** | 127,500,000 | 145,136,835** |
| **2001 Annual Payment** | 165,750,000 | 161,022,719 |
| **2002 Annual Payment** | 165,750,000 | 157,711,642 |
| **2003 Annual Payment** | 204,000,000 | 168,466,764 |
| **2004 Annual Payment** | 204,000,000 | 175,388,332 |
| **2005 Annual Payment** | 204,000,000 | 180,689,740 |
| **2006 Annual Payment** | 204,000,000 | 183,618,396 |
| **2007 Annual Payment** | 204,000,000 | 184,310,711 |
| **2008 Annual Payment** | 204,000,000 | 179,754,485 |
| **2009 Annual Payment** | 204,000,000 | 168,197,370 |
| **2010 Annual Payment** | 204,000,000 | 169,275,081 |

† Not subject to the Inflation Adjustment or the Volume Adjustment. Deposited in a cessation account administered by the Court, as permitted in the Minnesota Agreement and required by the Consent Judgment, to provide cessation opportunities to Minnesota smokers.

* As reported by the State and to the best of the State's knowledge, amounts reflect the State's actual receipts including applicable adjustments.

** Includes $29,025,087 paid by the Settling Defendants on June 11, 2001 pursuant to the 2001 Amendment.

The terms of the Minnesota Agreement relating to such payments and the two adjustments thereto are described above under the captions "—Initial Payments", "—Annual Payments", "—Inflation Adjustment" and "—Volume Adjustment". Subsequent revisions in the information delivered to the Minnesota Agreement Calculation Agent (on which the Minnesota Agreement Calculation Agent'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 Annual Payments shown above. No assurance can be given as to the magnitude of any such recalculation.

**Limited "Most Favored Nation" Provision**

In partial consideration for the monetary payments to be made by the Settling Defendants pursuant to the Minnesota Agreement, the State has agreed that if the Settling Defendants enter into any future pre-verdict settlement agreement of other similar litigation brought by a non-federal governmental plaintiff on terms more favorable to such non-federal governmental plaintiff than the terms of the

Minnesota Agreement (after due consideration of relevant differences in population or other appropriate factors), the terms of the Minnesota Agreement will not be revised except as follows: to the extent, if any, such other pre-verdict settlement agreement includes terms that provide (a) for joint and several liability among the Settling Defendants with respect to monetary payments to be made pursuant to such agreement, (b) a guarantee by the parent company of any of the Settling Defendants or other assurances of payment or creditors' remedies with respect to monetary payments to be made pursuant to such agreement, or (c) for the implementation of non-economic tobacco-related public health measures different from those contained in the Minnesota Agreement, then the Minnesota Agreement will, at the option of the Attorney General of the State, be revised to include terms comparable to such terms.

**Disbursement of Funds**

The Minnesota Agreement Calculation Agent makes all calculations necessary to determine the amounts to be paid by each Settling Defendant. Annually, on or about December 20th, the Minnesota Agreement Calculation Agent provides copies of the preliminary disbursement calculations to all parties to the Minnesota Agreement. Annual Payments are due no later than December 31st. The Minnesota Agreement Calculation Agent delivers a final disbursement calculation to all parties to the Minnesota Agreement in January. In the event of any subsequent adjustments, those adjustments in favor of the State are due from the Settling Defendants by the end of January, and those adjustments in favor of the Settling Defendants are credited to the Settling Defendants in the following Annual Payment.

There are no provisions in the Minnesota Agreement for challenges to the calculations of the Minnesota Agreement Calculation Agent, and there have been no challenges to date. The information provided by the Minnesota Agreement Calculation Agent to the State with respect to calculations of amounts to be paid by Settling Defendants is confidential under the terms of the Minnesota Agreement and may not be disclosed to the Authority or the Holders.

**Advertising and Marketing Restrictions; Educational Programs**

The Minnesota Agreement prohibits the Settling Defendants from certain advertising, marketing and other activities that may promote the sale of Tobacco Products. Under the Minnesota Agreement, the Settling Defendants are prohibited from marketing, licensing, distributing, selling or offering, directly or indirectly, including by catalogue or direct mail, in the State, any service or item (other than tobacco products or any item of which the sole function is to advertise tobacco products) which bears the brand name (alone or in conjunction with any other word), logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products. The Settling Defendants are prohibited from placing any new outdoor and transit advertising, and have removed existing outdoor and transit advertising for Tobacco Products in the State, and the Settling Defendants are prohibited from making 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 made in the United States. Other examples of prohibited activities include, subject to limited exceptions: (i) the making of any material misrepresentation of fact regarding the health consequence of using any Tobacco Product, including any tobacco additives, filters, paper or other ingredients; (ii) entering into any contract, combination or conspiracy between or among themselves, which has the purpose or effect of limiting competition in the production or distribution of information about the health hazards or other consequences of the use of their products, limiting or suppressing research into smoking and health, marketing or development of new products; and (iii) taking any action, directly or indirectly, to target children in the State in the advertising, promotion or marketing of cigarettes, or taking any action with the primary purpose of initiating, maintaining or increasing the incidence of underage smoking in the State.

In addition, the Settling Defendants have agreed under the Minnesota Agreement and the Consent Judgment to provide funding for the organization and operation of a charitable public health foundation (the "**Foundation**") and educational and research programs. The main purpose of the Foundation will be to support programs to diminish the human and economic consequences of tobacco use. One-half of the Initial Payments were used to fund the purposes of the Foundation. Under the Consent Judgment, $102 million of the Annual Payments were paid into a separate account to be used to fund smoking cessation opportunities to smokers in the State, and each Settling Defendant was required to pay, and has paid, its pro rata share of $10 million on or before June 1 of the years 1998 through 2007, inclusive, into a national research account, the plan for administration of which was approved by the Minnesota State district court having jurisdiction in Ramsey County (the "**Court**"). Amounts on deposit in that account are to be used for research grants relating to the elimination of tobacco use by children and program implementation.

**Termination of Agreement**

If the Court determines that there has been a failure of consideration legally sufficient to require termination of the Minnesota Agreement, the Minnesota Agreement can be terminated by the adversely affected party. In the event of such a termination, the action will be reinstated and all decisions of the Court, and the parties' rights with respect to such action, will have the same force and effect as if the parties had not entered into the Minnesota Agreement.

**Severability**

The terms of the Minnesota Agreement are severable. If a court materially modifies, renders unenforceable or finds unlawful any provision, the Attorney General of the State and the Settling Defendants are required by the Minnesota Agreement to attempt to negotiate substitute terms. If, however, the parties are unable to agree to a substitute term or appropriate credit adjustment then the parties are to submit the issue to the Court for resolution subject to available appeal rights. In the event that any third-party challenge is made to the Minnesota Agreement, any Annual Payments will be placed into a special escrow account pursuant to the Minnesota Agreement. To date, there have not been any third party challenges to the Minnesota Agreement.

**Amendments and Waivers**

The Minnesota Agreement may be amended by the Settling Defendants and the Attorney General. Parties to the Minnesota Agreement, including the State, may waive the performance provisions of the Minnesota Agreement. Any waiver will only be effective if it is made in writing by the waiving party and only with respect to the breach specifically waived.

**Litigation Challenging the Minnesota Agreement**

The Minnesota Agreement does not contain any provision requiring arbitration of disputes between the parties to the Minnesota Agreement. The Court retains exclusive jurisdiction with respect to implementing and enforcing the Minnesota Agreement against the State and the Settling Defendants and resolving disputes between the parties regarding the terms and conditions of the Minnesota Agreement. Third parties are not required to bring claims regarding the Minnesota Agreement in State courts.

Although no assurance can be given that legal challenges to the Minnesota Agreement will not be brought in the future, as of the date hereof, there have not been any legal challenges to the Minnesota Agreement.

**Potential Payment Decreases Under the Terms of the Minnesota Agreement**

*Adjustments to Minnesota Agreement Payments*. The Minnesota Agreement provides that the amounts payable by the Settling Defendants are subject to the Inflation Adjustment and the Volume Adjustment, which may be material. The Volume Adjustment could reduce the Pledged Settlement Payments available to the Authority below the respective amounts required to pay the Series 2011 Bonds and could lead to a decrease in the market value and/or the liquidity of the Series 2011 Bonds, which in certain circumstances could lead to a complete loss of a Bondholder's investment. For additional information regarding the Minnesota Agreement and the payment adjustments, see "—Inflation Adjustment" and "―Volume Adjustment" above. See "RISK FACTORS" herein.

The assumptions used to project debt service coverage ratios are based on the premise that the Inflation Adjustment and the Volume Adjustment will occur as set forth under "DEBT SERVICE REQUIREMENTS AND COVERAGE UNDER THE GLOBAL INSIGHT FORECAST". Actual adjustments could be materially different from what has been assumed and described herein.

A significant loss of market share by the Settling Defendants could have a material adverse effect on the payments by the Settling Defendants under the Minnesota Agreement, could lead to a decrease in the market value and/or the liquidity of the Series 2011 Bonds, and could have a material adverse effect on the amounts and/or timing of Pledged Settlement Payments available to the Authority. See "―Volume Adjustment".

*Disputed or Recalculated Payments and Disputes under the Terms of the Minnesota Agreement*. The Minnesota Agreement does not contain any terms providing for a process to dispute the calculation of Annual Payments or any adjustments to such payments. To date, neither the Settling Defendants nor the State have disputed any of the calculations of payments under the Minnesota Agreement. See "RISK FACTORS" herein.

## SUMMARY OF THE GLOBAL INSIGHT REPORT

*The following is a brief summary of the Global Insight Report, a copy of which is attached hereto as APPENDIX B. This summary does not purport to be complete and the Global Insight Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Minnesota Agreement payments are based in part on domestic sales of cigarettes (excluding roll-your-own cigarettes but including the Settling Defendants' smokeless volume), which in practice have been measured by shipments. The Global Insight Report forecasts future United States domestic cigarette consumption, excluding Puerto Rico consumption and roll-your-own volume, and excluding the Settling Defendants' smokeless volume as such volume currently represents only a small fraction of the smokeless tobacco market and does not have a material impact on this forecast. 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 Insight (USA), Inc. ("**Global Insight**"), formerly known as DRI•WEFA, Inc., has prepared a report dated November 17, 2011 on the consumption of cigarettes in the United States from 2011 through 2030 entitled, "*A Forecast of U.S. Cigarette Consumption (2011-2030) for the Tobacco Securitization Authority"* (the "**Tobacco Consumption Report**"). Global Insight is an internationally recognized econometric and consulting firm of economists in more than 30 countries. Global Insight is a privately held company, which is a provider of financial, economic and market research information.

Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2010. Global Insight constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, real per capita disposable personal income, the impact of 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), Global Insight employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.4% per year holding other recognized significant factors constant.

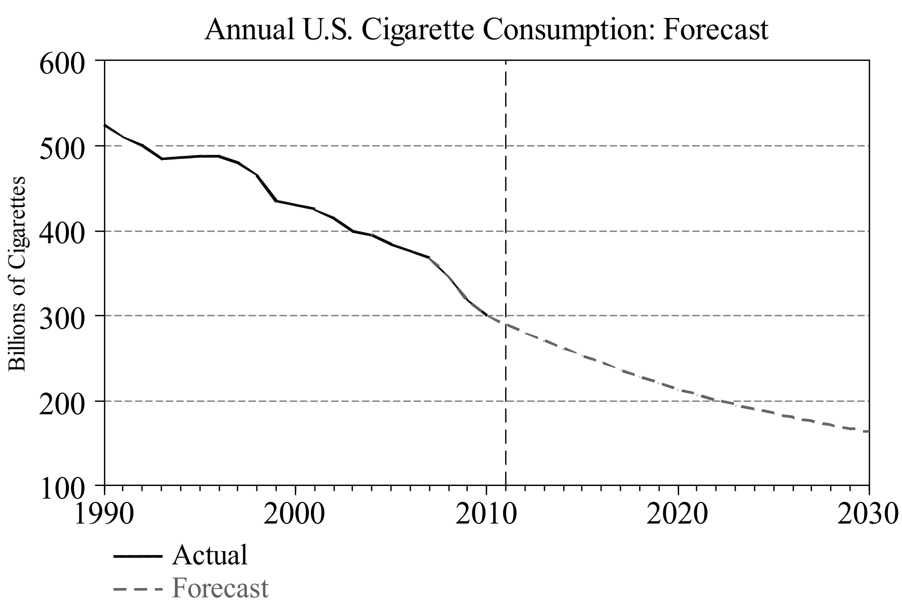
Global Insight's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2011 through 2030 (the "**Global Insight Forecast**"). The Global Insight Forecast indicates that the total United States cigarette consumption in 2030 will be approximately 163 billion cigarettes (approximately 8 billion packs), a 46% decline from the 2010 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 2.0%. The rate of decline accelerated dramatically beginning in 2008, with a 4.2% decline for that year, 8.3% in 2009, and 5.3% in 2010. For 2011 the decline is projected to be 3.8%. From 2011 through 2030 the average annual rate of decline is projected to be 3.0%. The fraction of the cigarette market accounted for by the three Settling Defendants under the Minnesota Agreement has been relatively unchanged since 2003, and consequently the Global Insight Forecast projects that the growth, or decline, rate of the cigarette volume subject to the Minnesota Agreement is equal to that of U.S. consumption. The total volume of tobacco products under the Minnesota Agreement in the U.S. is projected to fall from 256 billion in 2010 to 246 billion in 2011, 238 billion in 2012, and to 139 billion in 2030, as set forth in the following table. The Tobacco Consumption Report states that Global Insight believes the assumptions on which the Global Insight Forecast is based are reasonable.

***Global Insight Forecast Volume of Cigarettes***

| Year | Total Consumption *(billions)* | Minnesota Settling Defendants* *(billions)* | Decline Rate *(%)* |
|---|---|---|---|
| 2011 | 289.4 | 246.1 | -3.8% |
| 2012 | 279.9 | 238.0 | -3.3% |
| 2013 | 270.8 | 230.3 | -3.2% |
| 2014 | 262.1 | 222.9 | -3.2% |
| 2015 | 253.6 | 215.7 | -3.2% |
| 2016 | 245.2 | 208.5 | -3.3% |
| 2017 | 236.7 | 201.3 | -3.4% |
| 2018 | 228.6 | 194.4 | -3.4% |
| 2019 | 221.0 | 187.9 | -3.4% |
| 2020 | 213.8 | 181.8 | -3.2% |
| 2021 | 207.2 | 176.2 | -3.1% |
| 2022 | 201.1 | 171.0 | -3.0% |
| 2023 | 195.4 | 166.2 | -2.8% |
| 2024 | 190.2 | 161.7 | -2.7% |
| 2025 | 185.2 | 157.5 | -2.6% |
| 2026 | 180.6 | 153.5 | -2.5% |
| 2027 | 176.1 | 149.8 | -2.5% |
| 2028 | 171.8 | 146.1 | -2.5% |
| 2029 | 167.5 | 142.4 | -2.5% |
| 2030 | 163.3 | 138.9 | -2.5% |

* Excludes smokeless volume manufactured by the Settling Defendants.

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



## Historical Cigarette Consumption

The U.S. Department of Agriculture, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980s and 1990s, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2003 and an estimated 300 billion in 2010.

The following table sets forth United States domestic cigarette consumption for the ten years ended December 31, 2010. The data in this table vary from statistics on cigarette shipments in the United States. While the Tobacco Consumption Report is based on consumption, payments under the Minnesota Agreement are computed based on sales (which in practice have been measured by shipments) in or to the 50 states of the United States and the District of Columbia. 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 |
|---|---|---|
| 2010 | 301 | -5.27% |
| 2009 | 318 | -8.28 |
| 2008 | 346 | -4.22 |
| 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 |

## The Minnesota Agreement

The Minnesota Agreement includes the three Settling Defendants. Payments under the Minnesota Agreement are determined by the U.S. shipments of the three major manufacturers. In addition, shipments to Puerto Rico and other territories are excluded, and smokeless tobacco products are included. (Smokeless tobacco products are converted on a weight basis to cigarette equivalents at the rate of 0.12 ounces per cigarette). The smokeless products covered by the Minnesota Agreement include only those produced by the Settling Defendants, and represent a small fraction of the total U.S. smokeless market. They are currently immaterial relative to the reported cigarette volumes. The following table presents the volumes shipped by the Settling Defendants subject to the Minnesota Agreement, which differ from consumption presented in the previous table.

**Domestic Cigarette Shipments by the Settling Defendants**
**(Minnesota Agreement)**

| Year Ended December 31, | Consumption (Billions of Cigarettes) | Percentage Change |
|---|---|---|
| 2010 | 256 | -3.86% |
| 2009 | 266 | -10.10 |
| 2008 | 296 | -4.09 |
| 2007 | 309 | -4.55 |
| 2006 | 323 | -1.46 |
| 2005 | 328 | -2.11 |
| 2004 | 335 | -1.58 |
| 2003 | 341 | -5.73 |
| 2002 | 361 | -4.88 |
| 2001 | 380 | |

### Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trends over time, (vi) 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 affect current levels of consumption. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by Global Insight, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Global Insight's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify.

## SUMMARY OF ANNUAL PAYMENT CALCULATION METHODOLOGY AND STRUCTURING ASSUMPTIONS

### Introduction

The following discussion describes the methodology and assumptions used to calculate the Annual Payments to be received by the Trustee (the "**Cash Flow Assumptions**"), as well as the methodology and assumptions used to structure the Bonds (the "**Structuring Assumptions**"). The assumptions are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed here.

### Annual Payment Calculation Assumptions

The forecast of cigarette consumption in the United States developed by Global Insight and described as the Global Insight Forecast was applied to calculate Annual Payments to be made by the Settling Defendants and received by the Trustee pursuant to the Minnesota Agreement. The calculation of payments required to be made was performed in accordance with the terms of the Minnesota Agreement; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of the two adjustments to such payments set forth in the Minnesota Agreement. In addition, it was assumed that the Settling Defendants make all payments required to be made by them pursuant to the Minnesota Agreement, and that their market share remains constant throughout the term of the Series 2011 Bonds.

The Global Insight Forecast assumes that United States consumption is equal to the number of cigarettes (not including roll-your-own tobacco) shipped by the Settling Defendants in and to the 50 United States and the District of Columbia (but not including Puerto Rico), which is the number that is applied to determine the Volume Adjustment. The Global Insight Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. Global Insight's forecast for United States cigarette consumption is set forth herein under "SUMMARY OF THE GLOBAL INSIGHT REPORT." See APPENDIX B for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Global Insight Report.

**Annual Payments**

The amount of Annual Payments to be made by the Settling Defendants was calculated by applying the adjustments applicable to the Applicable Base Payments in the amounts set out in the Minnesota Agreement, as follows:

*Inflation Adjustment*. First, the Inflation Adjustment was applied to the schedule of Applicable Base Payments set forth in the Minnesota Agreement to calculate the Annual Payments. The inflation rate is compounded annually at the greater of 3.0% or the year-over-year percentage increase in the actual CPI in November of the applicable year as published by the Bureau of Labor Statistics. The calculations of Annual Payments assume the minimum Inflation Adjustment provided in the Minnesota Agreement of 3.0% in every year except for calendar years 2000, 2004, 2005 and 2007, where actual CPI results of 3.45%, 3.52%, 3.46% and 4.31% respectively, were used. Thereafter, the Inflation Adjustment was assumed to be the minimum provided in the Minnesota Agreement, at a rate of 3.0% per year, compounded annually, for the term of the Series 2011 Bonds.

*Volume Adjustment*. Next, the Applicable Base Payments calculated for each year after application of the Inflation Adjustment were adjusted for the Volume Adjustment by applying the Global Insight Forecast for United States cigarette consumption for the Settling Defendants. No add back or benefit was assumed from any Net Operating Profit Adjustment. See "SUMMARY OF THE MINNESOTA AGREEMENT —Volume Adjustment" for a description of the formula used to calculate the Volume Adjustment.

The following table shows a projection of Annual Payments from December 31, 2013 through December 31, 2030, calculated in accordance with the Global Insight Forecast and Assumptions described above.

**Projection of Annual Payments to be Received by the Trustee**

| December 31 | Global Insight Base Case Consumption Forecast | Applicable Base Payments | Inflation Adjustment | Volume Adjustment* | Annual Payments |
|---|---|---|---|---|---|
| 2013 | 230,266,246,000 | $204,000,000 | $122,328,498 | $(163,536,867) | $162,791,631 |
| 2014 | 222,882,422,000 | 204,000,000 | 132,118,356 | (173,604,168) | 162,514,188 |
| 2015 | 215,658,621,000 | 204,000,000 | 142,201,913 | (184,013,116) | 162,188,796 |
| 2016 | 208,462,701,000 | 204,000,000 | 152,587,961 | (194,869,674) | 161,718,287 |
| 2017 | 201,282,778,000 | 204,000,000 | 163,285,598 | (206,199,800) | 161,085,799 |
| 2018 | 194,387,745,000 | 204,000,000 | 174,304,169 | (217,810,225) | 160,493,944 |
| 2019 | 187,867,586,000 | 204,000,000 | 185,653,301 | (229,627,931) | 160,025,370 |
| 2020 | 181,818,554,000 | 204,000,000 | 197,342,909 | (241,565,457) | 159,777,452 |
| 2021 | 176,194,418,000 | 204,000,000 | 209,383,193 | (253,647,294) | 159,735,899 |
| 2022 | 170,991,458,000 | 204,000,000 | 221,784,679 | (265,863,695) | 159,920,984 |
| 2023 | 166,156,286,000 | 204,000,000 | 234,558,221 | (278,249,375) | 160,308,845 |
| 2024 | 161,682,096,000 | 204,000,000 | 247,714,976 | (290,799,825) | 160,915,152 |
| 2025 | 157,498,344,000 | 204,000,000 | 261,266,431 | (303,571,858) | 161,694,573 |
| 2026 | 153,544,151,000 | 204,000,000 | 275,224,417 | (316,619,710) | 162,604,708 |
| 2027 | 149,751,176,000 | 204,000,000 | 289,601,154 | (330,011,737) | 163,589,417 |
| 2028 | 146,055,814,000 | 204,000,000 | 304,409,188 | (343,819,121) | 164,590,067 |
| 2029 | 142,430,862,000 | 204,000,000 | 319,661,472 | (358,081,267) | 165,580,205 |
| 2030 | 138,886,928,000 | 204,000,000 | 335,371,308 | (372,798,818) | 166,572,490 |

* Assumes no Net Operating Profit Adjustment.

**Interest Earnings**

The annual payment calculation assumptions assume that the Trustee will receive on December 31st of each year the Annual Payments owed by the Settling Defendants in 2013 and each year thereafter. No earnings are assumed on the Annual Payments deposited into the Debt Service Account.

Amounts on deposit in the Debt Service Reserve Account are assumed to be invested at a rate per annum of 0% in 2011 and 2012; 0.25% in 2013; 0.40% in 2014; 0.50% in 2015; 0.65% in 2016; and 0.75% in 2017 and through the final maturity of the Series 2011 Bonds.

Amounts on deposit in the Capitalized Interest Subaccount are assumed to be invested at a rate of 0% per annum.

**Structuring Assumptions**

The Structuring Assumptions for the Series 2011 Bonds were applied to the projections of Annual Payments described above. See “SUMMARY OF THE GLOBAL INSIGHT REPORT” and APPENDIX B.

The Structuring Assumptions are described below:

*Issuance Date*. The Series 2011 Bonds were assumed to be issued on November 29, 2011.

*Interest Rates.* The Series 2011 Bonds were assumed to bear interest at the rates set forth on the inside front cover hereof. Computations of interest were assumed to be made on the basis of a 360-day year consisting of twelve 30-day months for the Series 2011 Bonds.

*Fixed Amortization Bonds.* The Series 2011 Bonds mature as set forth on the inside front cover hereof and certain Series 2011 Bonds are subject to mandatory redemption by operation of Sinking Fund Installments as set forth under "THE SERIES 2011 BONDS—Sinking Fund Installments".

*Debt Service Reserve Account*. The Debt Service Reserve Account Requirement was established for the Series 2011 Bonds at $73,553,424. It has been assumed that no surety, guaranty or similar agreement will be deposited in lieu of cash in the Debt Service Reserve Account.

*Capitalized Interest.* The first Annual Payment is due on December 31, 2013. Therefore, interest on the Bonds is capitalized through September 1, 2013 from bond proceeds. During the capitalized interest period, any earnings on the Debt Service Reserve Account are assumed to flow to the Capitalized Interest Subaccount of the Debt Service Account.

*Operating Expenses Assumptions*. Annual operating expenses of the Authority have been assumed at the Operating Cap limit, which is $100,000 for fiscal year 2014 assumed to be inflated at 3% per year for each year thereafter. Operating Expenses of $200,000 representing fiscal years 2012 and 2013 Authority operating expenses will be funded from proceeds of the Series 2011 Bonds. No operating expenses in excess of the annual Operating Cap are assumed.

*Miscellaneous.* The Cash Flow Assumptions assume that there is no optional redemption of the Series 2011 Bonds, no extraordinary optional redemption of the Series 2011B Bonds, that no Payment Default occurs, that no Lump Sum Payment or Partial Lump Sum Payment is received, that no Refunding Bonds are issued and that there is no Mandatory Clean-up Call exercised by the Authority from balances in the Pledged Accounts. It is further assumed that all Distribution Dates occur on the first day of each March and September, whether or not such date is a Business Day.

***No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2011 Bonds will be as assumed, or that the other assumptions underlying the Cash Flow Assumptions and Structuring Assumptions, including the market share of Settling Defendants, 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 Annual Payments available to the Authority to pay the principal of and interest on the Series 2011 Bonds could be adversely affected. See "RISK FACTORS" herein.***

## DEBT SERVICE REQUIREMENTS AND COVERAGE UNDER THE GLOBAL INSIGHT FORECAST

Set forth below is a schedule showing estimated debt service for the Series 2011 Bonds and the resulting estimated debt service coverage ratios, assuming the Series 2011 Bonds bear interest at the rates shown on the inside front cover hereof, cigarette consumption is consistent with the Global Insight Forecast and Collections are received in accordance with the Cash Flow Assumptions. As used herein, "**Debt Service Coverage**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Annual Payments received in such period which includes earnings on the Debt Service Reserve Account and other Pledged Accounts and earnings on Annual Payments until the applicable Distribution Date and the denominator of which is the sum of principal and interest required to be paid in such period plus Operating Expenses at the Operating Cap. The average debt service coverage ratio is 2.54x with a minimum debt service coverage ratio of 2.21x in 2014.

**Estimated Series 2011 Bonds Debt Service Coverage**
**Global Insight Base Case Consumption Decline (Average 3.01%), 2011-2030***

| Bond Payment Year | Total Available Funds(1) | Principal | Interest(2) | Operating Expenses(3) | Total Debt Service and Operating Expenses(4) | Debt Service Coverage |
|---|---|---|---|---|---|---|
| 2014 | $162,975,515 | $36,900,000 | $36,653,424 | $100,000 | $73,653,424 | 2.21x |
| 2015 | 162,808,402 | 37,785,000 | 35,581,445 | 103,000 | 73,469,445 | 2.22x |
| 2016 | 162,556,564 | 30,255,000 | 34,290,725 | 106,090 | 64,651,815 | 2.51x |
| 2017 | 162,196,384 | 31,690,000 | 32,809,600 | 109,273 | 64,608,873 | 2.51x |
| 2018 | 161,637,449 | 32,410,000 | 31,224,600 | 112,551 | 63,747,151 | 2.54x |
| 2019 | 161,045,595 | 32,940,000 | 29,612,788 | 115,927 | 62,668,715 | 2.57x |
| 2020 | 160,577,020 | 34,300,000 | 27,953,725 | 119,405 | 62,373,130 | 2.57x |
| 2021 | 160,329,102 | 35,785,000 | 26,217,475 | 122,987 | 62,125,462 | 2.58x |
| 2022 | 160,287,550 | 37,480,000 | 24,401,725 | 126,677 | 62,008,402 | 2.58x |
| 2023 | 160,472,635 | 38,550,000 | 22,452,788 | 130,477 | 61,133,265 | 2.62x |
| 2024 | 160,860,496 | 40,720,000 | 20,371,950 | 134,392 | 61,226,342 | 2.63x |
| 2025 | 161,466,802 | 43,165,000 | 18,169,969 | 138,423 | 61,473,392 | 2.63x |
| 2026 | 162,246,224 | 45,715,000 | 15,849,019 | 142,576 | 61,706,595 | 2.63x |
| 2027 | 163,156,358 | 49,310,000 | 13,366,763 | 146,853 | 62,823,616 | 2.60x |
| 2028 | 164,141,068 | 52,385,000 | 10,697,269 | 151,259 | 63,233,528 | 2.60x |
| 2029 | 165,141,718 | 55,660,000 | 7,861,088 | 155,797 | 63,676,884 | 2.59x |
| 2030 | 166,131,856 | 59,155,000 | 4,847,194 | 160,471 | 64,162,664 | 2.59x |
| 2031 | 166,848,315 | 62,750,000 | 1,647,188 | 165,285 | 64,562,472 | 2.58x |

* Assumes the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement.
(1) Includes Annual Payments plus earnings on the Debt Service Reserve Account.
(2) Debt service on Bonds through September 1, 2013 is capitalized.
(3) Includes Operating Expenses at the Operating Cap.
(4) Includes principal, interest and Operating Expenses at the Operating Cap.

## DEBT SERVICE COVERAGE UNDER ALTERNATIVE CONSUMPTION DECLINE SCENARIOS

Set forth below are schedules showing debt service for the Series 2011 Bonds and the resulting projected debt service coverage ratios, assuming the Series 2011 Bonds bear interest at the rates shown on the inside front cover hereof under four cigarette consumption decline scenarios. Each of the four projection tables assumes a base consumption volume of 255.88 billion in 2010, and from 2011 and thereafter a constant year-over-year consumption decline (as measured by shipments) equal to (i) 5% under the 5% Decline Case; (ii) 7% under the 7% Decline Case; and (iii) calculated constant annual "breakeven" consumption decline rates at which debt service on all Series 2011 Bonds would still be paid in full (a) assuming the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement under the 8.05% Breakeven Decline Case; and (b) assuming the Debt Service Reserve Account is used to pay debt service prior to the final maturity of the Series 2011 Bonds under the 10.22% Breakeven Decline Case. The cigarette shipment levels corresponding to these four constant annual rates of decline are shown in the following table.

**Cigarette Consumption (In Billions)**

| December 31 | 5% Decline Case(1) | 7% Decline Case(1) | 8.05% Breakeven Decline Case(1) | 10.22% Breakeven Decline Case(2) |
|---|---|---|---|---|
| 2013 | 219.39 | 205.82 | 198.93 | 185.17 |
| 2014 | 208.42 | 191.41 | 182.91 | 166.25 |
| 2015 | 198.00 | 178.01 | 168.19 | 149.26 |
| 2016 | 188.10 | 165.55 | 154.65 | 134.00 |
| 2017 | 178.69 | 153.96 | 142.20 | 120.31 |
| 2018 | 169.76 | 143.19 | 130.75 | 108.01 |
| 2019 | 161.27 | 133.16 | 120.23 | 96.97 |
| 2020 | 153.21 | 123.84 | 110.55 | 87.06 |
| 2021 | 145.55 | 115.17 | 101.65 | 78.17 |
| 2022 | 138.27 | 107.11 | 93.47 | 70.18 |
| 2023 | 131.36 | 99.61 | 85.94 | 63.01 |
| 2024 | 124.79 | 92.64 | 79.03 | 56.57 |
| 2025 | 118.55 | 86.16 | 72.66 | 50.78 |
| 2026 | 112.62 | 80.13 | 66.81 | 45.59 |
| 2027 | 106.99 | 74.52 | 61.44 | 40.93 |
| 2028 | 101.64 | 69.30 | 56.49 | 36.75 |
| 2029 | 96.56 | 64.45 | 51.94 | 33.00 |
| 2030 | 91.73 | 59.94 | 47.76 | 29.62 |

(1) Assumes the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement.
(2) Assumes the Debt Service Reserve Account is used to pay debt service prior to the final maturity of the Series 2011 Bonds.

**Estimated Series 2011 Bonds Debt Service Coverage**
**5% Year-Over-Year Consumption Decline, 2011-2030***

| Bond Payment Year | Total Available Funds[1] | Total Debt Service[2] | Operating Expenses[3] | Total Debt Service and Operating Expenses[4] | Debt Service Coverage |
|---|---|---|---|---|---|
| 2014 | $155,592,888 | $73,553,424 | $100,000 | $73,653,424 | 2.11x |
| 2015 | 152,698,045 | 73,366,445 | 103,000 | 73,469,445 | 2.08x |
| 2016 | 149,841,120 | 64,545,725 | 106,090 | 64,651,815 | 2.32x |
| 2017 | 147,094,357 | 64,499,600 | 109,273 | 64,608,873 | 2.28x |
| 2018 | 144,382,946 | 63,634,600 | 112,551 | 63,747,151 | 2.26x |
| 2019 | 141,668,878 | 62,552,788 | 115,927 | 62,668,715 | 2.26x |
| 2020 | 139,024,514 | 62,253,725 | 119,405 | 62,373,130 | 2.23x |
| 2021 | 136,448,693 | 62,002,475 | 122,987 | 62,125,462 | 2.20x |
| 2022 | 133,940,289 | 61,881,725 | 126,677 | 62,008,402 | 2.16x |
| 2023 | 131,498,215 | 61,002,788 | 130,477 | 61,133,265 | 2.15x |
| 2024 | 129,121,422 | 61,091,950 | 134,392 | 61,226,342 | 2.11x |
| 2025 | 126,808,890 | 61,334,969 | 138,423 | 61,473,392 | 2.06x |
| 2026 | 124,559,627 | 61,564,019 | 142,576 | 61,706,595 | 2.02x |
| 2027 | 122,372,678 | 62,676,763 | 146,853 | 62,823,616 | 1.95x |
| 2028 | 120,247,128 | 63,082,269 | 151,259 | 63,233,528 | 1.90x |
| 2029 | 118,182,085 | 63,521,088 | 155,797 | 63,676,884 | 1.86x |
| 2030 | 116,176,694 | 64,002,194 | 160,471 | 64,162,664 | 1.81x |
| 2031 | 113,954,299 | 64,397,188 | 165,285 | 64,562,472 | 1.77x |

* Assumes the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement.
(1) Includes Annual Payments plus earnings on the Debt Service Reserve Account.
(2) Debt service on Bonds through September 1, 2013 is capitalized.
(3) Includes Operating Expenses at the Operating Cap.
(4) Includes principal, interest and Operating Expenses at the Operating Cap.

**Estimated Series 2011 Bonds Debt Service Coverage**
**7% Year-Over-Year Consumption Decline, 2011-2030***

| Bond Payment Year | Total Available Funds(1) | Total Debt Service(2) | Operating Expenses(3) | Total Debt Service and Operating Expenses(4) | Debt Service Coverage |
|---|---|---|---|---|---|
| 2014 | $146,386,358 | $73,553,424 | $100,000 | $73,653,424 | 1.99x |
| 2015 | 140,812,131 | 73,366,445 | 103,000 | 73,469,445 | 1.92x |
| 2016 | 135,454,565 | 64,545,725 | 106,090 | 64,651,815 | 2.10x |
| 2017 | 130,376,961 | 64,499,600 | 109,273 | 64,608,873 | 2.02x |
| 2018 | 125,495,971 | 63,634,600 | 112,551 | 63,747,151 | 1.97x |
| 2019 | 120,765,442 | 62,552,788 | 115,927 | 62,668,715 | 1.93x |
| 2020 | 116,249,958 | 62,253,725 | 119,405 | 62,373,130 | 1.86x |
| 2021 | 111,940,942 | 62,002,475 | 122,987 | 62,125,462 | 1.80x |
| 2022 | 107,830,188 | 61,881,725 | 126,677 | 62,008,402 | 1.74x |
| 2023 | 103,909,858 | 61,002,788 | 130,477 | 61,133,265 | 1.70x |
| 2024 | 100,172,460 | 61,091,950 | 134,392 | 61,226,342 | 1.64x |
| 2025 | 96,610,826 | 61,334,969 | 138,423 | 61,473,392 | 1.57x |
| 2026 | 93,218,109 | 61,564,019 | 142,576 | 61,706,595 | 1.51x |
| 2027 | 89,987,764 | 62,676,763 | 146,853 | 62,823,616 | 1.43x |
| 2028 | 86,913,546 | 63,082,269 | 151,259 | 63,233,528 | 1.37x |
| 2029 | 83,989,483 | 63,521,088 | 155,797 | 63,676,884 | 1.32x |
| 2030 | 81,209,878 | 64,002,194 | 160,471 | 64,162,664 | 1.27x |
| 2031 | 78,293,460 | 64,397,188 | 165,285 | 64,562,472 | 1.21x |

* Assumes the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement.
(1) Includes Annual Payments plus earnings on the Debt Service Reserve Account.
(2) Debt service on Bonds through September 1, 2013 is capitalized.
(3) Includes Operating Expenses at the Operating Cap.
(4) Includes principal, interest and Operating Expenses at the Operating Cap.

The following tables set forth the "breakeven" year-over-year consumption declines at which each maturity of the Series 2011 Bonds would still be paid in full at maturity or, in the case of term bonds, earlier redemption from Sinking Fund Installments. If the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement, the breakeven year-over-year consumption decline is 8.05%. If the Debt Service Reserve Account is used to pay debt service prior to the final maturity of the Series 2011 Bonds, the breakeven year-over-year consumption decline is 10.22%.

**Estimated Series 2011 Bonds Debt Service Coverage**
**8.05% Year-Over-Year Breakeven Consumption Decline, 2011-2030***

| Bond Payment Year | Total Available Funds(1) | Total Debt Service(2) | Operating Expenses(3) | Total Debt Service and Operating Expenses(4) | Debt Service Coverage |
|---|---|---|---|---|---|
| 2014 | $141,708,613 | $73,553,424 | $100,000 | $73,653,424 | 1.92x |
| 2015 | 134,871,314 | 73,366,445 | 103,000 | 73,469,445 | 1.84x |
| 2016 | 128,381,107 | 64,545,725 | 106,090 | 64,651,815 | 1.99x |
| 2017 | 122,291,715 | 64,499,600 | 109,273 | 64,608,873 | 1.89x |
| 2018 | 116,510,830 | 63,634,600 | 112,551 | 63,747,151 | 1.83x |
| 2019 | 110,983,921 | 62,552,788 | 115,927 | 62,668,715 | 1.77x |
| 2020 | 105,767,741 | 62,253,725 | 119,405 | 62,373,130 | 1.70x |
| 2021 | 100,846,396 | 62,002,475 | 122,987 | 62,125,462 | 1.62x |
| 2022 | 96,204,845 | 61,881,725 | 126,677 | 62,008,402 | 1.55x |
| 2023 | 91,828,868 | 61,002,788 | 130,477 | 61,133,265 | 1.50x |
| 2024 | 87,705,013 | 61,091,950 | 134,392 | 61,226,342 | 1.43x |
| 2025 | 83,820,556 | 61,334,969 | 138,423 | 61,473,392 | 1.36x |
| 2026 | 80,163,461 | 61,564,019 | 142,576 | 61,706,595 | 1.30x |
| 2027 | 76,722,353 | 62,676,763 | 146,853 | 62,823,616 | 1.22x |
| 2028 | 73,486,478 | 63,082,269 | 151,259 | 63,233,528 | 1.16x |
| 2029 | 70,445,671 | 63,521,088 | 155,797 | 63,676,884 | 1.11x |
| 2030 | 67,590,325 | 64,002,194 | 160,471 | 64,162,664 | 1.05x |
| 2031 | 64,635,535 | 64,397,188 | 165,285 | 64,562,472 | 1.00x |

* Assumes the Debt Service Reserve Account is maintained at the Debt Service Reserve Requirement.
(1) Includes Annual Payments plus earnings on the Debt Service Reserve Account.
(2) Debt service on Bonds through September 1, 2013 is capitalized.
(3) Includes Operating Expenses at the Operating Cap.
(4) Includes principal, interest and Operating Expenses at the Operating Cap.

**Estimated Series 2011 Bonds Debt Service Coverage**
**10.22% Year-Over-Year Breakeven Consumption Decline, 2011-2030**

| Bond Payment Year | Total Available Funds(1) | Total Debt Service(2) | Operating Expenses(3) | Total Debt Service and Operating Expenses(4) | Debt Service Coverage |
|---|---|---|---|---|---|
| 2014 | $132,374,618 | $73,553,424 | $100,000 | $73,653,424 | 1.80x |
| 2015 | 123,222,508 | 73,366,445 | 103,000 | 73,469,445 | 1.68x |
| 2016 | 114,751,379 | 64,545,725 | 106,090 | 64,651,815 | 1.77x |
| 2017 | 106,981,375 | 64,499,600 | 109,273 | 64,608,873 | 1.66x |
| 2018 | 99,789,584 | 63,634,600 | 112,551 | 63,747,151 | 1.57x |
| 2019 | 93,093,596 | 62,552,788 | 115,927 | 62,668,715 | 1.49x |
| 2020 | 86,924,787 | 62,253,725 | 119,405 | 62,373,130 | 1.39x |
| 2021 | 81,244,173 | 62,002,475 | 122,987 | 62,125,462 | 1.31x |
| 2022 | 76,015,725 | 61,881,725 | 126,677 | 62,008,402 | 1.23x |
| 2023 | 71,206,148 | 61,002,788 | 130,477 | 61,133,265 | 1.16x |
| 2024 | 66,784,680 | 61,091,950 | 134,392 | 61,226,342 | 1.09x |
| 2025 | 62,722,891 | 61,334,969 | 138,423 | 61,473,392 | 1.02x |
| 2026† | 61,706,595 | 61,564,019 | 142,576 | 61,706,595 | 1.00x |
| 2027† | 62,823,616 | 62,676,763 | 146,853 | 62,823,616 | 1.00x |
| 2028† | 63,233,528 | 63,082,269 | 151,259 | 63,233,528 | 1.00x |
| 2029† | 63,676,884 | 63,521,088 | 155,797 | 63,676,884 | 1.00x |
| 2030† | 64,162,664 | 64,002,194 | 160,471 | 64,162,664 | 1.00x |
| 2031† | 64,562,472 | 64,397,188 | 165,285 | 64,562,472 | 1.00x |

† Assumes funds on deposit in the Debt Service Reserve Account are used to pay debt service prior to the final maturity of the Series 2011 Bonds.
(1) Includes Annual Payments plus earnings on the Debt Service Reserve Account.
(2) Debt service on Bonds through September 1, 2013 is capitalized.
(3) Includes Operating Expenses at the Operating Cap.
(4) Includes principal, interest and Operating Expenses at the Operating Cap.

## RISK FACTORS

The Series 2011 Bonds differ from many other securities in a number of respects, and differ significantly from tobacco revenue bonds that are payable primarily from payments under the MSA. The Series 2011 Bonds are primarily payable from the Pledged Revenues, which consist primarily of the Pledged Settlement Payments, as well as a pledge of the amounts in the Pledged Accounts. There are certain risk factors set forth below that are associated with this source of payment. Prospective investors should carefully consider these factors in making an investment in the Series 2011 Bonds, as well as other information contained in this Official Statement. However, certain risk factors associated with tobacco revenue bonds payable from payments under the MSA are not factors associated with the Series 2011 Bonds primarily due to the difference between the terms of the Minnesota Agreement and those of the MSA.

The following 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 Securities and Exchange Commission (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 list of risks set forth herein is not a complete list of the risks associated with the Pledged Settlement Payments nor does the order of presentation necessarily reflect the relative importance of the various and separate risks.

Potential purchasers of the Series 2011 Bonds are advised to consider the following factors, among others, and to review the other information in this Official Statement in evaluating the Series 2011 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 2011 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 MINNESOTA AGREEMENT" and "DOMESTIC TOBACCO INDUSTRY" herein.

**Potential Payment Decreases Under the Terms of the Minnesota Agreement**

The Minnesota Agreement provides that the amounts payable by the Settling Defendants are subject to the Volume Adjustment, which is material. The Volume Adjustment could reduce the Pledged Settlement Payments available to the Authority. No assurance can be given as to the magnitude of the adjustments. For additional information regarding the Minnesota Agreement and the payment adjustments, see "SUMMARY OF THE MINNESOTA AGREEMENT — Volume Adjustment."

A significant loss of market share by the Settling Defendants could have a material adverse effect on the payments by the Settling Defendants under the Minnesota Agreement, could lead to a decrease in the market value and/or the liquidity of the Series 2011 Bonds, and could have a material adverse effect on the amounts and/or timing of Pledged Settlement Payments available to the Authority. See "SUMMARY OF THE MINNESOTA AGREEMENT — Volume Adjustment".

**Litigation Seeking Monetary Relief from Tobacco Industry Participants May Adversely Impact the Ability of the Settling Defendants to Continue to Make Payments Under the Minnesota Agreement**

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 public health caused by smoking. The Minnesota Agreement and the other State Settlement Agreements (defined below) were the result of such litigation. If additional litigation against the Settling Defendants is successful on a significant level, the ability of the Settling Defendants to continue to operate their businesses and make payments under the Minnesota Agreement may be adversely affected. See "DOMESTIC TOBACCO INDUSTRY — Civil Litigation" for more information regarding the litigation described below.

***The tobacco companies are defendants in over 10,000 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 Settling Defendants and it is likely that similar claims will continue to be filed for the foreseeable future.

The claimants seek 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 seek 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 cases, individually or in the aggregate, could result in bankruptcy or cessation of operations by one or more of the Settling Defendants. It is also possible that the Settling Defendants 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 Settling Defendants 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 Settling Defendants. 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, which in practice have been measured by shipments, and thus payments under the Minnesota Agreement. See "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) was certified 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 actual damages to three individuals and approximately $145 billion in punitive damages to the certified class. During 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 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. The Settling Defendants are defendants in approximately 6,000 cases pending in various state and federal courts in Florida that were filed by members of the *Engle* class (the "***Engle*** **Progeny Cases**"). It is not possible to predict the final outcome of this litigation, but it may adversely affect the operations of the Settling Defendants and thus payments under the Minnesota Agreement. See "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 previously labeled as "lights" or "low tar"***

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 Food and Drug Administration's ("**FDA**") ban thereof in June 2010. The Settling Defendants recently reported that there are approximately 25 such "lights" class actions pending in various courts.

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 motion to dismiss plaintiffs' petition. 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.

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

In 1998, the Settling Defendants settled asserted and unasserted health care cost recovery and other claims brought by the State, Florida, Mississippi and Texas (the "**Previously Settled State Settlements**"). Subsequently, in 1998, U.S. tobacco product manufacturers, including the Settling Defendants, entered into the MSA to settle similar claims. The Minnesota Agreement, the settlement agreements with the other Previously Settled States and the MSA, are referred to as the "**State Settlement Agreements**". Except for the impact of the State Settlement Agreements on an annual basis when calculated, the Settling Defendants state in their regulatory or SEC filings that they are unable to make meaningful estimates of the amount or range of loss that could result from an unfavorable outcome of material pending litigation and, therefore, they generally have not made provisions in their consolidated financial statements for any such unfavorable outcomes. 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 Settling Defendants.

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 Settling Defendants, 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 Settling Defendants to substantially increase cigarette prices, thereby reducing cigarette consumption. In addition, the financial condition of any or all of the Settling 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 Settling Defendant is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected Settling Defendant's ability to make payments under the Minnesota Agreement and could have an adverse affect on the amount and/or timing of Pledged Settlement Payments available to the Authority. See "DOMESTIC TOBACCO INDUSTRY — Civil Litigation" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS."

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

Under the State Settlement Agreements, the Settling Defendants 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, in the year preceding the year in which payment is due, and, with respect to the Minnesota Settlement and other Previously Settled State Settlements, in the year in which payment is due. If the volume of cigarette sales by the Settling Defendants were materially reduced, these payment obligations could adversely affect the financial condition of the Settling Defendants and potentially the ability of Settling Defendants to make payments under the Minnesota Agreement. See "SUMMARY OF THE MINNESOTA AGREEMENT."

***Failures by any of the Settling Defendants to make payments under the Minnesota Agreement could lead to a delay of or default under the payment obligations of the Settling Defendants***

If a Settling Defendant were to discontinue making payments under the Minnesota Agreement for any reason, the corresponding payments to the Authority would be adversely affected. Any attempts to enforce payments under the Minnesota Agreement from a Settling Defendant in breach could be costly and time consuming as well as likely to include litigation. Failure by other Settling Defendants to make payments coupled with an inability on the part of the State to enforce and collect defaulted payments under the Minnesota Agreement could adversely affect the payments actually received by the Authority.

***The verdict returned in the federal government's reimbursement case (the "DOJ Case") could impose financial burdens on the tobacco industry and adversely affect future cigarette sales and thus payments under the Minnesota Agreement***

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 also would place certain prohibitions on the manner in which defendants market their cigarette products and would eliminate 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. Defendants have filed a notice of appeal. As of October 21, 2011, the Court of Appeals had not ruled on defendants' appeal, and the trial court had not yet entered an amended final judgment with respect to the issues that were remanded. On November 17, 2011, the trial court requested that the parties submit briefs with their views on the issue of whether the trial court should delay entry of any amended final judgment in the case until the conclusion of litigation challenging the FDA's rule containing new tobacco marketing restrictions and requiring textual and graphic warning labels on cigarette packaging and advertisements, which litigation is discussed below under DOMESTIC TOBACCO INDUSTRY--Regulatory Issues—*Federal Regulation*. It is possible that the remedial order, including the prohibitions on the use of the descriptors relating to low tar cigarettes, will negatively affect the Settling Defendants' future sales of and profits from cigarettes. See "DOMESTIC TOBACCO INDUSTRY — Civil Litigation."

**Declines in Cigarette Consumption May Materially Adversely Affect Pledged Settlement Payments Available for the Series 2011 Bonds**

Cigarette consumption in the U.S. has declined significantly over the last several decades. Continuing declines in cigarette consumption could adversely impact the amount and timing of the Pledged Settlement Payments available to pay debt service on the Series 2011 Bonds. 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 Minnesota Agreement***

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 2011 Bonds, payments under the Minnesota Agreement could be adversely affected. In addition, consumers may become more price-sensitive, which may result in some consumers switching to lower priced or counterfeit brands. Reductions in consumption or switching to brands not manufactured by the Settling Defendants could lead to reductions of payments under the Minnesota Agreement and could have an adverse affect on the amount and/or timing of Pledged Settlement Payments available to the Authority.

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

The 2009 Family Smoking Prevention and Tobacco Control Act (the "**FSPTCA**") granted the FDA broad authority over the manufacture, sale, marketing and packaging of tobacco products. The legislation:

- 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;

- 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.

The legislation permits the FDA to ban menthol upon a finding that such a prohibition would be appropriate for the public health.

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 the Settling Defendants, potentially resulting in a material adverse effect on the Settling Defendants' financial condition, results of operations and cash flows. The FDA has issued a proposed rule which requires cigarette packages and advertisements to have larger and more visible graphic health warnings by the fall of 2012. Five tobacco companies (including Reynolds Tobacco and Lorillard) have filed a complaint against the FDA in the U.S. District Court for the District of Columbia challenging the rule and seeking a declaratory judgment that the FDA's final rule violates the First Amendment and Administrative Procedure Act ("**APA**"). See "DOMESTIC TOBACCO INDUSTRY" below. The FDA has also 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 FDA has yet to issue guidance with respect to many other provisions of the FSPTCA, which may result in less efficient operation by the Settling Defendants in the near term as they may be reluctant to increase production, research or development prior to final regulations from the FDA. Additionally, the ability of the Settling Defendants 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.

***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 Minnesota Agreement***

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 may seek restrictions or a ban on the production and sale of mentholated 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 Settling Defendants, especially Lorillard, which is heavily dependent on sales of its *Newport* brand mentholated cigarettes. According to Lorillard, mentholated cigarettes are reported to have comprised 29.6% of the U.S. domestic cigarette market in 2010 and 30.6% in the nine months ended September 30, 2011. 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 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, adding that after peer review, the results and the preliminary scientific assessment will be available for public comment in the Federal Register. The external peer review is expected to be completed by mid-November. 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. 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 restrict 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 Settling Defendants, thereby reducing payments under the Minnesota Agreement.

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

Payments under the Minnesota Agreement are determined in part by the volume of cigarettes sold by the Settling Defendants in the U.S. cigarette market (excluding Puerto Rico), which in practice have been measured by shipments. 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. Reductions in consumption could lead to reductions of payments under the Minnesota Agreement and could have an adverse effect on the amount and/or timing of Pledged Settlement Payments available to the Authority.

In the U.S., tobacco products are subject to substantial and increasing taxation, which has a negative effect on consumption. Tobacco products are subject to substantial federal and state excise taxes in the United States. On April 1, 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 from $48.502 per thousand to $50.33 per thousand. The average state cigarette tax stands at $1.46 per pack, up from approximately $0.41 per pack in 2000. The total state and federal excise tax now equals $2.47 on average in the United States. The average price of cigarettes, including excise taxes in September 2011 was $6.80 per pack. In addition, legislation currently pending in the U.S. Senate, the Individuals with Disabilities Education Act (IDEA) Full Funding Act, would double the Federal excise tax on cigarettes to $2.01 and increase the taxes on smokeless tobacco products. The bill was introduced by Senator Tom Harkin in July 2011 to reauthorize and fund the Individuals with Disabilities Act, and currently has 14 sponsors in the Senate. A similar bill has not been introduced in the U.S. House of Representatives.

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, higher rates of smuggling 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 Minnesota Agreement and could have a negative effect on the amount and/or timing of Pledged Settlement Payments available to the Authority.

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

In recent years, states 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 Minnesota Agreement. See “DOMESTIC TOBACCO INDUSTRY — State and Local Regulation; Private Restrictions.”

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

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. The Minnesota Agreement prohibits the marketing, licensing, distributing, selling or offering, directly or indirectly within the State, of any service or item (other than tobacco products or any item of which the sole function is to advertise tobacco products) which bears the brand name, logo, symbol, motto, selling message, recognizable color or pattern of colors or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products. Under the FSPTCA, the FDA has issued rules restricting access and marketing of cigarettes and smokeless tobacco products to youth. 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 volumes of cigarettes in the U.S.

***Several of the Settling Defendants and their competitors have developed alternative tobacco and cigarette products, sales of which may not result in payments under the Minnesota Agreement***

Certain of the major cigarette makers have developed and marketed alternative cigarette products. For example, Philip Morris developed an alternative cigarette, called Accord, in which the tobacco is heated rather than burned. RJR Tobacco has developed and is marketing dissolvable tobacco tablets, orbs, strips and sticks. Sales of moist snuff products have increased recently. RJR 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, and Philip Morris manufactures Marlboro Snus and Marlboro Smokeless Tobacco Stick. Lorillard entered into an agreement with Swedish Match North America to develop smokeless products in the United States, which has since been discontinued. The Minnesota Agreement captures smokeless volume sold by the Settling Defendants but does not capture smokeless volume by separately owned subsidiaries such as Altria's UST Inc. or Reynolds American's American Snuff Company. The volume of snus sold by the Settling Defendants represents only a small fraction of the smokeless market and currently does not have a material impact on the Pledged Settlement Payments, and is therefore not included in the Global Insight consumption forecast set forth herein. Numerous manufacturers have developed and are marketing "electronic cigarettes", battery powered devices that vaporize liquid nicotine which is then inhaled. Should such alternative cigarette products that do not involve burning tobacco gain a significant share of the domestic cigarette market, payments under the Minnesota Agreement, and thus amounts of Pledged Settlement Payments available to the Authority, may decrease because payments under the Minnesota Agreement derive from the sale of products that involve the burning of tobacco and only smokeless products manufactured and sold directly by the Settling Defendants.

***Smoking cessation products may reduce cigarette sales volumes and adversely affect payments under the Minnesota Agreement***

Large pharmaceutical companies have developed and increasingly expanded their marketing of smoking cessations 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 multi-billion dollar business in the U.S. at the drug store level. Studies have shown that these programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. 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 Minnesota Agreement. See "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 their businesses, results of operations or financial condition***

The consumption of cigarettes in the U.S., and therefore the amounts payable under the Minnesota Agreement, 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 Settling Defendants under the Minnesota Agreement***

Sales of counterfeit cigarettes in the U.S. could adversely impact sales by the Settling Defendants 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 Settling Defendants 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 Settling Defendants, resulting in lower payments under the Minnesota Agreement.

A decline in the overall consumption of cigarettes could have an adverse effect on the payments by Settling Defendants under the Minnesota Agreement and the amount and/or timing of Pledged Settlement Payments available to the Authority. See "DOMESTIC TOBACCO INDUSTRY" for a further discussion of the foregoing factors and events.

**General Economic Conditions and Lack of Access to Favorable Financing May Materially Adversely Impact the Ability of the Settling Defendants to Continue to Operate, Leading to Reduced Sales of Volumes of Cigarettes and Payments under the Minnesota Agreement**

The ability of the Settling Defendants 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 Settling Defendants may sell fewer cigarettes, potentially resulting in reduced payments under the Minnesota Agreement.

***Adverse changes in financial market conditions or the credit ratings of the Settling Defendants could result in lack of access to financing, losses, higher costs and decreased profitability for the Settling Defendants, 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 Settling Defendants, which would negatively impact the Settling Defendants consolidated results of operations, cash flows and financial position. Changes in financial market conditions could negatively impact the Settling Defendants' 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 Minnesota Agreement may decrease.

The outstanding notes issued by the Settling Defendants 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 Settling Defendants 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 Minnesota Agreement may decrease.

**Litigation May be Commenced Challenging the Minnesota Agreement**

No parties have filed actions against the State alleging that the Minnesota Agreement is void or unenforceable. However, the Minnesota Agreement may be challenged in the future. A determination by a court having jurisdiction over the State and the Authority that the Minnesota Agreement is void or unenforceable could have a materially adverse effect on the payments by the Settling Defendants under the Minnesota Agreement and the amount and/or the timing of Pledged Settlement Payments available to the Authority. See "SUMMARY OF THE MINNESOTA AGREEMENT." For a description of the opinions of Nixon Peabody LLP addressing such matters, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS — Minnesota Agreement Enforceability" and "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS."

**Other Risks Relating to the Minnesota Agreement**

***Severability***

The terms of the Minnesota Agreement are severable. If a court materially modifies, renders unenforceable or finds unlawful any provision, the Attorney General of the State and the Settling Defendants are required by the Minnesota Agreement to attempt to negotiate substitute terms. If, however, the parties are unable to agree to a substitute terms or appropriate credit adjustment, then the parties must submit the issue to the Court for resolution subject to available appeal rights. In the event that any third-party challenge is made to the Minnesota Agreement, any Annual Payments will be placed into a special escrow account pursuant to the Minnesota Agreement. See "SUMMARY OF THE MINNESOTA AGREEMENT — Severability."

***Amendments, Waivers and Termination***

As a settlement agreement between the Settling Defendants and the State, the Minnesota Agreement is subject to amendment in accordance with its terms, and was amended in 2001, and may be terminated upon consent of the parties thereto. Parties to the Minnesota Agreement, including the State, may waive the performance provisions of the Minnesota Agreement. See "COVENANTS OF THE STATE — Amendments Affecting State Covenants." If the Court determines that there has been a failure of consideration legally sufficient to require termination of the Minnesota Agreement, the Minnesota Agreement can be terminated by the adversely affected party. In the event of such a termination, the action will be reinstated and all decisions of the trial court, and the parties' rights with respect to such action, will have the same force and effect as if the parties had not entered into the Minnesota Agreement. The Authority is not a party to the Minnesota Agreement and has no right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Holders of the Series 2011 Bonds will presumably be the same in many circumstances, no assurance can be given that such an amendment, waiver or termination of the Minnesota Agreement would not have a material adverse effect on the receipt of Pledged Settlement Payments by the Authority. See "SUMMARY OF THE MINNESOTA AGREEMENT — Amendments and Waivers" and "— Termination".

***Reliance on State Enforcement of the Minnesota Agreement and State Non-Impairment***

The State may not convey and has not conveyed to the Authority or the Bondholders any right to enforce the terms of the Minnesota Agreement. Pursuant to its terms, the Minnesota Agreement, as it relates to the State, can only be enforced by the State. Failure by the State to enforce the Minnesota Agreement may have a material adverse effect on the receipt of Pledged Settlement Payments by the Authority. In the Sale Agreement, the State has covenanted not to amend, supersede or repeal the Minnesota Agreement or the Act in any way that would materially adversely affect the amount of a payment to, or the rights to the Pledged Settlement Payments of, the Authority or the Bondholders. 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 Series 2011 Bonds. In that event, the Holders of the Series 2011 Bonds, the Trustee or the Authority 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."

**Bankruptcy of a Settling Defendant May Delay, Reduce, or Eliminate Payments of Pledged Settlement Payments**

If one or more Settling Defendants 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 Settling Defendant, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Authority, the Trustee, the registered owner of the Series 2011 Bonds, or the beneficial owners of the Series 2011 Bonds to collect any Pledged Settlement Payments or any other amounts owing by the bankrupt Settling Defendant. In addition, even if the bankrupt Settling Defendant 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 Minnesota Agreement was not an "executory contract" under the Bankruptcy Code, the Settling Defendant may be unable to make further payments of Pledged Settlement Payments. If the Minnesota Agreement is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt Settling Defendant may be able to repudiate the Minnesota Agreement and stop making payments under it.

Furthermore, payments previously made to the registered owners of the Series 2011 Bonds or the beneficial owners of the Series 2011 Bonds could be avoided as preferential payments, so that the registered owners and the beneficial owners of the Series 2011 Bonds would be required to return such payments to the bankrupt Settling Defendant. Also, the bankrupt Settling Defendant may have the power to alter the terms of its payment obligations under the Minnesota Agreement without the consent, and even over the objection of the State, the Authority, the Trustee, the registered owners, or the beneficial owners of the Series 2011 Bonds. There may be other possible effects of a bankruptcy of a Settling Defendant that could result in delays or reductions or elimination of Pledged Settlement Payments. Regardless of any specific adverse determination in a Settling Defendant bankruptcy proceeding, the fact of a Settling Defendant bankruptcy proceeding could have an adverse effect on the timing of receipt, amount and value of the Pledged Settlement Payments. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS RELATING TO PLEDGED SETTLEMENT PAYMENTS — Bankruptcy Considerations."

**Limited Resources of the Authority**

The Series 2011 Bonds are payable only from the assets of the Authority pledged under the Indenture. In the event that such assets of the Authority have been exhausted, no amounts will thereafter be available to be paid on the Series 2011 Bonds. The Series 2011 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 2011 Bonds. Investors in the Series 2011 Bonds must look solely to the assets of the Authority pledged under the Indenture for repayment of their investment. The Authority's only sources of funds for payments on the Series 2011 Bonds are the Pledged Revenues. The Authority has no taxing power and no assets are available to pay Series 2011 Bonds other than the assets acquired pursuant to the

Sale Agreement and pledged under the Indenture. No assets of the State are pledged to secure or will be available to pay debt service on the Series 2011 Bonds.

**Limited Remedies**

The Trustee is limited under the terms of the Sale Agreement to enforcing the terms of the agreement and to receiving the Pledged Settlement Payments and applying them in accordance with the Indenture. If an Event of Default occurs, the Trustee cannot sell its rights under the Sale Agreement. The Authority is not a party to the Minnesota Agreement and has not made any representation or warranty that the Minnesota Agreement is enforceable. Remedies under the Sale Agreement do not include the repurchase by the State of the Pledged Settlement Payments under any circumstances, including unenforceability of the Minnesota Agreement or breach of any representation or warranty. The remedies of the Holders of the Series 2011 Bonds are no greater than those afforded to the Trustee.

## 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 2011 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 Holders of the Series 2011 Bonds) and of the obligations of a Settling Defendant under the Minnesota Agreement 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 Settling Defendant are described below and include the risks of delay in or reduction of amount of the payment or of nonpayment under the Minnesota Agreement and the risk that the State (and, thus, the Authority) may be stayed for an extended time from enforcing any rights under the Minnesota Agreement or with respect to the payments owed by the bankrupt Settling Defendant or from commencing legal proceedings against the bankrupt Settling Defendant. As a result, if a Settling Defendant becomes a debtor in a bankruptcy case and defaults in making payments required under the Minnesota Agreement, Pledged Settlement Payments available to the Authority to pay Holders of Series 2011 Bonds may be reduced or eliminated. Furthermore, certain payments previously made to Holders of the Series 2011 Bonds could be avoided as preferential payments, so that the Holders would be required to return such payments to the bankrupt Settling Defendant.

*Chapter 7 Bankruptcy.* If a Settling Defendant becomes bankrupt and does not reorganize under Chapter 11, it will 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 Settling Defendant that is in the Chapter 7 case. To the extent that the volume of cigarettes sold by other Settling Defendants increased as a result of cessation of operations by the Settling Defendant being liquidated under Chapter 7 of the Bankruptcy Code, the market share of such other Settling Defendants should increase.

*Chapter 11 Reorganization.* Should a Settling Defendant become a debtor in a Chapter 11 reorganization bankruptcy case, the Settling Defendant may not be authorized to make any payments owing under the Minnesota Agreement, or may be required to obtain bankruptcy court approval before making such payments. Legal proceedings necessary to determine whether such Settling Defendant's obligations under the Minnesota Agreement 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 Settling Defendant.

Examples of other bankruptcy-related risks include:

*Minnesota Agreement as Executory Contract.* The treatment of the Minnesota Agreement under the Bankruptcy Code may be dependent upon whether it is construed to be an executory contract (which is not defined by the Bankruptcy Code but generally is considered to be a contract in which performance remains due to some extent from both parties). Under the Bankruptcy Code, if the Minnesota Agreement is treated as an executory contract, a trustee in bankruptcy or a Settling Defendant acting as a debtor-in-possession would have the right to assume or reject the Minnesota Agreement. However, there is no time period within which a trustee or Settling Defendant in bankruptcy would be required to assume or reject the Minnesota Agreement. Legal proceedings necessary to resolve the issue of whether the Minnesota Agreement 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 Settling Defendant.

Nixon Peabody LLP will render an opinion to the Authority 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 a Settling Defendant, a court, exercising reasonable judgment after full consideration of all relevant factors in a properly presented and argued case, would (a) hold that the Minnesota Agreement is an executory contract pursuant to Section 365 of the Bankruptcy Code and (b) approve a decision by a Settling Defendant to assume or reject the Minnesota Agreement as an executory contract.

*Assumption or Rejection of Minnesota Agreement.* Should a bankrupt Settling Defendant determine to assume the Minnesota Agreement, it would have to cure all outstanding payment defaults under it and provide “adequate assurance” that all future payments under it 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 Settling Defendant cannot provide such adequate assurance, payments under the Minnesota Agreement may be delayed or eliminated.

If a bankrupt Settling Defendant determines to reject the Minnesota Agreement, the State (and thus the Authority, the Trustees and the Holders of the Series 2011 Bonds, 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 Settling Defendant. However, under the Bankruptcy Code, the State (and thus the Authority, the Trustees and the Holders of the Series 2011 Bonds) nevertheless may be enjoined from commencing or continuing any action against the Settling Defendant to enforce remedies under the Minnesota Agreement (including an action to collect payments due under the Minnesota Agreement). In addition, because amounts owed by the Settling Defendant under the Minnesota Agreement are not fixed, legal proceedings may be necessary to quantify the claims of the State (and thus the Authority, the Trustee and the Holders of the Series 2011 Bonds) for damages as a result of the Settling Defendant’s rejection of the Minnesota Agreement. Such legal proceedings could be time consuming and could result in delays, reductions, or elimination of, payments by the bankrupt Settling Defendant.

*Modification of Minnesota Agreement Obligations.* If the Minnesota Agreement is determined not to be an “executory contract”, the Settling Defendant determines to reject it or the Settling Defendant is otherwise not authorized to make payments under it, then a bankruptcy of the Settling Defendant could result in long delays and possibly in large reductions in the amount of Pledged Settlement Payments available to pay the Holders of the Series 2011 Bonds because, under the Bankruptcy Code, the obligations of the Settling Defendant under the Minnesota Agreement could be modified or discharged in their entirety. For example, the bankruptcy court may approve a plan of reorganization or liquidation of the Settling Defendant that alters the timing or the amount of payments to be made by the Settling Defendant under the Minnesota Agreement to the State (and, thus, to the Authority, the Trustees and Holders of the Series 2011 Bonds).

**Enforceability of the Minnesota Agreement**

The major provisions of the Minnesota Agreement are severable. If a court materially modifies, renders unenforceable or finds unlawful any provision, the Attorney General of the State and the Settling Defendants are required by the Minnesota Agreement to attempt to negotiate substitute terms. If, however, the parties are unable to agree to a substitute term or appropriate credit adjustment then the parties are to submit the issue to the Court for resolution subject to available appeal rights. In the event that any third-party challenge is made to the Minnesota Agreement, any Annual Payments will be placed into a special escrow account pursuant to the Minnesota Agreement. See "SUMMARY OF THE MINNESOTA AGREEMENT — Severability." Even if substitute terms are agreed upon, payments under such terms may be less than payments under the Minnesota Agreement 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 2011 Bonds.

No lawsuits challenging the validity or enforceability of the Minnesota Agreement have been commenced. However, certain cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes and smokers' rights organizations have instituted lawsuits against some, and in certain cases all, of the signatories to the MSA, alleging, among other things, that the MSA violates certain provisions of the United States Constitution, the federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws and unfair competition laws, which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. All of the judgments on the merits have rejected the challenges presented in these cases. In the most recent decision, *Grand River*, the district court determined on summary judgment that the MSA and related legislation did not violate Section 1 of the Sherman Antitrust Act or the Commerce Clause of the Constitution of the United States. That decision is now on appeal to the United States Court of Appeals for the Second Circuit. In another recent decision, *Freedom Holdings IV*, 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. In the other decisions upholding the MSA, the decisions were rendered either on motions to dismiss or motions for summary judgment. Certain of these cases have appeals pending. If similar challenges were made to the Minnesota Agreement and there was a determination by a court that the Minnesota Agreement is void or voidable, Holders of the Series 2011 Bonds could incur a complete loss of the Pledged Settlement Payments. See "SUMMARY OF THE MINNESOTA AGREEMENT — Litigation Challenging the Minnesota Agreement."

In rendering the opinion described below, Nixon Peabody LLP considered the claims asserted in the federal and state actions described above under the caption "SUMMARY OF THE MINNESOTA AGREEMENT — Litigation Challenging the Minnesota Agreement" that it believes are representative of the legal theories that an opponent of the Minnesota Agreement would advance in an attempt to invalidate the Minnesota Agreement. Subject to the qualifications and assumptions set forth in such opinion, Nixon Peabody LLP will render an opinion to the Authority 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 Minnesota Agreement is a valid, binding and enforceable obligation of the signatories thereto and is lawful and enforceable. This opinion as to the enforceability of the Minnesota Agreement 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 Minnesota Agreement is void or voidable, 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 2011 Bonds. In that event, the Bondholders, the Trustees or the Authority could assert claims based on contractual or constitutional rights.

*Contractual Remedies*. Under Minnesota law, settlements are treated as contracts and may be enforced according to their terms. The Consent Judgment coupled with the Minnesota Agreement is a court-approved settlement of lawsuits that establishes the State's right to receive the Pledged Settlement Payments. The Sale Agreement obligates the State to take all necessary action to protect the Authority's interest in the Pledged Settlement Payments. Thus, if the State violates the provisions of the Minnesota Agreement, the Trustees, as assignees of the Authority's rights under the Sale Agreement, could seek to compel the State to enforce its payment rights under the Minnesota Agreement. As interested parties, the Authority on its own behalf and the Trustees on behalf of the Holders of the Series 2011 Bonds could also seek to enforce the State's rights under the Minnesota Agreement, although, as third parties to the Minnesota Agreement, 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 the Minnesota Agreement or the financing arrangements in a manner that would substantially impair the rights of the Holders of the Series 2011 Bonds to be paid from the Pledged Settlement 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 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 Holders of the Series 2011 Bonds to be paid from the Pledged Settlement 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 rights of the Holders of the Series 2011 Bonds are based upon reasonable conditions and are of a character appropriate to the public purpose justifying the legislation's adoption.

Finally, Holders of the Series 2011 Bonds may also have constitutional claims under the Due Process Clauses of the United States Constitution and State Constitution.

**No Assurance as to the Outcome of Litigation**

With respect to all matters of litigation mentioned above that have been brought and may in the future be brought against the Settling Defendants, or involving the enforceability or constitutionality of the Minnesota Agreement or the enforcement of the right to the Pledged Settlement Payments or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be predicted with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amount of Pledged Settlement Payments available to the Authority to pay the principal of and interest on the Series 2011 Bonds.

## 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. The Settling Defendants 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 Authority has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Authority has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. Prospective investors in the Series 2011 Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2011 Bonds is consistent with their investment objectives.

Minnesota Agreement payments are computed based in part on cigarette sales, which in practice have been measured by shipments in or to the 50 states of the United States and the District of Columbia and do not include Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States and the District of Columbia 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 Settling Defendants for purposes of their filings with the SEC, may be different from Market Share for purposes of the Minnesota Agreement and the respective obligations of the Settling Defendants to**

**contribute to Annual Payments. The Market Share information reported is confidential under the Minnesota Agreement, except to the extent reported by NAAG. See "SUMMARY OF THE MINNESOTA AGREEMENT — Overview of Payments by the Settling Defendants" and "– Annual Payments". Additionally, aggregate market share information, based upon shipments as reported by Lorillard, Inc., Reynolds American Inc. and the Altria Group, Inc. and reflected in the chart below entitled "Manufacturers' Domestic Market Share of Cigarettes" is different from that utilized in the bond structuring assumptions. See "DEBT SERVICE REQUIREMENTS AND COVERAGE UNDER THE GLOBAL INSIGHT FORECAST".**

**Industry Overview**

As reported by NAAG, based upon Settling Defendant shipments reported to MSAI, the Settling Defendants accounted for approximately 83.56% of the U.S. domestic cigarette market in 2010 (excluding roll-your-own cigarettes). However, according to publicly available documents of the Settling Defendants, in 2010 the Settling Defendants collectively accounted for approximately 90.2% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the U.S. divides generally into premium and discount sales, approximately 70.2% and 29.8%, respectively, measured by volume of all domestic cigarette sales for calendar year 2010, as reported by Lorillard, Inc.

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 calendar year 2010, Altria reported that Philip Morris's domestic cigarette market share for calendar year 2010 was 49.8% (based on retail sales), which represents a decrease of 0.1 share points from its reported domestic market share (based on retail sales) of 49.9% for calendar year 2009. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2011, Altria reported that Philip Morris's domestic cigarette market share for the three months ended March 31, 2011 was 49.0% (based on retail sales), a decrease of 1.2 share points when compared to the first three months of 2010. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2011, Altria reported that Philip Morris's domestic cigarette market share for the six months ended June 30, 2011 was 49.1% (based on retail sales), a decrease of 0.3 share points when compared to the first six months of 2010. In its Form 10-Q filed with the SEC for the nine month period ended September 30, 2011, Altria reported that Philip Morris' domestic cigarette market share for the nine months ended September 30, 2011 was 49.0%, a decrease of 1.0 share points when compared to the first nine months of 2010. Philip Morris's major premium brands are Marlboro, Virginia Slims and Parliament. Its principal discount brand is Basic. Marlboro is the largest selling cigarette brand in the U.S., with approximately 42.6% of the U.S. domestic retail share for calendar year 2010, up from 41.8% from the calendar year 2009, and has been the world's largest-selling cigarette brand since 1972. 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. Philip Morris'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 or direct mail sales.

Reynolds American Inc. ("**Reynolds American**") is the second largest tobacco company in the U.S. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of 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 Minnesota Agreement 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 Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc.

In its Form 10-K filed with the SEC for calendar year 2010, Reynolds American reported that its domestic retail cigarette market share for calendar year 2010 was 28.1% (measured by sales volume), which represents a decrease of 0.2 share points from the 28.3% for calendar year 2009. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2011, Reynolds American reported that its domestic retail market share for the three months ended March 31, 2011 was 27.9% (measured by sales volume), no change in market share when compared to the first three months of 2010. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2011, Reynolds American reported that its domestic retail market share for the six months ended June 30, 2011 was 27.4% (measured by sales volume), a decrease of 0.5 share points when compared to the first six months of 2010. In its Form 8-K filed with the SEC on October 25, 2011, Reynolds American reported that its domestic retail market share for the nine months ended September 30, 2011 was 27.5% (measured by sales volume), , a decrease of 0.5 share points when compared to the first nine months of 2010. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), formerly a wholly-owned subsidiary of Loews Corporation prior to June 2008, is the third largest tobacco company in the U.S. In its Form 10-K filed with the SEC for calendar year 2010, Lorillard reported that its domestic cigarette market share for calendar year 2010 was 12.3% (measured by wholesale shipment volume), which represents an increase of 1.0 share points from its reported domestic market share of 11.3% (measured by wholesale shipment volume) for calendar year 2009. In its Form 10-Q filed with the SEC for the three-month period ended March 31, 2011, Lorillard reported that its domestic cigarette market share for the three months ended March 31, 2011 was 13.7% (measured by wholesale shipment volume), an increase of 1.6 share points when compared to the first three months of 2010. In its Form 10-Q filed with the SEC for the six-month period ended June 30, 2011, Lorillard reported that its domestic cigarette market share for the six months ended June 30, 2011 was 14.2% (measured by wholesale shipment volume), an increase of 1.5 share points when compared to the first six months of 2010. In its Form 10-Q filed with the SEC for the nine-month period ended September 30, 2011, Lorillard reported that its domestic cigarette market share for the nine months ended September 30, 2011 was 14.2% (measured by wholesale shipment volume), an increase of 1.4 share points when compared to the first nine months of 2010. Lorillard's principal brands are Newport, Kent, True, Maverick, Old Gold and Max. Its largest selling brand is Newport, which accounted for approximately 90.0% of Lorillard's net sales for the calendar year 2010 and 91.5% for the calendar year 2009. 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 data made available by MSAI.

Based on the domestic retail market shares discussed above, the remaining share of the U.S. retail cigarette market for calendar year 2010 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc., a wholly-owned subsidiary of Vector Group Ltd., and Commonwealth Brands, Inc. ("**CBI**"), a wholly-owned subsidiary of Imperial Tobacco Group PLC ("**Imperial Tobacco**"), which markets deep discount brands. Imperial Tobacco is listed on the London Stock Exchange and does not file reports with the SEC. However, Imperial Tobacco reported in its 2010 annual report that it held a 3.9% market share of the U.S. cigarette market, a decrease of 0.3 share points from its 4.2% market share of the U.S. cigarette market for 2009. CBI's brands include USA Gold, Sonoma and Davidoff. Liggett is the operating successor to the Liggett & Myers Tobacco Company. In its Form 10-K filed with the SEC for calendar year 2010, Vector reported that Liggett's domestic market share in 2010 was 3.5% (measured by shipment volume), which represents an increase of 0.8 share points from its 2009 domestic market share of 2.7%. All of Liggett's unit sales volume for the calendar years

2008, 2009 and 2010 was in the discount segment. Its brands include Liggett Select, Grand Prix, Eve, Pyramid and USA. Liggett makes a $100,000 payment to the State which is not part of the Pledged Settlement Payments. Vector 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 has determined to postpone the national launch of QUEST indefinitely. In February 2008, Liggett announced that it will begin selling "snus", a smokeless tobacco product, under its Grand Prix brand but does not appear to have yet entered that market as there is no mention of it in Vector's recent SEC filings. Liggett, Vector Group Ltd., CBI and Imperial Tobacco are not Settling Defendants under the Minnesota Agreement.

**Industry Market Share**

The following table sets forth the approximate comparative positions of the leading producers of cigarettes in the U.S. domestic tobacco industry, each of which is a Settling Defendant under the Minnesota Agreement, as well as other manufacturers which are not Settling Defendants under the Minnesota Agreement. Individual and total domestic Settling Defendant market shares presented below are derived from the publicly available documents of the Settling Defendants and, as a result of varying methodologies used by the Settling Defendants to calculate market share, may not be comparable and may be inaccurate when combined as presented.

**Manufacturers' Domestic Market Share of Cigarettes***

| Manufacturer | 2011** | 2010 | 2009 | 2008 | 2007 |
|---|---|---|---|---|---|
| Philip Morris | 49.0% | 49.8% | 49.9% | 50.9% | 50.6% |
| Reynolds American | 27.5 | 28.1 | 28.3 | 28.1 | 29.0 |
| Lorillard | 14.2 | 12.3 | 11.3 | 10.7 | 10.0 |
| Other*** | 9.3 | 9.8 | 10.5 | 10.3 | 10.4 |

* Aggregate market share as reported above is different from that utilized in the Cash Flow Assumptions.

** As of September 30, 2011.

*** The market share, other than the Settling Defendants, has been determined by subtracting the total market share percentages of the Settling Defendants 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. Such sales are not captured under the Minnesota Agreement.

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 are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

The following table sets forth the industry's approximate cigarette shipments in the U.S. for the four years ended December 31, 2010. The Minnesota Agreement payments are calculated based on sales, which in practice have been measured by shipments by the Settling Defendants in or to the U.S.

(excluding Puerto Rico and roll-your-own and including smokeless volume produced by the Settling Defendants) rather than consumption.

| Years Ended December 31 | Shipments (Billions of Cigarettes) |
|---|---|
| 2010 | 303.7 |
| 2009 | 315.7 |
| 2008 | 345.3 |
| 2007 | 357.2 |

* As reported in SEC filings of Lorillard and the Loews Corporation, based on MSAI data.

According to Lorillard's SEC filings, based on MSAI data, domestic industry shipments continue to decrease during 2011, compared with the corresponding quarterly periods of 2010.

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

**Cigarette Shipment Trends**

According to data from NAAG, overall shipments dropped approximately 6.45% to 304 billion cigarettes in 2010 from 325.2 billion cigarettes in 2009 primarily due to the excise tax increases and the difficult macroeconomic environment for the domestic consumer. The NAAG figures include roll own tobacco sales which sales are not included in the definition of "cigarette" under the Minnesota Agreement. According to Global Insight, the NAAG data, when adjusted to subtract roll-your-own tobacco sales, resulted in overall shipments of 301 billion cigarettes in 2010. According to NAAG data, domestic U.S. cigarette consumption over the past 10 years (including roll-your-own tobacco) was as follows:

| Year | No. of Cigarettes (in billions) | % Change |
|---|---|---|
| 2010 | 304 | -6.45 |
| 2009 | 325 | -9.23 |
| 2008 | 358 | -3.84 |
| 2007 | 373 | -4.77 |
| 2006 | 391 | 0.26 |
| 2005 | 390 | -3.51 |
| 2004 | 404 | 0.09 |
| 2003 | 404 | -3.30 |
| 2002 | 418 | -2.68 |
| 2001 | 429 | -1.51 |

According to data from the Department of Treasury, Alcohol and Tobacco Tax and Trade Bureau, overall shipments dropped approximately 6.22% to 304 billion cigarettes in 2010 from 324 billion cigarettes in 2009 (measuring roll-your-own tobacco sales at 0.0325 ounces per cigarette conversion rate). According to this data, domestic U.S. cigarette consumption over the past 10 years was as follows:

| Year | No. of Cigarettes (in billions) | % Change |
|---|---|---|
| 2010 | 304 | -6.22 |
| 2009 | 324 | -9.35 |
| 2008 | 357 | -3.71 |
| 2007 | 371 | -4.69 |
| 2006 | 389 | -0.13 |
| 2005 | 390 | -3.60 |
| 2004 | 404 | -0.56 |
| 2003 | 407 | -3.54 |
| 2002 | 421 | -2.31 |
| 2001 | 431 | -2.29 |

**Physical Plant, Distribution, Competition and Raw Materials**

The production facilities of the Settling Defendants tend to be highly concentrated. For instance, all of the cigarette production of Lorillard comes from a single facility in North Carolina. The other Settling Defendants 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 each 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. Only discount cigarettes manufactured by the Settling Defendants are captured by the Minnesota Agreement.

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 Minnesota Agreement 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. 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. Snuff is now being marketed to adult cigarette smokers as an alternative to cigarettes. UST, the largest producer of moist smokeless tobacco, is explicitly targeting adult smoker conversion in its growth strategy. The industry is responding to both the proliferation of indoor smoking bans and to a perception that smokeless use is a less harmful mode of tobacco and nicotine usage than cigarettes. In 2006, the three largest U.S. cigarette manufacturers entered the market. 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. 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 2008, Liggett announced it would introduce Grand Prix snus, which has yet to be marketed based on a review of Lorillard's 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 to increased risks of oral cancer among other health concerns. Snuff use is also often criticized as a gateway to cigarette use.

In 2008 a new firm, Fuisz Tobacco, was formed to commercialize a film-based smokeless tobacco 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. Numerous manufacturers have developed and are marketing "electronic cigarettes", battery powered devices that vaporize liquid nicotine, which is then inhaled by the consumer.

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.

Although the Minnesota Agreement provides for the inclusion of smokeless tobacco products sold by the Settling Defendants in the calculation of the Volume Adjustment, since the volume of smokeless tobacco products sold by the Settling Defendants represents only a small fraction of the smokeless market and currently does not have a material impact on the Volume Adjustment calculation, it is therefore not included in the Global Insight consumption forecasts set forth herein.

## Smoking Cessation Products

A variety of smoking cessation products and services have developed to assist individuals to quit smoking. Studies have shown that smoking cessation products and programs are effective, and that excise taxes, 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.

Studies have shown that these products and programs are effective, and that excise taxes and smoking restrictions drive additional expenditures to the smoking cessation market. Additionally, 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 Centers for Disease Control 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 have in essence 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, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet, and charge state employees who smoke higher health insurance premiums than non-smoking state employees. 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. Several large corporations are now charging smokers higher premiums.

*Federal Regulation*. The FSPTCA signed by President Obama on June 22, 2009, grants the FDA authority to regulate tobacco products. Among other provisions, FSPTCA:

- establishes the 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;
- 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 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; and
- required warning labels for smokeless tobacco products.

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 earlier in 2011 and remains subject to continuing TPSAC hearings, and recommendations on dissolvable products are due in March of 2012. Written comments regarding dissolvable tobacco products were due for submission to the TPSAC on October 19, 2011 ahead of its next meeting, at which the TPSAC will continue its discussions of issues related to the nature and impact of dissolvable tobacco products on public health. The meeting was scheduled for November 2-3, 2011 but has been postponed. 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 will be available for public comment in the Federal Register. The external peer review is expected to be completed by mid-November.

The FDA has stated that it has issued approximately 1,200 warning letters to retailers in 15 states for violating Federal tobacco regulations since the agency's Center for Tobacco Products began conducting retail inspections under the FSPTCA. Most of the letters were issued for selling tobacco products to minors. Over the last two years the FDA has 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.

Pursuant to requirements of the FSPTCA, the FDA issued a proposed rule on November 10, 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 11, 2011. On June 21, 2011, the FDA unveiled nine new graphic health warnings that must appear on cigarette packages and advertisements no later than September 2012.

On August 16, 2011, five tobacco companies (including Settling Defendants 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 challenging the Agency's rule requiring new textual and graphic warning labels on cigarette packaging and advertisements. The tobacco companies seek a declaratory judgment that the FDA's final rule violates the First Amendment and the APA, and declarative and injunctive relief that the new textual and graphic warnings will not become effective until 15 months after 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, therefor, 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. It has been reported that six U.S. Senators sent a letter to the Department of Justice and the FDA calling for an immediate appeal of the U.S. District Court's decision to grant a preliminary injunction.

On October 6, 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 will be coordinated by researchers at the NIH's National Institute on Drug Abuse and the FDA's Center for Tobacco Products. 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.

On November 1, 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 relates to an up to $390 million campaign to prevent tobacco use among teenagers thirteen to seventeen years old. The second request for proposals is 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.

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.

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

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

- 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.

Since the initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports 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. 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. In addition, 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.

*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 95.5% of a $10.14 billion payment to tobacco quota holders and growers over a ten-year period. 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. It is likely that these federal excise tax increases have had, and will continue to have, a significant and adverse impact on cigarette sales volume. In addition, press reports have noted that many consumers who previously purchased roll-your-own tobacco are now 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.

Legislation currently pending in the U.S. Senate, the Individuals with Disabilities Education Act (IDEA) Full Funding Act, would double the Federal excise tax on cigarettes and increase the taxes on smokeless tobacco products. The bill, S. 1403, introduced by Senator Tom Harkin in July 2011 and sponsored by 14 senators, would increase the Federal excise tax on cigarettes from $1.01 to $2.01 per pack, on snuff from $1.51 to $26.79 per pound and on chewing tobacco from $0.51 to $10.72 per pound, while also taxing dissolvables, snus and other portioned smokeless products at $0.10 per piece. This would make the excise taxes on smokeless tobacco products comparable to those on cigarettes. A similar bill has not been introduced in the U.S. House of Representatives.

All of the states and the District of Columbia currently impose cigarette taxes, which as of August 1, 2011, range from $0.17 per pack in Missouri to $4.35 per pack in New York. The average state cigarette tax stands at $1.46 per pack (up from approximately $0.41 per pack in 2000). Since January 1, 2002, 47 states and 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. Connecticut, Florida and Rhode Island each raised taxes by $1.00 per pack of cigarettes, while Arkansas, Hawaii, Delaware, Mississippi, New Hampshire and Wisconsin significantly raised their cigarette taxes by $0.45 to $0.75 per pack. In 2010, six states raised taxes on cigarettes, including Hawaii, New York, New Mexico, South Carolina, Utah and Washington, and in 2011, Connecticut, Hawaii and Vermont increased taxes on cigarettes. It is expected that states will continue to raise excise taxes on cigarettes in 2012 and future years.

The State currently imposes a 75-cent "health impact fee" on tobacco manufacturers for each pack of cigarettes sold. The purpose of this fee is to recover Minnesota's health costs related to or caused by tobacco use. The imposition of this fee was contested by Philip Morris and upheld by the Minnesota Supreme Court as not in violation of Minnesota's settlement with the tobacco companies. On February 20, 2007, the U.S. Supreme Court declined to hear Philip Morris' appeal of that decision.

In 2004, Michigan imposed an equity assessment on MSA NPMs selling cigarettes in the state. The purpose of the equity assessment is to fund enforcement and administration of Michigan's MSA-related statutes. 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 MSA 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 MSA NPM will sell in Michigan in the current calendar year multiplied by 17.5 mills. Utah also imposes an equity assessment on MSA NPMs. An extra $0.35 is added to each pack of cigarettes sold by an MSA NPM, in addition to other applicable taxes on tobacco.

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

*State and Local Regulation; Private Restrictions*. 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 State Settlement Agreements.

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 the American Lung Association's Tobacco Policy Project/State Legislated Actions on Tobacco Issues (SLATI), as of March 16, 2011, six states require product disclosure of tobacco products. Massachusetts and Texas require disclosure of any added substance of tobacco products other than water, tobacco and reconstituted tobacco sheet, while Minnesota and Utah require disclosure when any of the following substances are added: ammonia or any compound of ammonia, arsenic, cadmium, formaldehyde and lead. New Hampshire requires its state Department of Health and Human Services to obtain the list of additives for tobacco products from the Massachusetts Department of Public Health. In addition, Massachusetts, Texas and Utah require disclosure of nicotine yields for each brand of cigarette to their respective health authorities. In Connecticut, the Commissioner of Public Health is required to issue regulations concerning how the Commissioner will obtain nicotine yield ratings for each brand of tobacco product.

In 2003, New York passed 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 the Coalition for Fire-Safe Cigarettes, similar laws have been enacted in 49 other states and the District of Columbia. By July 1, 2011, laws requiring cigarettes to be fire safe will be effective in all 50 states. All states use the "model" regulatory bill based on New York's fire-safe cigarettes law to maintain uniform manufacturing standards.

According to the American Nonsmokers' Rights Foundation ("**ANRF**"), as of October 7, 2011, 35 states and the District of Columbia have laws that require 100% smoke-free non-hospitality workplaces and/or restaurants and/or bars. The states are: Arizona, California, Colorado, Connecticut, Delaware, Florida, Hawaii, Idaho, Illinois, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Dakota, Utah, Vermont, Washington and Wisconsin. Restrictions in Arizona, Hawaii, Illinois, New Mexico and Washington are stronger than those in other states as they include a ban on outdoor smoking within at least 15 feet of the entrances of restaurants and other public places. Even states without a statewide smoking ban have local municipalities that have enacted smoking regulations. It is expected that these restrictions will continue to proliferate.

ANRF tracks clean indoor air ordinances by local governments throughout the U.S. As of October 7, 2011, there were 3,397 municipalities with local laws that restrict where smoking is allowed, including 2,106 municipalities that restrict smoking in one or more outdoor areas. Of these, 755 local governments required non-hospitality workplaces to be 100% smoke free, and 100% smoke free conditions were required for restaurants by 771 municipalities, and for bars by 634. The number of such ordinances grew rapidly beginning in the 1980s, from less than 200 in 1985 to over 1,000 by 1993, and 1,500 by 2001. The ordinances completely restricting smoking in restaurants and bars have generally appeared in the past decade.

*Smoking Bans Have Also Extended Outdoors*. According to ANRF, currently, only Hawaii, Iowa, Maine, Michigan and Washington prohibit smoking in outdoor dining areas, but as many as 192 municipalities in other states have also banned smoking in those areas, including Los Angeles, Philadelphia and San Francisco. At least 574 municipalities prohibit smoking in parks, including San Diego County and Cook County, which includes Chicago. Along with the state of Maine, which prohibits smoking on beaches in its state parks, as many as 123 municipalities have banned smoking on beaches, including Chicago, Santa Monica and Seattle. Along with Iowa, New York and Wisconsin, at least 222 municipalities have banned smoking at public transit stops, and smoking in zoos is prohibited in 52 municipalities and Oklahoma.

Smoking bans have been enacted for smaller governmental and private entities. According to the ANRF, there are at least 586 universities and colleges that prohibit smoking on campuses with no exemptions, including dormitory housing. Complete smoking bans, indoor and outdoor, have also been implemented on the campuses of at least four national and 2,890 local health providers. Federal correctional facilities are completely smoke free, as well as those in 16 states. Twenty-three other states allow smoking in correctional facilities but only in outdoors areas. Finally, many states mandate a certain minimum percentage of hotel rooms to be nonsmoking. For example, Ohio requires 80% of the rooms to be nonsmoking and California requires 35%. Many municipalities around the country have set their own minimums.

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. 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.

*International Agreements*. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the U.S., that had ratified the treaty prior to November 30, 2004. As of August 10, 2011, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. According to the World Health Organization, as of September 2011, at least 174 countries had ratified or otherwise approved the FCTC.

## 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 claims for 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 Settling Defendants and the market for or prices of securities such as the Series 2011 Bonds payable from tobacco settlement payments made under the Minnesota Agreement. Lorillard reported that, as of October 21, 2011, 9,556 product liability cases are pending against cigarette manufacturers in the United States. A total of 5,951 of these lawsuits are *Engle* Progeny Cases, described below, which include approximately 4,400 *Engle* Progeny claims initially asserted in a small number of multi-plaintiff actions that were severed into separate lawsuits by one Florida federal court in 2009.

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 Minnesota Agreement does not release the Settling Defendants 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 seek treble damages, statutory damages, disgorgement of profits, equitable and injunctive relief, and medical monitoring, among other damages.

The list below specifies the types 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. Some of the *Engle* Progeny cases have been filed on behalf of multiple class members. The time period for filing *Engle* Progeny Cases expired in January 2008 and no additional cases may be filed. It is possible that courts may sever remaining suits filed by multiple class members into separate individual cases.

*West Virginia Individual Personal Injury Cases*. In a 1999 administrative order, the West Virginia Supreme Court of Appeals transferred a group of cases brought by individuals who allege cancer or other health effects caused by smoking cigarettes, by smoking cigars, or by using smokeless tobacco products, to a single West Virginia court (the "**West Virginia Cases**"). The plaintiffs' claims alleging injury from smoking cigarettes have been consolidated for trial. Jury selection for the consolidated claims began on October 26, 2011, and ended in a mistrial on November 8, 2011. 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 ETS 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 brought on behalf of large numbers of individuals for damages allegedly caused by smoking, including "lights" Class Action Cases and Class Action Cases that are based primarily on medical monitoring.

*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*., that sought to recover profits earned by the defendants and other equitable relief. In August 2006, the trial court issued its final judgment and remedial order and granted injunctive and other equitable relief. The final judgment did not award monetary damages. In May 2009, the final judgment was largely affirmed by an appellate court. In June 2010, the U.S. Supreme Court denied review of the case. See "Reimbursement Cases" below for further discussion.

*Tobacco-Related Antitrust Cases*. A number of cases have been 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. In these cases, plaintiffs seek 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, 2009, verdicts have been returned in nine Conventional Product Liability Cases against cigarette manufacturers. Juries found in favor of the plaintiffs in six of these trials. Two of the six trials resulted in an award of compensatory damages to the plaintiff. Two cases were re-trials ordered by appellate courts in which juries were permitted to consider only the amount of punitive damages to award. Both of these trials resulted in punitive damages verdicts that awarded the plaintiffs $1.5 million in one of the cases and $13.8 million in the other. In a fifth trial, the plaintiff was awarded actual damages and $4 million in punitive damages. The defendants have contested each of these five verdicts. In one of the cases in which plaintiffs' award was limited to compensatory damages, the defendant has exhausted its appeals and has paid the verdict. In the second case in which the award plaintiff received was limited to compensatory damages, the court denied the defendant's motions but the deadline for the defendant to notice an appeal had not expired as of October 21, 2011. Appeals are pending in three other cases in which plaintiffs were awarded damages. Juries found in favor of the defendants in the three remaining trials. Two of these three trials are concluded because the plaintiffs did not pursue appeals. Plaintiff has appealed the third case.

In a sixth trial, the jury awarded $50 million in actual 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 defendant's motion to reduce or eliminate 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 defendant filed following trial that contested the jury's verdict. During September 2011, the court entered a judgment that reflect 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. Defendant has noticed an appeal from the judgment to the Massachusetts Appeals Court. Plaintiff has asked the court to enter a preliminary injunction that directs defendant to set aside $272 million in cash or cash equivalents to secure the amounts awarded by the jury and the interest obligations plaintiff expects the court to order in a final judgment. As of October 21, 2011, the court had not ruled on plaintiff's motion for preliminary injunction.

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 twelve individual cases since 2001. Punitive damages were paid to the smokers in five of these cases. As of October 21, 2011, trial was underway in one Conventional Product Liability Case. No additional cases are scheduled for trial in 2011, however, trial dates are subject to change.

***Engle Progeny Cases***

In 2006, the Florida Supreme Court issued a ruling in *Engle* that had been certified 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. During a three-phase trial, a Florida jury awarded actual damages to three individuals and approximately $145 billion in punitive damages to the certified class. In its 2006 decision, 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 actual damages awards to two of the three individuals whose claims were heard during the first phase of the *Engle* trial. These two awards totaled $7 million, and 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.

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 and was scheduled to expire on December 31, 2012, but the expiration date was rescinded by an amendment enacted in 2011. The plaintiffs in some of the cases have challenged the constitutionality of the amended statute. As of October 21, 2011, none of these motions had been granted and courts either denied these challenges or rulings have not been issued.

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 of alleged former class members have also brought derivative claims. In 2010, one Florida court approved plaintiff's motions to dismiss approximately 500 cases in deference to cases filed by these individuals that are pending in state court. In April 2011, one federal court dismissed approximately 235 cases because they were duplicative of cases pending in other courts. The federal court also addressed approximately 500 cases filed by family members of alleged former class members. The court had previously separated these 500 cases into individual actions, but its 2011 orders combined each one of these cases with the case filed by the smoker from which the family members' claim purportedly derived.

The *Engle* Progeny Cases are pending in various Florida state and federal courts. Some of these courts, including courts that have presided over *Engle* Progeny Cases that have been tried, have issued rulings that address whether 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. Some of these decisions have led to appeals, which are still pending. In one of these appeals, the U.S. Court of Appeals for the Eleventh Circuit returned to a federal trial court for further consideration the question of how courts should apply the jury's findings in favor of the plaintiffs in the first phase of the *Engle* trial. The Court of Appeals determined that, based on Florida law, plaintiffs in the *Engle* Progeny Cases are entitled to some use of those jury findings but that, on the basis of the appellate record, it was premature for the Court of Appeals to decide what use plaintiffs can make of these findings. The Court of Appeals did not address the question of the effect of federal due process limitations on the application of the jury findings on the basis that consideration of federal constitutional limitations was not necessary to its decision. In another appeal, an intermediate state appellate court issued a decision in December 2010 in which it ruled that the trial court correctly construed the Florida Supreme Court's 2006 decision and that it properly instructed the jury on the preclusive effect of certain of the *Engle* jury's findings. In July 2011, the Florida Supreme Court declined to review these cases, including the December 2010 appellate decision concerning the preclusive effect of the *Engle* jury's findings.

On September 28, 2011, the Florida Third District Court of Appeal, an intermediate Florida appellate court, issued a decision in *Rey v. Philip Morris, Inc.*, in which it reinstated conspiracy claims against Lorillard Tobacco Company, Liggett Group LLC and Vector Group Ltd. and determined that the Florida Supreme Court's decision in *Engle* did not preclude plaintiff from recovering on claims against defendants for conspiracy to withhold information regarding addictiveness of cigarettes as well as health risks even if defendants did not manufacture the brands of cigarettes smoked by plaintiff.

A number of *Engle* Progeny Cases have either been placed on courts' 2011 trial calendars or specific trial dates have been set. Trial schedules are subject to change and it is not possible to predict how many of the cases will be tried during 2011. It also is not possible to predict whether some courts will implement procedures that consolidate multiple *Engle* Progeny Cases for trial. According to Lorillard, as of October 21, 2011, trial was not underway in any of the *Engle* Progeny Cases, and as of such date, verdicts have been returned in 47 *Engle* Progeny Cases since the Florida Supreme Court issued its 2006 ruling that permitted members of the *Engle* class to bring individual lawsuits. Juries awarded actual damages and punitive damages in 18 of the trials. The 18 punitive damages awards have totaled $600 million (not including *Webb v. R.J. Reynolds Tobacco Co*., described below) and have ranged from $50,000 to $244 million. In twelve of the trials, juries' awards were limited to compensatory damages. In the seventeen remaining trials, juries found in favor of the defendants.

According to Lorillard, as of October 21, 2011, defendants had filed or were expected to file, challenges to each of the verdicts in which plaintiffs were awarded damages. In July 2011, the Florida Supreme Court declined to review these cases, including the December 2010 appellate decision concerning the preclusive effect of the *Engle* jury's findings. The decision by the intermediate appellate court with respect to the preclusive effect of the *Engle* jury's finding will be binding on the parties in other *Engle* Progeny Cases, unless it is modified. In some of the trials decided in defendants' favor, plaintiffs have filed motions challenging the verdicts. As of October 21, 2011, none of these motions had resulted in rulings in favor of the plaintiffs.

Altria reported that since the end of August 2010 until November 12, 2010, eight consecutive *Engle* Progeny Case verdicts were decided in favor of defendant tobacco companies. However, on November 15, 2010, a jury in the *Engle* Progeny Case of *Webb v. R.J. Reynolds Tobacco Co*., tried in the Florida Circuit Court (Levy County), awarded $8 million in compensatory damages and $72 million in punitive damages to the plaintiff. Reynolds America filed a notice of appeal and posted a supersedes bond in the amount of $5 million. The plaintiff filed a notice of cross appeal. As of March 31, 2011, briefing was underway.

On June 16, 2011, a jury in the *Engle* progeny case of *Soffer v. R.J. Reynolds*, tried in the Florida Circuit Court (Alachua County) in Gainesville, Florida, awarded $5 million in compensatory damages to the survivors of Maurice Soffer. The jury allocated 40% of the fault to R.J. Reynolds and 60% of fault to Maurice Soffer. The total award was reduced to $2 million based on the fault allocation. Reynolds America has filed a notice of appeal in *Soffer*.

In July 2011, a jury in the *Engle* progeny case of *Ciccone v. R.J. Reynolds,* tried in the Florida Circuit Court (Broward County) in Fort Lauderdale, Florida, awarded $3.1 million in compensatory damages and $50,000 in punitive damages to the survivors of George Ciccone. The jury allocated 70% of the fault to George Ciccone and 30% of the fault to R.J. Reynolds. Reynolds America has filed a notice of appeal in *Ciccone*.

In a case tried prior to the Florida Supreme Court's 2006 decision permitting members of the *Engle* class to bring individual lawsuits, one Florida court allowed the plaintiff to rely at trial on certain of the *Engle* jury's findings. That trial resulted in a verdict for the plaintiffs in which they were awarded approximately $25 million in actual damages. In March 2010, a Florida appellate court affirmed the jury's verdict. The court denied defendants' petitions for rehearing in May 2010, and the defendants have satisfied the judgment by paying the damages award.

### *West Virginia Cases*

The West Virginia Cases pending brought by individuals who allege cancer or other health effects caused by smoking cigarettes, by smoking cigars, or by using smokeless tobacco products are in a single West Virginia court. According to Lorillard, approximately 615 West Virginia Cases are pending and most have been consolidated for trial. 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.

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 (the "**IPIC Cases**"). Approximately 630 IPIC Cases have been dismissed in their entirety, however, some or all of the dismissals could be contested in subsequent appeals.

The court has severed from the IPIC Cases those claims alleging injury from the use of tobacco products other than cigarettes, including smokeless tobacco and cigars (the "**Severed IPIC Claims**"). The Severed IPIC 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 will be considered during the consolidated trial of the IPIC Cases, while the latter claims are among the Severed IPIC 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 will be considered in the consolidated trial of the IPIC Cases.

The court has entered a trial plan for the IPIC Cases that calls for a multi-phase trial. During 2010, the court attempted to begin trial of the IPIC cases two separate times. In both instances, the court suspended trial due to complications that arose during jury selection. The first phase of that trial began on October 26, 2011, but ended in a mistrial on November 8, 2011. As of October 21, 2011, the Severed IPIC Claims were not subject to a trial plan and none of the Severed IPIC Claims were scheduled for trial as of October 21, 2011. Trial dates are subject to change.

### *Flight Attendant Cases*

Four cigarette manufacturers are the defendants in each of 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 ETS. 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 trials. 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 second 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 21, 2011, 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 was filed. According to Lorillard, cigarette manufacturers have defeated motions for class certification in a total of 36 cases, thirteen of which were in state court and 23 of which were in federal court. 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), the Louisiana Court of Appeal, Fourth Circuit, issued a decision in April 2010 (the "**April 2010 Decision**") that modified the trial court's 2008 amended final judgment. The April 2010 Decision reduced the judgment amount from approximately $262 million to approximately $242 million to fund a ten year, court-supervised smoking cessation program. The April 2010 Decision also changed the date on which the award of post-judgment interest will accrue to July 2008. Interest awarded by the amended final judgment will continue to accrue from July 2008 until the judgment either is paid or is reversed on appeal. 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. Plaintiffs may seek an award of costs and attorneys' fees. As of October 21, 2011, plaintiffs had not petitioned the court for costs or attorneys' fees.

In 1997, *Scott* was certified as a class action on behalf of certain cigarette smokers resident in the State of Louisiana who desire 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 allege that defendants undermined compliance with the warnings on cigarette packages. Trial in *Scott* 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 $312 million; struck an award of prejudgment interest, which totaled approximately $444 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. In January 2008, the Louisiana Supreme Court denied plaintiffs' and defendants' separate petitions for review. In May 2008, the U.S. Supreme Court denied defendants' request that it review the case. 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 the court-supervised smoking cessation program for the members of the certified class. The Court of Appeal's April 2010 Decision was an appeal from this judgment.

The parties filed a stipulation in the trial court agreeing that an article of Louisiana law required that the amount of the bond for the appeal be set at $50 million for all defendants collectively. The parties further agreed that the plaintiffs have full reservations of rights to contest in the trial court the sufficiency of the bond on any grounds. Defendants collectively posted a surety bond in the amount of $50 million. While the defendants believe the limitation on the appeal bond amount is valid as required by Louisiana law, in the event of a successful challenge the amount of the appeal bond could be set as high as 150% of the judgment and judicial interest combined.

*Other Class Action Cases*. In one pending 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 trial court has informed the parties that it believes the class previously certified in *Brown* has been reinstated as a result of the California Supreme Court's ruling. The class previously certified 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 also has ruled that it will permit plaintiffs to assert claims regarding the allegedly fraudulent marketing of "light" or "ultra-light" cigarettes. Trial is set for September 14, 2012. Trial dates are subject to change.

In another pending Class Action Case, *Cleary v. Philip Morris Incorporated, et al*. (U.S. District Court, Northern District, Illinois, filed June 3, 1998), a court allowed plaintiffs to amend their complaint in an existing class action to assert claims on behalf of a subclass of individuals who purchased "light" cigarettes from the defendants. In June 2010, the court dismissed plaintiffs' remaining claims, and it entered final judgment in defendants' favor. Plaintiffs appealed from the final judgment, including the prior ruling that dismissed plaintiffs' "lights" claims, to the U.S. Court of Appeals for the Seventh Circuit. The appeal was argued in April 2011 and on August 25, 2011, the Seventh Circuit affirmed in favor of the defendants. As of October 21, 2011, the Seventh Circuit had not ruled on plaintiffs' motion for reconsideration of the order affirming the dismissal of the case.

Six actions have been filed against various defendants, including Philip Morris, Altria and Reynolds Tobacco, along with other cigarette manufacturers, in the Canadian provinces of Alberta, Manitoba, Nova Scotia, Saskatchewan and British Columbia. In Saskatchewan and British Columbia, plaintiffs seek class certification on behalf of individuals who suffer or have suffered from various diseases including chronic obstructive pulmonary disease, emphysema, heart disease or cancer after smoking defendants' cigarettes. In the actions filed in Alberta, Manitoba and Nova Scotia, plaintiffs seek certification of classes of all individuals who smoked defendants' cigarettes.

*"Lights" Class Action Cases*. According to Lorillard, there are approximately 25 Class Action Cases in which plaintiffs' claims are based on the allegedly fraudulent marketing of "light" or "ultra-light" cigarettes and 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 FTC's regulation of cigarettes' tar and nicotine disclosures preempts (or bars) some of plaintiffs' claims. In 2009, the Judicial Panel on Multidistrict Litigation consolidated various federal court "lights" Class Action Cases pending against Philip Morris or Altria and transferred those cases to the U.S. District Court of Maine. Sixteen cases were part of that consolidated proceeding. Philip Morris reported that on November 24, 2010 the U.S. District Court of Maine, which is the coordinating court responsible for conducting pretrial proceedings in Multidistrict Litigation involving nearly 20 "lights" Class Action Cases pending around the country, denied the plaintiffs' class certification in four separate "lights" Class Action Cases pending in Illinois, California, Washington, D.C., and Maine. According to Philip Morris, these four cases had been selected by the parties to serve as "sample" cases for the court and the parties involved in the remaining cases

pending or awaiting transfer to the Multidistrict Litigation proceedings. Plaintiffs sought appellate review of this decision but on February 22, 2011, the United States Court of Appeals for the First Circuit denied plaintiffs' petition for leave to appeal. Following the appellate court's ruling, plaintiffs dismissed thirteen of the Multidistrict Litigation Cases, including *Good v. Altria Group, Inc., et al.* Plaintiffs in the four Multidistrict Litigation Cases that remain pending have asked the court to transfer their claims to the courts in which each originated. As of October 21, 2011, the court had not ruled on whether it would grant the motions to transfer the four pending Multidistrict Litigation Cases.

*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' 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.

On October 17, 2011, a Missouri jury in the case of *Larsen v. Philip Morris, Inc. (formerly Craft v Philip Morris, Inc.)* began deliberating whether to award at least $700 million to a class of as many as 400,000 current and former smokers of Marlboro Lights. The judge declared a mistrial on October 25, 2011 after jurors failed to reach agreement on whether Missouri smokers were misled into believing Marlboro Lights were safer than conventional cigarettes. The Missouri Court of Appeals affirmed the class certification order in *Larsen* in August 2005.

***Reimbursement Cases***

Three Reimbursement Cases are pending in the U.S. In addition to the cases brought in the U.S., four Reimbursement Cases are pending against tobacco industry participants, including Philip Morris, Altria and Reynolds Tobacco, outside of the U.S., one in Israel and four in Canada. In the case in Israel, the defendants' appeal of the district court's denial of their motion to dismiss was heard by the Israel Supreme Court in March 2005, and the parties are awaiting the court's decision.

In the first of the four Reimbursement Cases filed in Canada, the Canadian Supreme Court ruled in September 2005 that legislation authorizing a cause of action to permit the government of British Columbia to recover the costs of certain healthcare expenditures from the defendants was constitutional, and, as a result, the case was permitted to proceed and that litigation remains pending. During 2008, the Province of New Brunswick, Canada, proclaimed into law previously adopted legislation allowing reimbursement claims to be brought against cigarette manufacturers, and it filed suit shortly thereafter. In September 2009, the Province of Ontario, Canada, filed suit against a number of cigarette manufacturers based on previously adopted legislation nearly identical in substance to the New Brunswick legislation. On February 8, 2011, the Province of Newfoundland and Labrador filed a case substantially similar to the ones brought by New Brunswick and Ontario. Several other provinces and territories in Canada have enacted similar legislation or are in the process of enacting similar legislation.

*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" concerning: the health effects of smoking; the addictiveness of smoking; that there are no significant health benefits to be gained by smoking "low tar," "light," "ultra-light," "mild" or "natural" cigarettes; that cigarette design has been manipulated to ensure optimum nicotine delivery to smokers; and that there are adverse effects from exposure to secondhand smoke. 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.

The final judgment and remedial order has not yet been fully implemented. Following trial, the final judgment and remedial order was stayed because the defendants, the government and several intervenors 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. The Court of Appeals stayed its order that formally relinquished jurisdiction of defendants' appeal pending the disposition of the petitions for writ of certiorari to the U.S. Supreme Court that were noticed by the defendants, the government and the intervenors. 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 two alternative 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. Defendants have filed a notice of appeal. The government filed a motion following remand requesting clarification of the extent of the defendants' obligation to make disclosures of disaggregated marketing data and the use the government can make of that data. The trial court granted that motion in April 2011, holding 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 have noticed an appeal from this order to the U.S. Court of Appeals for the District of Columbia Circuit. As of October 21, 2011, the Court of Appeals had not ruled on defendants' appeals, and the trial court had not entered an amended final judgment with respect to the issues that were remanded. On November 17, 2011, the trial court requested that the parties submit briefs with their views on the issue of whether the trial court should delay entry of any amended final judgment in the case until the conclusion of litigation challenging the FDA's rule containing new tobacco marketing restrictions and requiring textual and graphic warning labels on cigarette packaging and advertisements, which litigation is discussed above in DOMESTIC TOBACCO INDUSTRY--Regulatory Issues—*Federal Regulation*.

Prior to trial, the government had claimed that it was entitled to approximately $280 billion from the defendants for its claim to recover profits earned by the defendants. The Court of Appeals ruled that the government may not seek to recover profits earned by the defendants. The U.S. Supreme Court declined to address the decisions dismissing recovery of profits when it denied review of the government's and the intervenors' petitions.

*Settlement of State Reimbursement Litigation*. The State Settlement Agreements require that the domestic tobacco industry make annual payments of $10.4 billion, subject to adjustment for several factors, including inflation, market share and industry volume. In addition, the domestic tobacco industry is required to pay settling plaintiffs' attorneys' fees, subject to an annual cap of $500 million, as well as an additional amount of up to $125 million in each year through 2008. These payment obligations are the several and not joint obligations of each settling defendant. The State Settlement Agreements also include provisions relating to significant advertising and marketing restrictions, public disclosure of certain industry documents, limitations on challenges to tobacco control and underage use laws, and other provisions.

The MSA PMs have notified the states that they intend to seek an adjustment in the amount of payments made in 2003 and subsequent years pursuant to a provision in the MSA that permits such adjustment if the companies can prove that the MSA was a significant factor in their loss of market share to companies not participating in the MSA and that the Settling States failed to diligently enforce certain statutes passed in connection with the MSA. If the MSA PMs are ultimately successful, any recovery would be in the form of reimbursement of proceeds already paid or as a credit against future payments by the MSA PMs.

From time to time, lawsuits have been brought against the MSA PMs, or against one or more of the states, challenging the validity of the MSA on certain grounds, including as a violation of the antitrust laws. See "MSA-Related Antitrust Suit" below.

***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 *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 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. Discovery currently is ongoing. As of October 21, 2011, the Court had not set dates for dispositive motions and trial.

*MSA-Related Antitrust Suit*. An action filed in the Western District of Kentucky, *VIBO Corporation, Inc. d/b/a/ General Tobacco v. Conway, et al.*, in October 2008 alleges that the named defendants, which include 52 state and territorial attorneys general and 19 tobacco manufacturers, violated the Sherman Act by entering into and participating in the MSA. The plaintiff alleges that MSA participants, such as itself, that were not in existence when the MSA was executed in 1998 but subsequently became participants, are unlawfully required to pay significantly more sums to the states than companies that joined the MSA within 90 days after its execution. In addition to the Sherman Act claim, plaintiff has raised a number of constitutional claims against the states. Plaintiff seeks a declaratory judgment in its favor on all claims, an injunction against the continued enforcement of the MSA, treble damages against the tobacco manufacturer defendants, and damages and injunctive relief against the states, including contract recession and restitution. In December 2008, the court dismissed the complaint against all defendants. The court entered its final judgment dismissing the suit in January 2010. Thereafter, the plaintiff filed a notice of appeal to the U.S. Court of Appeals for the Sixth Circuit. The appeal was argued on October 6, 2011. As of October 21, 2011, the Court of Appeals for the Sixth Circuit had not ruled on plaintiff's appeal.

***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 Settling Defendants 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 the Settling Defendants intend to defend 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 above, and it is possible that one or more of the pending actions could be decided unfavorably as to the Settling Defendants or the other defendants. The Settling Defendants may enter into discussions in an attempt to settle particular cases if the Settling Defendants 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 Settling Defendants to prevail in smoking and health litigation and could influence the filing of new suits against the Settling Defendants.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the examination or analysis by the Authority of the court records of the cases mentioned or of any other court records. It is based on SEC filings by Settling Defendants and on other publicly available information published by the Settling Defendants or others. Prospective purchasers of the Series 2011 Bonds are referred to the reports filed with the SEC by the Settling Defendants and applicable court records for additional descriptions thereof.

Litigation is subject to many uncertainties. In its SEC filing, one Settling Defendant states that it is not possible to predict the outcome of litigation pending against it, and that it is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of pending litigation, and that it is possible that its business, volume, results of operations, cash flows, or financial position could be materially affected by an unfavorable outcome or settlement of certain pending litigation or by the enactment of federal or state tobacco legislation. It can be expected that at any time and from time to time there will be developments in the litigation presently pending and filing of new litigation that could materially adversely affect the business of the Settling Defendants and the market for or prices of securities such as the Series 2011 Bonds payable from tobacco settlement payments made under the Minnesota Agreement.

## THE AUTHORITY

The Authority is a body corporate and politic, and a public instrumentality of, but having a legal existence independent and separate from, the State, and was established under the Tobacco Securitization Authority Act. Pursuant to the provisions of the Act, the Authority is governed by a three-member board, consisting of the Commissioner of Management and Budget, the Commissioner of Revenue and the Commissioner of Health. The Authority has no staff and will rely on the services of staff from the Office of the Commissioner of Management and Budget. The Act provides that the Authority and its corporate existence are to continue until twelve months after all its liabilities (including the Series 2011 Bonds) have been met or otherwise discharged, at which time all of its rights and property shall pass to and be vested in the State.

## THE SALE AGREEMENT

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

### Conveyance of Pledged Settlement Payments

The Sale Agreement provides that the State irrevocably sells and conveys to the Authority, as of the Closing Date, without recourse (subject to certain continuing obligations described herein) in accordance with and subject to the terms of the Sale Agreement, all right, title and interest of the State on the Closing Date in and to the Pledged Settlement Payments. As consideration for such sale and conveyance of the Pledged Settlement Payments by the State to the Authority, the Authority promises to pay and otherwise convey to the State, without recourse, on the Closing Date, the proceeds (net of the Financing Costs) of the Series 2011 Bonds and the Residual Certificate in accordance with and subject to the terms of the Indenture and the Act. In addition, the Authority further promises to pay and otherwise convey to the State, without recourse, on the closing date of any Bonds issued under the Indenture, the proceeds (net of Financing Costs) of such Bonds in accordance with and subject to the terms of the Indenture and the Act.

In accordance with the Act, the Sale Agreement provides that upon execution and delivery of the Sale Agreement, the sale and conveyance and other transfer of the right to receive the Pledged Settlement Payments shall for all purposes be a true sale and absolute conveyance of all right, title, and interest therein and not as a pledge or other security interest for any borrowing, valid, binding and enforceable in accordance with the terms of the Sale Agreement and the Indenture shall not be subject to disavowal, disaffirmance, cancellation, or avoidance by reason of insolvency of any party, lack of consideration, or any other fact, occurrence or rule of law.

**Delivery of Pledged Settlement Payments to the Trustee**

From and after the Closing Date all Pledged Settlement Payments required by the Minnesota Agreement to be made to the State are by the terms of the Sale Agreement to be made to the Trustee in accordance with the provisions of the Indenture. Simultaneously with the delivery of the Bonds and the purchase of the Pledged Settlement Payments, the State, acting through the Commissioner of Management and Budget, must notify the Minnesota Agreement Calculation Agent and the Settling Defendants that the Pledged Settlement Payments have been sold to the Authority and must irrevocably instruct the Minnesota Agreement Calculation Agent and the Settling Defendants that the Pledged Settlement Payments are to be paid directly to the Trustee on behalf of the Authority. Should the State receive any such payments from the Settling Defendants, it is required to immediately remit such payments to the Trustee. The Trustee shall immediately deposit such Pledged Settlement Payments in the Pledged Revenues Account.

**Amendment**

Except as otherwise described under "Further Actions" above, after issuance of the Series 2011 Bonds, the Sale Agreement may be amended by the State and the Authority with the consent of the Trustee, but without the consent of any of the Bondholders: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the Sale Agreement; (c) to correct or amplify the description of the Pledged Settlement Payments; (d) to add additional covenants for the benefit of the Authority; or (e) 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.

Except as otherwise provided in the preceding paragraph, the Sale Agreement may also be amended from time to time by the State and the Authority with the consent of a Majority in Interest of the Bonds for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the 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 the Holders of all the outstanding bonds.

Without the prior written consent of the holder of the Residual Certificate and the Trustee, which consent may be granted or withheld in such Person's sole discretion, no amendment, supplement or other modification of the Sale Agreement shall be entered into or be effective if such amendment, supplement or modification affects the holder of the Residual Certificate or the Trustee's, as applicable, own rights, duties or immunities under the Sale Agreement or otherwise.

**Use of the Purchase Price**

In accordance with the Act, the purchase price of the Pledged Settlement Payments payable to the State pursuant to the Sale Agreement corresponding directly or indirectly to the proceeds of the Series 2011 Bonds (net of Financing Costs) shall be transferred, on the Closing Date, to the Commissioner for deposit in the Tobacco Settlement Bond Proceeds Fund created by the Act.

**Assignment to Trustee**

The State acknowledges that the Authority will assign to the Trustee for the benefit of the Bondholders all of its rights and remedies with respect to the breach of any representations and warranties of the State under the Sale Agreement. Upon discovery by the State or the Authority of a breach of any of the foregoing representations, warranties or covenants that materially and adversely affects the value of the Pledged Settlement Payments or the sale thereof to the Authority under the Sale Agreement, the party discovering such breach shall give prompt written notice to the other party and to the Trustee.

The State shall not be liable to the Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Trustee to promptly notify the State upon the discovery by a Responsible Officer of the Trustee of a breach of any representation, warranty or covenant contained in the Sale Agreement.

## THE RESIDUAL CERTIFICATE

The Residual Certificate represents the entitlement of the State to receive all amounts required to be distributed pursuant to the Indenture in respect of the Residual Certificate, including the Residual Revenues upon deposit in the Residual Account, which are any Pledged Settlement Payments received in any year in excess of the amounts required to pay, in accordance with the provisions of the Indenture, the Operating Expenses, debt service on Bonds, replenishment of the Debt Service Reserve Account and Junior Payments described in the Indenture.

## CONTINUING DISCLOSURE UNDERTAKING

In order to assist the Underwriters in complying with the provisions of paragraph (b)(5) of Rule 15c2-12 (the "**Rule**"), promulgated by the SEC under the Securities Exchange Act of 1934 (the "**1934 Act**") for the benefit of the holders and beneficial owners of the Series 2011 Bonds, the Authority will provide an executed copy of its agreement to provide continuing disclosure (the "**Disclosure Agreement**"). Pursuant to the Undertaking, the Authority will provide to the Trustee and to the Electronic Municipal Market Access System ("**EMMA System**") implemented by the Municipal Securities Rulemaking Board (the "**MSRB**") established in accordance with the provisions of Section 15B(b)(1) of the 1934 Act, or any successor thereto or to the functions of the MSRB:

(1) (a) no later than December 31, beginning with the Fiscal Year ending June 30, 2012, and continuing with each Fiscal Year thereafter, the Annual Financial Information (as defined below) relating to such Fiscal Year; and

(b) no later than February 15 of each calendar year, beginning February 15, 2012, the amount of annual tobacco settlement revenues (which, if received by the State on and after July 1, 2013, shall be Pledged Settlement Payments) due pursuant to the Minnesota Agreement on or after February 15 of the preceding calendar year; and

(2) in a timely manner not in excess of ten Business Days after the occurrence of the event, notice of the occurrence of any of the following events ("**Notice Events**") with respect to the Series 2011 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-exempt status of the Tax-Exempt Series 2011B Bonds, or other material events affecting the tax-exempt status of the Tax-Exempt Series 2011B Bonds;

(g) modifications to rights of Bondholders, if material;

(h) bond calls, if material, and tender offers;

(i) defeasances;

(j) release, substitution, or sale of property securing repayment of the Series 2011 Bonds, if material;

(k) rating changes;

(l) bankruptcy, insolvency, receivership or similar event of the Authority;

(m) the consummation of a merger, consolidation, or acquisition involving the Authority or the sale of all or substantially all of the assets of the Authority, 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 the Trustee, if material; and

(3) in a timely manner, notice of a failure to provide by the date set forth in paragraph (1) above any Annual Financial Information required as described below.

"**Annual Financial Information**" means the financial information or Operating Data with respect to the Authority, provided at least annually. The financial statements included in the Annual Financial Information shall be prepared in accordance with generally accepted accounting principles ("**GAAP**") as prescribed by the Governmental Accounting Standards Board ("**GASB**"). Such financial statements may, but are not required to be, Audited Financial Statements.

"**Audited Financial Statements**" means the Authority's annual financial statements, prepared in accordance with GAAP as prescribed by GASB, which annual financial statements shall have been audited by an independent auditor or firm of independent auditors as shall be then retained by the Authority.

"**Operating Data**" means (i) an update of the actual operating data for the preceding Fiscal Year set forth in this Official Statement under the columns titled "Pledged Settlement Payments," "Net Revenue," "Debt Service Reserve Earnings," "Net Debt Service," "Residual Revenues" and "Coverage" in a form generally consistent with the information contained in the tables captioned "Estimated Debt Service Coverage of Series 2011 Bonds" under the heading "DEBT SERVICE REQUIREMENTS AND COVERAGE UNDER THE GLOBAL INSIGHT FORECAST" with such "Coverage" ratio for such preceding Fiscal Year determined in substantially the same manner as described therein, and (ii) identification of the specific investments the Debt Service Reserve Account was invested in at the end of the preceding Fiscal Year and of any changes in such investments during such preceding Fiscal Year.

If not provided as part of the Annual Financial Information, the Authority will provide the Audited Financial Statements when and if available while any Series 2011 Bonds are Outstanding to the MSRB and the Trustee.

Any filing or report under the Disclosure Agreement may be made solely by transmitting such filing or report to the MSRB (with a copy to the Trustee) in an electronic format accompanied by identifying information as prescribed by the MSRB.

The Disclosure Agreement may be amended, without the consent of the Bondholders, but only if the Authority obtains and provides to the Trustee an opinion of nationally recognized bond counsel to the effect that such amendment, and giving effect thereto, will not adversely affect the compliance of the Disclosure Agreement and by the Authority with the Rule, provided that the Authority will have provided notice of such delivery and of the amendment to the MSRB. Any such amendment shall satisfy, unless otherwise permitted by the Rule, the following conditions: (i) the amendment may only be made in connection with a change in circumstances that arises from a change in legal requirements, change in law or change in the identity, nature or status of the Authority or type of business conducted; (ii) the Disclosure Agreement, as amended, would have complied with the requirements of the Rule at the time of the primary offering, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances; and (iii) the amendment does not materially impair the interests of Bondholders, as determined either by parties unaffiliated with the Authority (such as nationally recognized bond counsel) or by approving vote of Bondholders pursuant to the terms of the Indenture at the time of the amendment. The initial Annual Financial Information after the amendment shall explain, in narrative form, the reasons for the amendment and the effect of the change, if any, in the type of operating data or financial information being provided.

Any failure by the Authority to perform in accordance with the Disclosure Agreement will not constitute an Event of Default with respect to the Series 2011 Bonds. If the Authority fails to comply with the Disclosure Agreement, any Bondholder or beneficial owner may take such actions as may be necessary and appropriate, including seeking specific performance by court order, to cause the Authority to comply with its obligations hereunder.

The Undertaking will remain in full force and effect until all of the Series 2011 Bonds are or are deemed to be no longer outstanding by reason of redemption or legal defeasance or at maturity.

## TAX MATTERS

### The Tax-Exempt Bonds

*General.* In the opinion of Kutak Rock LLP, Transaction Counsel, to be delivered at the time of original issuance of Tax-Exempt Series 2011B Bonds (the "**Tax-Exempt Bonds**"), under existing federal and Minnesota laws, regulations, rulings and judicial decisions, and assuming the accuracy of certain representations and continuing compliance with certain covenants described below, the interest to be paid on the Tax-Exempt Bonds is excludable from gross income for federal income tax purposes and from taxable net income of individuals, estates or trusts for Minnesota income tax purposes; is includable in the income of corporations and financial institutions for purposes of the Minnesota franchise tax; and is not a specific tax preference item for purposes of the federal alternative minimum tax or the Minnesota alternative minimum tax applicable to individuals, estates and trusts. The interest to be paid on the Tax-Exempt Bonds is included in adjusted current earnings of corporations in determining the alternative minimum taxable income of such corporations for purposes of the federal alternative minimum tax.

*Arbitrage/Use of Proceeds.* Failure to comply with certain provisions of the Internal Revenue Code of 1986, as amended (the "**Code**"), may cause interest on the Tax-Exempt Bonds to become subject to federal and Minnesota income taxation retroactive to the date of issuance of the Tax-Exempt Bonds. These provisions include investment restrictions, required periodic payments of arbitrage profits to the United States, and requirements concerning the timely and proper use of Bond proceeds and the facilities and activities financed or refinanced therewith and certain other matters. The documents authorizing the issuance of the Tax-Exempt Bonds include provisions which, if complied with by the State, are designed to meet the requirements of the Code. Such documents also include a covenant of the Authority to take all legally permissible actions necessary to preserve the tax exemption of interest on the Tax-Exempt Bonds. However, no provision is made for redemption of the Tax-Exempt Bonds or for an increase in the interest rate on the Tax-Exempt Bonds in the event that interest on the Tax-Exempt Bonds becomes subject to federal or Minnesota income taxation.

*Discount Bonds.* The Tax-Exempt Bonds having a stated maturity in the year 2026 and bearing interest at a rate of 4.85% per annum, and the Tax-Exempt Bonds having a stated maturity in the year 2031 (collectively, the "**Discount Bonds**") are being sold at a discount from the principal amount payable on the Discount Bonds at maturity. The difference between the price at which a substantial amount of the Discount Bonds of a given maturity is first sold to the public (the "**Issue Price**") and the principal amount payable at maturity constitutes "original issue discount" under the Code. The amount of original issue discount that accrues to a holder of a Discount Bond under Section 1288 of the Code is excludable from gross income for federal income tax purposes and from taxable net income of individuals, estates and trusts for Minnesota income tax purposes to the same extent that stated interest on such Discount Bonds would be so excluded. The amount of the original issue discount that accrues with respect to a Discount Bond under Section 1288 is added to the tax basis of the owner in determining gain or loss upon disposition of such Discount Bond (whether by sale, exchange, redemption or payment at maturity). Original issue discount is taxable under the Minnesota franchise tax on corporations and financial institutions.

Interest in the form of original issue discount accrues under Section 1288 pursuant to a constant yield method that reflects semiannual compounding on days that are determined by reference to the maturity date of the applicable Discount Bond. The amount of original issue discount that accrues for any particular semiannual accrual period generally is equal to the excess of: (a) the product of (i) one-half of the yield to maturity on such Discount Bonds (adjusted as necessary for an initial short period) and (ii) the adjusted issue price of such Discount Bonds, over (b) the amount of stated interest actually payable on such Discount Bond for such semiannual accrual period. For purposes of the preceding sentence, the adjusted issue price is determined by adding to the Issue Price for such Discount Bonds the original issue discount that is treated as having accrued during all prior semiannual accrual periods. If a Discount Bond is sold or otherwise disposed of between semiannual compounding dates, then the original issue discount that would have accrued for that semiannual accrual period for federal income tax purposes is allocated ratably to the days in such accrual period.

If a Discount Bond is purchased for a cost that exceeds the sum of the Issue Price plus accrued interest and accrued original issue discount, the amount of original issue discount that is deemed to accrue thereafter to the purchaser is reduced by an amount that reflects amortization of such excess over the remaining term of such Discount Bond.

Except for the Minnesota rules described above, no opinion is expressed as to state and local income tax treatment of original issue discount.

Holders of Discount Bonds should consult their own advisors with respect to computation and accrual of original issue discount and with respect to the state and local tax consequences of owning such Discount Bonds.

*Premium Bonds.* The Tax-Exempt Bonds having a stated maturity in the years 2016 through 2025, inclusive, and the Tax-Exempt Bonds having a stated maturity in the year 2026 and bearing interest at a rate of 5.25% per annum (collectively, the "**Premium Bonds**") are being issued at a premium to the principal amount payable at maturity. Except in the case of dealers, which are subject to special rules, Bondholders who acquire Premium Bonds must, from time to time, reduce their federal and Minnesota tax bases for the Premium Bonds for purposes of determining gain or loss on the sale, redemption or payment at maturity of such Premium Bonds. Premium generally is amortized for federal and Minnesota income and franchise tax purposes on the basis of a bondholder's constant yield to maturity or to certain call dates with semiannual compounding. Bondholders who acquire Premium Bonds might recognize taxable gain upon sale of such Premium Bonds, even if such Premium Bonds are sold for an amount equal to or less than their original cost. The amount of premium amortized in any period offsets a corresponding amount of interest for such period. Amortized premium is not deductible for federal or Minnesota income tax purposes. Bondholders who acquire Premium Bonds should consult their tax advisors concerning the calculation of bond premium and the timing and rate of premium amortization, as well as the state and local tax consequences of owning and selling such Premium Bonds.

*Collateral Tax Matters.* The following tax provisions also may be applicable to the Tax-Exempt Bonds and interest thereon:

(a) Section 86 of the Code and corresponding provisions of Minnesota law require recipients of certain Social Security and Railroad Retirement benefits to take into account interest on the Tax-Exempt Bonds in determining the taxability of such benefits;

(b) passive investment income, including interest on the Tax-Exempt Bonds, may be subject to taxation under Section 1375 of the Code and corresponding provisions of Minnesota law for an S corporation that has accumulated earnings and profits at the close of the taxable year if more than 25 percent of its gross receipts is passive investment income;

(c) interest on the Tax-Exempt Bonds may be includable in the income of a foreign corporation for purposes of the branch profits tax imposed by Section 884 of the Code and is includable in the net investment income of foreign insurance companies for purposes of Section 842(b) of the Code;

(d) in the case of an insurance company subject to the tax imposed by Section 831 of the Code, the amount which otherwise would be taken into account as losses incurred under Section 832(b)(5) of the Code must be reduced by an amount equal to 15 percent of the interest on the Tax-Exempt Bonds that is received or accrued during the taxable year;

(e) Section 265 of the Code denies a deduction for interest on indebtedness incurred or continued to purchase or carry the Tax-Exempt Bonds, and Minnesota law similarly denies a deduction for such interest expense in the case of individuals, estates and trusts; indebtedness may be allocated to the Bonds for this purpose even though not directly traceable to the purchase of the Tax-Exempt Bonds;

(f) federal and Minnesota laws also restrict the deductibility of other expenses allocable to the Tax-Exempt Bonds;

(g) in the case of a financial institution, no deduction is allowed under the Code for that portion of the holder's interest expense which is allocable to interest on the Tax-Exempt Bonds within the meaning of Section 265(b) of the Code; and

(h) receipt of interest on the Tax-Exempt Bonds may affect taxpayers otherwise entitled to claim the earned income credit under Section 32 of the Code.

The foregoing is not intended to be an exhaustive discussion of collateral tax consequences arising from ownership, disposition, or receipt of interest on the Tax-Exempt Bonds. Prospective purchasers or bondholders should consult their tax advisors with respect to collateral tax consequences and applicable state and local tax rules in states other than Minnesota.

*Backup Withholding.* As a result of the enactment of the Tax Increase Prevention and Reconciliation Act of 2005, interest on Tax-Exempt obligations such as the Tax-Exempt Bonds is subject to information reporting in a manner similar to interest paid on taxable obligations. Backup withholding may be imposed on payments made after March 31, 2007 to any bondholder who fails to provide certain required information including an accurate taxpayer identification number to any person required to collect such information pursuant to Section 6049 of the Code. The reporting requirement does not in and of itself affect or alter the excludability of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes or any other federal tax consequence of purchasing, holding or selling Tax-Exempt obligations.

**The Taxable Bonds**

*General.* The interest on the Taxable Series 2011A Bonds (the "**Taxable Bonds**") is included in gross income for federal income tax purposes, in taxable net income of individuals, trusts and estates for Minnesota income tax purposes and in the income of corporations and financial institutions for purposes of the Minnesota franchise tax. Purchasers of the Taxable Bonds should consult their own tax advisors as to the federal, state or local tax consequences of purchasing or owning the Taxable Bonds.

*Backup Withholding.* Certain purchasers may be subject to backup withholding at the application rate determined by statute with respect to interest paid with respect to the Taxable Bonds if the purchasers, upon issuance, fail to supply the their brokers with their taxpayer identification numbers, furnish incorrect taxpayer identification numbers, fail to report interest, dividends or other "reportable payments" (as defined in the Code) properly, or, under certain circumstances, fail to provide a certified statement, under penalty of perjury, that they are not subject to backup withholding.

*To ensure compliance with Treasury Circular 230, taxpayers holding the Taxable Bonds are hereby notified that: (a) any discussion of U.S. federal tax issues in this Official Statement is not intended or written by us to be relied upon, and cannot be relied upon, by taxpayers for the purpose of avoiding penalties that may be imposed on taxpayers under the Code; (b) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) taxpayers should seek advice based on their particular circumstances from an independent tax advisor.*

**Changes in Federal and State Tax Law**

From time-to-time, there are legislative proposals in the Congress and in the states that, if enacted, could alter or amend the federal and state tax matters referred to above or adversely affect the market value of the Series 2011 Bonds. One such proposal is the American Jobs Act of 2011 (S. 1549), proposed by the President and introduced in the Senate on September 13, 2011. If enacted as introduced, a provision of S. 1549 would limit the amount of exclusions (including tax-exempt interest) and deductions available to certain high income taxpayers for taxable years after 2012, and as a result could affect the market price or marketability of the Tax-Exempt Series 2011B Bonds. It cannot be predicted whether or in what form any such proposal might be enacted or whether if enacted it would apply to bonds issued prior to enactment. In addition, regulatory actions are from time-to-time announced or proposed and litigation is threatened or commenced which, if implemented or concluded in a particular manner, could adversely affect the market value of the Series 2011 Bonds. It cannot be predicted whether any such regulatory action will be implemented, how any particular litigation or judicial action will be resolved, or whether the Series 2011 Bonds or the market value thereof would be impacted thereby. Purchasers of the Series 2011 Bonds should consult their tax advisors regarding any pending or proposed legislation, regulatory initiatives or litigation. The opinions expressed by Transaction Counsel are based upon existing legislation and regulations as interpreted by relevant judicial and regulatory authorities as of the date of issuance and delivery of the Series 2011 Bonds and Transaction Counsel has expressed no opinion as of any date subsequent thereto or with respect to any pending legislation, regulatory initiatives or litigation.

## ERISA CONSIDERATIONS

The Employee Retirement Income Security Act of 1974, as amended ("**ERISA**"), imposes certain fiduciary obligations and prohibited transaction restrictions on employee pension and welfare benefit plans subject to ERISA ("**ERISA Plans**"). Section 4975 of the Code imposes substantially similar prohibited transaction restrictions on certain employee benefit plans, including tax qualified retirement plans described in Section 401(a) of the Code ("**Qualified Retirement Plans**") and on individual retirement accounts and annuities described in Sections 408 (a) and (b) of the Code ("IRAs," collectively, with Qualified Retirement Plans, "**Tax Favored Plans**"). Certain employee benefit plans, such as governmental plans (as defined in Section 3(32) of ERISA), and, if no election has been made under Section 410(d) of the Code, church plans (as defined in Section 3(33) of ERISA) ("**Non ERISA Plans**"), are not subject to the requirements set forth in ERISA or the prohibited transaction restrictions under Section 4975 of the Code. Accordingly, the assets of such Non ERISA Plans may be invested in the Taxable Bonds without regard to the ERISA or Code considerations described below, provided that such investment is not otherwise subject to the provisions of other applicable federal and state law ("**Similar Laws**"). Any governmental plan or church plan that is qualified under Section 401(a) and exempt from taxation under Section 501(a) of the Code is, nevertheless, subject to the prohibited transaction rules set forth in Section 503 of the Code.

In addition to the imposition of general fiduciary requirements, including those of investment prudence and diversification and the requirement that an ERISA Plan's investment of its assets be made in accordance with the documents governing such ERISA Plan, Section 406 of ERISA and Section 4975 of the Code prohibit a broad range of transactions involving assets of ERISA Plans and Tax Favored Plans ("**Plan**" or collectively "**Plans**") and entities whose underlying assets include "plan assets" by reason of Plans investing in such entities with persons ("**Parties in Interest**" or "**Disqualified Persons**" as such terms are defined in ERISA and the Code, respectively) who have certain specified relationships to the Plans, unless a statutory, class or administrative exemption is available. Parties in Interest or Disqualified Persons that participate in a prohibited transaction may be subject to a penalty (or an excise tax) imposed pursuant to Section 502(i) of ERISA or Section 4975 of the Code unless a statutory, class or administrative exemption is available. Section 502(l) of ERISA requires the Secretary of the U.S. Department of Labor (the "**DOL**") to assess a civil penalty against a fiduciary who violates any fiduciary responsibility under ERISA or commits any other violation of part 4 of Title I of ERISA or any other person who knowingly participates in such breach or violation. If the investment constitutes a prohibited transaction under Section 408(e) of the Code, the IRA may lose its tax exempt status.

The investment in a security by a Plan may, in certain circumstances, be deemed to include an investment in the assets of the entity issuing such security, such as the Authority. Certain transactions involving the purchase, holding or transfer of Taxable Bonds may be deemed to constitute prohibited transactions if assets of the Authority are deemed to be assets of a Plan. These concepts are discussed in greater detail below.

**Plan Asset Regulation**

The DOL has promulgated a regulation set forth at 29 C.F.R. § 2510.3 101 (the "**Plan Asset Regulation**") concerning whether or not the assets of an ERISA Plan would be deemed to include an interest in the underlying assets of an entity (such as the Authority) for purposes of the general fiduciary responsibility provisions of ERISA and for the prohibited transaction provisions of ERISA and Section 4975 of the Code, when a Plan acquires an "equity interest" in such entity. ERISA Section 3(42) defines the term "plan assets." Depending upon a number of factors set forth in the Plan Asset Regulation, "plan assets" may be deemed to include either a Plan's interest in the assets of an entity (such as the Authority) in which it holds an equity interest or merely to include its interest in the instrument evidencing such equity interest. For purposes of this section, the terms "plan assets" ("**Plan Assets**") and the "assets of a Plan" have the meaning specified in the Plan Asset Regulation and ERISA Section 3(42) and include an undivided interest in the underlying interest of an entity which holds Plan Assets by reason of a Plan's investment therein (a "**Plan Asset Entity**").

Under the Plan Asset Regulation, the assets of the Authority would be treated as Plan Assets if a Plan acquires an equity interest in the Authority and none of the exceptions contained in the Plan Asset Regulation is applicable. The Plan Asset Regulation provides an exemption from "plan asset" treatment for securities issued by an entity if such securities are debt securities under applicable state law with no "substantial equity features." If the Taxable Bonds are treated as having substantial equity features, a Plan or a Plan Asset Entity that purchases Taxable Bonds could be treated as having acquired a direct interest in the Authority. In that event, the purchase, holding, transfer or resale of the Taxable Bonds could result in a transaction that is prohibited under ERISA or the Code. While not free from doubt, on the basis of the Taxable Bonds as described herein, it appears that the Taxable Bonds should be treated as debt without substantial equity features for purposes of the Plan Asset Regulation.

In the event that the Taxable Bonds cannot be treated as indebtedness for purposes of ERISA, under an exception to the Plan Asset Regulation, the assets of a Plan will not include an interest in the assets of an entity, the equity interests of which are acquired by the Plan, if at no time do Plans in the aggregate own 25% or more of the value of any class of equity interests in such entity, as calculated under the Plan Asset Regulation and ERISA Section 3(42). Because the availability of this exception depends upon the identity of the Taxable Bondholders at any time, there can be no assurance that the Taxable Bonds will qualify for this exception and that the Authority's assets will not constitute a Plan Asset subject to ERISA's fiduciary obligations and responsibilities. Therefor, neither a Plan nor a Plan Asset Entity should acquire or hold Taxable Bonds in reliance upon the availability of this exception under the Plan Asset Regulation.

**Prohibited Transactions**

The acquisition or holding of Taxable Bonds by or on behalf of a Plan, whether or not the underlying assets are treated as Plan Assets, could give rise to a prohibited transaction if the Authority or any of its respective affiliates is or becomes a Party in Interest or Disqualified Person with respect to such Plan, or in the event that a Taxable Bond is purchased in the secondary market by a Plan from a Party in Interest or Disqualified Person with respect to such Plan. There can be no assurance that the Authority or any of its respective affiliates will not be or become a Party in Interest or a Disqualified Person with respect to a Plan that acquires Taxable Bonds. Any such prohibited transaction could be treated as exempt under ERISA and the Code if the Taxable Bonds were acquired pursuant to and in accordance with one or more statutory exemptions, individual exemptions or "class exemptions" issued by the DOL. Such class exemptions include, for example, Prohibited Transaction Class Exemption ("**PTCE**") 75 1 (an exemption for certain transactions involving employee benefit plans and broker dealers, reporting dealers and banks), PTCE 84 14 (an exemption for certain transactions determined by an independent qualified professional asset manager), PTCE 90 1 (an exemption for certain transactions involving insurance company pooled separate accounts), PTCE 91 38 (an exemption for certain transactions involving bank collective investment funds), PTCE 95 60 (an exemption for certain transactions involving an insurance company's general account) and PTCE 96 23 (an exemption for certain transactions determined by a qualifying in house asset manager).

The Underwriters, the Trustee or their affiliates may be the sponsor of, or investment advisor with respect to, one or more Plans. Because these parties may receive certain benefits in connection with the sale or holding Taxable Bonds, the purchase of Taxable Bonds using plan assets over which any of these parties or their affiliates has investment authority might be deemed to be a violation of a provision Title I of ERISA or Section 4975 of the Code. Accordingly, Taxable Bonds may not be purchased using the assets of any Plan if any of the Underwriters, the Trustee or their affiliates has investment authority for those assets, or is an employer maintaining or contributing to the plan, unless an applicable prohibited transaction exemption is available and such prohibited transaction exemption covers such purchase.

**Purchaser's/Transferee's Representations and Warranties**

Each purchaser and each transferee of a Taxable Bond (including a Plan's fiduciary, as applicable) shall be deemed to represent and warrant that (a) it is not a Plan and is not acquiring the Taxable Bond directly or indirectly for, or on behalf of, a Plan or with Plan Assets, Plan Asset Entity or any entity whose underlying assets are deemed to be plan assets of such Plan; or (b) the acquisition and holding of the Taxable Bonds by or on behalf of, or with Plan Assets of, any Plan, Plan Asset Entity or any entity whose underlying assets are deemed to be Plan Assets of such Plan is permissible under applicable law, will not result in any non exempt prohibited transaction under Section 406 of ERISA or Section 4975 of the Code or Similar Law, and will not subject the Authority or Underwriters to any obligation not affirmatively undertaken in writing.

**Consultation With Counsel**

Any Plan fiduciary or other investor of Plan Assets considering whether to acquire or hold Taxable Bonds on behalf of or with Plan Assets of any Plan or Plan Asset Entity, and any insurance company that proposes to acquire or hold Taxable Bonds, should consult with its counsel with respect to the potential applicability of the fiduciary responsibility provisions of ERISA and the prohibited transaction provisions of Section 406 of ERISA and Section 4975 of the Code with respect to the proposed investment and the availability of any prohibited transaction exemption. A fiduciary with respect to a Non ERISA Plan which is a Tax Favored Plan that proposes to acquire or hold Taxable Bonds should consult with counsel with respect to the applicable federal, state and local laws.

## LITIGATION

There is no litigation pending in any court (either State or federal) to restrain or enjoin the issuance or delivery of the Series 2011 Bonds or questioning the creation, organization or existence of the Authority, the validity or enforceability of the Indenture, the sale of the Pledged Settlement Payments by the State to the Authority, the proceedings for the authorization, execution, authentication and delivery of the Series 2011 Bonds, or the validity of the Series 2011 Bonds.

## RATINGS

It is a condition to the obligation of the Underwriters to purchase the Series 2011 Bonds that, at the date of delivery thereof to the Underwriters, the Series 2011 Bonds maturing on March 1, 2014 through March 1, 2022 will be assigned a rating of "A" by S&P, and the Series 2011 Bonds maturing on March 1, 2023 and thereafter will be assigned a rating of "A-" by S&P, and the Series 2011 Bonds will be assigned a rating of "BBB+" by Fitch.

A credit rating is not a recommendation to buy, sell or hold securities, and such ratings may be subject to revision or withdrawal at any time. The ratings by S&P and Fitch of the Series 2011 Bonds reflect only the views of such organization and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agency with respect thereto should be obtained from the Rating Agencies.

The Rating Agencies' respective views of the tobacco industry are a key factor in their ratings of tobacco settlement securitizations. See also "RISK FACTORS—Limited Nature of the Rating of the Series 2011 Bonds; Reduction, Suspension or Withdrawal of a Rating".

Except as may be required by the Undertaking as defined above under the heading "CONTINUING DISCLOSURE UNDERTAKING" the State undertakes no responsibility either to bring to the attention of the owners of the Bonds any proposed change in or withdrawal of such ratings or to oppose any such revision or withdrawal.

There is no assurance that the initial ratings assigned to the Series 2011 Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by the Rating Agency. Any such downward revision, suspension or withdrawal of such rating may have an adverse effect on the availability of a market for or the market price of the Series 2011 Bonds.

## LEGAL INVESTMENT

The Act provides that the State, the investment board, public officers, municipal corporations, political subdivisions and public bodies, and banks, bankers, savings and loan associations, credit unions, trust-companies, savings banks and institutions, investment companies, insurance companies, insurance associations, and other persons carrying on a banking or insurance business, and personal representatives, guardians, trustees, and other fiduciaries may legally invest any sinking funds, moneys, or other funds belonging to them or under their control in the Series 2011 Bonds issued pursuant to the Act, provided, however, that nothing contained in the Act may be construed as relieving any person, firm, or corporation from any duty of exercising reasonable care in selecting securities for purchase or investment.

## UNDERWRITING

The underwriters listed on the cover page hereof (the "**Underwriters**") have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2011 Bonds from the Authority at an aggregate underwriters' discount of $3,942,307.28. The Underwriters will be obligated to purchase all of the Series 2011 Bonds if any are purchased. The initial public offering prices of the Series 2011 Bonds may be changed from time to time by the Underwriters.

Barclays Capital Inc. is acting as representative on behalf of the Underwriters.

Wells Fargo Securities is the trade name for certain capital markets and investment banking services of Wells Fargo & Company and its subsidiaries, including Wells Fargo Bank, National Association ("**WFBNA**"). WFBNA, one of the underwriters of the Series 2011 Bonds, has entered into an agreement (the "**Distribution Agreement**") with Wells Fargo Advisors, LLC ("**WFA**") for the retail distribution of certain municipal securities offerings, such as the Series 2011 Bonds. Pursuant to the Distribution Agreement, WFBNA will share with WFA a portion of its underwriting compensation, relating to any Series 2011 Bonds that are sold by WFA. WFBNA and WFA are both subsidiaries of Wells Fargo & Company.

## LEGAL MATTERS

Kutak Rock LLP, Omaha, Nebraska, as Transaction Counsel, will render its opinion with respect to the validity of the Series 2011 Bonds in substantially the form set forth in Appendix C hereto.

Certain legal matters with respect to the State will be passed upon by the Attorney General of the State.

Certain legal matters will be passed upon for the Underwriters by Nixon Peabody LLP, as Underwriters' Counsel.

## OTHER PARTIES

### Financial Advisor

Public Financial Management, Inc. is employed as Financial Advisor to the Authority in connection with the issuance of the Series 2011 Bonds. The Financial Advisor's fee for services rendered with respect to the sale of the Series 2011 Bonds is not contingent upon the issuance and delivery of the Series 2011 Bonds. Public Financial Management, Inc., in its capacity as Financial Advisor, does not assume any responsibility for the information, covenants and representations contained in any of the legal documents with respect to the federal income tax status of the Series 2011 Bonds, or the possible impact of any present, pending or future actions taken by any legislative or judicial bodies.

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

**Global Insight**

Global Insight has been retained as an independent econometric expert. The Global Insight Report attached as APPENDIX B hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as the independent econometric consultant are not contingent upon the issuance of the Series 2011 Bonds. The Global Insight Report should be read in its entirety.

**TOBACCO SECURITIZATION AUTHORITY**

By: /s/ James D. Schowalter
Chair

Dated: November 17, 2011

# APPENDIX A

# THE MINNESOTA AGREEMENT

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**STATE OF MINNESOTA** **DISTRICT COURT**

**COUNTY OF RAMSEY** **SECOND JUDICIAL DISTRICT**

THE STATE OF MINNESOTA,
BY HUBERT H. HUMPHREY III,
ITS ATTORNEY GENERAL,

**Case Type: Other Civil**
**Court File No. C1-94-8565**

and

BLUE CROSS AND BLUE SHIELD
OF MINNESOTA,

Plaintiffs,

vs.

PHILIP MORRIS INCORPORATED,
R.J. REYNOLDS TOBACCO COMPANY,
BROWN & WILLIAMSON TOBACCO
CORPORATION, B.A.T. INDUSTRIES
P.L.C., BRITISH-AMERICAN TOBACCO
COMPANY LIMITED, BAT (U.K. &
EXPORT) LIMITED, LORILLARD
TOBACCO COMPANY, THE AMERICAN
TOBACCO COMPANY, LIGGETT GROUP,
INC., THE COUNCIL FOR TOBACCO
RESEARCH-U.S.A., INC., and THE
TOBACCO INSTITUTE, INC.,

Defendants.

**SETTLEMENT AGREEMENT AND STIPULATION**
**FOR ENTRY OF CONSENT JUDGMENT**

THIS SETTLEMENT AGREEMENT AND RELEASE ("Settlement Agreement") is made as of the date hereof, by and among the parties hereto, as indicated by their signatures below, to settle and resolve with finality all claims of the State of Minnesota relating to the subject matter of this action which have been or could have been asserted by the State of Minnesota.

WHEREAS, the State of Minnesota, through its Attorney General Hubert H. Humphrey III, and Blue Cross and Blue Shield of Minnesota, commenced this action on August 17, 1994, asserting various claims for monetary, equitable and injunctive relief on behalf of the State of Minnesota and Blue Cross and Blue Shield of Minnesota against certain tobacco manufacturers and others as Defendants;

WHEREAS, the Defendants have denied each and every one of Plaintiffs' allegations of unlawful conduct or wrongdoing and have asserted a number of defenses to Plaintiffs' claims, which defenses have been contested by Plaintiffs;

WHEREAS, the parties hereto wish to avoid the further expense, delay, inconvenience, burden and uncertainty of continued litigation of this matter (including appeals from any verdict), the State of Minnesota and the Settling Defendants have agreed to settle this litigation pursuant to terms which will achieve for the State of Minnesota (and thus for the people of the State of Minnesota) significant funding for the advancement of public health, the implementation of important tobacco-related public health measures in Minnesota, as well as funding for national research dedicated to studying and significantly reducing the use of Tobacco Products by youth;

WHEREAS, the State of Minnesota and Settling Defendants have agreed to settle this lawsuit on terms set forth in this Settlement Agreement and Stipulation for Entry of Consent Judgment and the attached Consent Judgment;

WHEREAS, the parties have further agreed to jointly petition the Court for approval of the Consent Judgment, on the grounds that settlement would be in the public interest;

NOW, THEREFORE, BE IT KNOWN THAT, in consideration of the payments to be made by the Settling Defendants, the dismissal and release of claims by the State of Minnesota and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the parties hereto, acting by and through their authorized agents, memorialize and agree as follows:

## I. GENERAL PROVISIONS

A. Jurisdiction. The State and the Settling Defendants acknowledge that this Court has jurisdiction over the subject matter of this action and over each of the parties to this Settlement Agreement, and that this Court shall retain jurisdiction for the purposes of implementing and enforcing this Settlement Agreement. The parties hereto agree to present any disputes under this Settlement Agreement, including without limitation any claims for breach or enforcement of this Settlement Agreement, exclusively to this Court. The Court may, upon the State's application, enter a Consent Judgment in the form attached hereto as Exhibit A. The cumulative terms of this Settlement Agreement and Stipulation for Entry of Consent Judgment, and the attached Consent Judgment, may be referred to for convenience as this "Agreement" or "Settlement Agreement."

B. Voluntary Agreement of the Parties. The State and the Settling Defendants acknowledge and agree that this Settlement Agreement is voluntarily entered into by all parties hereto as the result of arm's-length negotiations during which all such parties were represented by counsel. The State and Settling Defendants understand that Congress may enact legislation dealing with some of the issues addressed in this Agreement. Settling Defendants and their assigns, affiliates, agents, and successors hereby waive any right to challenge this Agreement or the Consent Judgment, directly or through third parties, on the ground that any term hereof is unconstitutional, outside the power or jurisdiction of the Court, preempted by or in conflict with any current or future federal legislation (except where non-economic terms of future federal legislation are irreconcilable).

C. Definitions.

For the purposes of this Settlement Agreement and attached Consent Judgment, the following terms shall have the meanings set forth below:

1. "*State*" or "*State of Minnesota*" means the State of Minnesota acting by and through its Attorney General;

2. "*Blue Cross*" means BCBSM, Inc., d/b/a Blue Cross and Blue Shield of Minnesota, and all of its administrators, representatives, employees, directors, officers, agents, attorneys, parents and divisions;

3. "*Settling Defendants*" means those Defendants in this action that are signatories hereto;

4. "*Defendants*" means Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, B.A.T Industries P.L.C., British-American Tobacco Company Limited, BAT (U.K. and Export) Limited, Lorillard Tobacco Company, The American Tobacco Company, The Council for Tobacco Research-U.S.A., Inc., and the Tobacco Institute, Inc. and their successors and assigns;

5. "*Consumer Price Index*" shall mean the Consumer Price Index for All Urban Consumers, for the most recent twelve-month period for which such percentage information is available as published by the Bureau of Labor Statistics of the U.S. Department of Labor.

6. *"Court"* means the District Court of the State of Minnesota, County of Ramsey, Second Judicial District;

7. "*Market Share*" means a Settling Defendant's respective share of sales of cigarettes by unit for consumption in the United States during (i) with respect to payments made pursuant to Paragraph II.D. of this Settlement Agreement, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made, and (ii) with respect to all other payments made pursuant to this Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made;

8. *"Cigarettes"* means any product which contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (ii) 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 (iii) 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 subparagraph (i) of this paragraph;

9. *"Smokeless Tobacco"* means any powder that consists of cut, ground, powdered, or leaf tobacco that contains nicotine and that is intended to be placed in the oral cavity;

10. "*Tobacco Products*" means Cigarettes and Smokeless Tobacco;

11. "*Billboards*" includes billboards, as well as all signs and placards in arenas and stadiums, whether open-air or enclosed. Billboards" does not include (1) any advertisements

placed on or outside the premises of retail establishments which sell tobacco products, or any retail point-of-sale; and (2) billboards or advertisements in connection with the sponsorship by the Defendants of any entertainment, sporting or similar event, such as NASCAR, that appears in the State of Minnesota as part of a national or multi-state tour;

12. "*Children*" or "*youth*" means persons under the age of 18;

13. "*Depository*," unless otherwise specified, means the Minnesota document depository established by the Court's Order dated June 16, 1995. "Depositories" includes both the Minnesota depository and the Guildford, U.K. document depository established by the Court's Order dated September 6, 1995;

14. "*Transit Advertisements*" means advertising on private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, waiting area, train station, airport or any similar location. "*Transit Advertisements*" does not include any advertisements placed on or outside the premises of retail establishments licensed to sell Tobacco Products or any retail point-of-sale;

15. "*Special State Counsel*" means Robins, Kaplan, Miller & Ciresi L.L.P. or a successor, if any; and

16. "*Final Approval*" means the date on which this Settlement Agreement and the form of State Escrow Agreement are approved by the Court. At the time of such approval, the settlement between the parties is final.

## II. SETTLEMENT PAYMENTS

A. <u>Settlement Receipts</u>. The payments to be made by the Settling Defendants under this Settlement Agreement are in satisfaction of all of the State of Minnesota's claims for damages incurred by the State in the year of such payment or earlier years related to the subject matter of this action, including, without limitation, claims for equitable and injunctive relief, claims for health care expenditures and claims for punitive damages, except that no part of any payment under this Settlement Agreement is made in settlement of an actual or potential liability for a fine, penalty (civil or criminal) or enhanced damages.

B. Settlement Payments to the State of Minnesota. Each Settling Defendant severally shall cause to be paid to an account designated in writing by the State of Minnesota in accordance with and subject to paragraph II.E. of this Settlement Agreement, the following amounts: the amount listed for it in Schedule A hereto, such amount representing its share of $240,000,000, to be paid on or before September 5, 1998; pro rata in proportion to its Market Share, its share of $220,800,000, to be paid on or before January 4, 1999; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 3, 2000; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 2, 2001; pro rata in proportion to its Market Share, its share of $242,550,000, to be paid on or before January 2, 2002; and pro rata in proportion to its Market Share, its share of $121,550,000, to be paid on or before January 2, 2003. The payments made by the Settling Defendants pursuant to this Paragraph shall be adjusted upward by the greater of 3% or the Consumer Price Index applied each year on the previous year, beginning with the payment due to be made on or before January 3, 2000. The payments due to be made by the Settling Defendants pursuant to this Paragraph on or before January 3, 2000, on or before January 2, 2001, on or before January 2, 2002, and on or before January 2, 2003, will also be decreased or increased, as the case may be, in accordance with the formula for adjustments of payments as set forth in Appendix A. The payments due to be made by the Settling Defendants pursuant to this Paragraph on or before September 5, 1998, and on or before January 4, 1999, shall not be subject to inflation escalation and volume adjustments described in the preceding sentences.

In the event that any of the Settling Defendants fails to make any payment required of it pursuant to this Paragraph (a "Defaulting Defendant") by the applicable date set forth in this paragraph II.B. (a "Missed Payment"), the State of Minnesota shall provide notice to each of the Settling Defendants of such non-payment. The Defaulting Defendant shall have 15 days after receipt of such notice to pay the Missed Payment, together with interest accrued from the original applicable due date at the prime rate as published in the Wall Street Journal on the latest publication date on or before the date of default plus 3%. If the Defaulting Defendant does not make such payment within such 15-day period, the State of Minnesota shall provide notice to each of the Settling Defendants of such continued non-payment. Any or all of the Settling Defendants (other than the Defaulting Defendant) shall thereafter have 15 days after receipt of such notice to elect (in such Settling Defendant's or such Settling Defendants' sole and absolute discretion) to pay the Missed Payment, together with interest accrued from the original applicable due date at the prime rate as published in the Wall Street Journal on the latest publication date on or before the date of default plus 3%. In the event that the State of Minnesota does not receive the Missed Payment, together with such accrued interest, within such additional 15-day period, all payments required to be made by each of the respective Settling Defendants pursuant to this Paragraph shall at the end of such additional 15-day period be accelerated and shall immediately become due and owing to the State of Minnesota from each Settling Defendant pro rata in proportion to its Market Share; provided, however, that any such accelerated payments (a) shall all be adjusted upward by the greater of (i) the rate of 3% per annum or (ii) the actual total percent change in the CPI, in either instance for the period between January 1 of the year in which the acceleration of payments pursuant to this Paragraph occurs and the date on which such accelerated payments are due pursuant to this subsection, and (b) shall all immediately be adjusted in accordance with the formula for adjustments of payments set forth in Appendix A.

Nothing in this Paragraph shall be deemed under any circumstance to create any obligation on the part of any Settling Defendant to pay any amount owed or payable to the State of Minnesota by any other Settling Defendant. All obligations of the Settling Defendants pursuant to this Paragraph are intended to be and shall remain several, and not joint.

C. Public Health Foundation. The Attorney General will propose, and the Settling Defendants have agreed not to oppose, that the Legislature appropriate to a foundation one-half the payments due in September 1998, and in January of the years 1999 through 2003, to be used for such activities as the directors of the foundation may determine will diminish the human and economic consequences of tobacco use. It is contemplated that the directors of the foundation will include public representatives, and representatives of such groups as the American Lung Association, Minnesota Chapter; the University of Minnesota School of Public Health; the Minnesota SmokeFree 2000 Coalition; the American Cancer Society, Minnesota Division; the American Heart Association, Minnesota Chapter; the Association for Non-Smokers' Rights--Minnesota; and the Mayo Clinic Nicotine Dependence Center.

D. Annual Payments. Each of the Settling Defendants agrees that, beginning on December 31, 1998, and annually thereafter on December 31st of each year after 1998 (subject to final adjustment within 30 days), it shall severally cause to be paid to an account designated in writing by the State of Minnesota in accordance with and subject to paragraph II.E. of this Settlement

Agreement, pro rata in proportion to its respective Market Share, its share of 2.55% of the following amounts (in billions):

| Year | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | thereafter |
|---|---|---|---|---|---|---|---|
| | 1 | 2 | 3 | 4 | 5 | 6 | |
| Amount | $4B | $4.5B | $5B | $6.5B | $6.5B | $8B | $8B |

The payments made by Settling Defendants pursuant to this Paragraph shall be adjusted upward by the greater of 3% or the Consumer Price Index applied each year on the previous year, beginning with the annual payment due on December 31, 1999. Such payments will also be decreased or increased, as the case may be, beginning with the annual payment due on December 31, 1999, in accordance with the formula for adjustments of payments set forth in Appendix A.

E. Payment of Settlement Proceeds. Any payment made pursuant to this Settlement Agreement shall be made to an account designated in writing by the State of Minnesota or the Court, as applicable; provided that after Final Approval, if the Court's approval is challenged by any third party, payments due to be made shall be paid into a special escrow account (the "State Escrow Account"), and held in escrow pursuant to this Section V.B. and the State Escrow Agreement.

F. Adjustments in Event of Federal Legislation. The enactment of federal tobacco-related legislation shall not affect the payments required by this Agreement except as follows:

1. If federal tobacco-related legislation providing for the resolution or other disposition of State Attorney General actions brought against tobacco companies is enacted on or before November 30, 2000, and if such legislation provides for payment(s) by tobacco companies (whether by settlement payment, tax or any other means), all or part of which is made available to States, the State of Minnesota shall elect to receive any funds that are (i)

unrestricted as to their use, or (ii) are restricted to any form of health care or to any use related to tobacco (collectively "Federal Settlement Funds"), and Settling Defendants shall receive a dollar-for-dollar offset up to the full amount of payments required under Section II.D of this Agreement for any and all Settlement Funds received by the State of Minnesota, until all Federal Settlement Funds provided however:

a. There shall be no offset to payments required by this Agreement on account of any federal program, subsidies, payments, credits or other aid to the State which are not conditioned or tied to the settlement of a state tobacco-related suit or the relinquishment of state tobacco-related claims;

b. The State relinquishes no rights or benefits under this Agreement except for payments subject to the offset;

c. There are no federally imposed preconditions to the receipt of Federal Settlement Funds other than (i) the settlement of any state tobacco-related lawsuit or the relinquishment of state tobacco-related claims, (ii) actions or expenditures related to tobacco, including but not limited to, education, cessation, control or enforcement, or (iii) actions or expenditures related to health care;

d. If Settling Defendants enter into any pre-verdict settlement agreement (subsequent to the date of this Agreement) of similar litigation brought by a non-federal governmental plaintiff which does not require such an offset, this Section is null and void;

e. If Settling Defendants enter into any pre-verdict settlement agreement (subsequent to the date of this Agreement) of similar litigation brought by a non-federal governmental plaintiff which has an offset term more favorable to the plaintiff, this Settlement Agreement shall, at the option of the Office of the Attorney General of the State of Minnesota, be revised to include a comparable term.

2. Nothing in this section is intended to or shall reduce the total amounts payable to the State under this Agreement by Settling Defendants beyond the amount of Federal Settlement Funds actually received by the State of Minnesota.

## III. DISMISSAL OF CLAIMS AND RELEASES

A. State of Minnesota's Dismissal of Claims. Upon approval of this Settlement Agreement by the Court, the Court shall enter a Final Judgment dismissing with prejudice all claims as to all Defendants.

This Agreement resolves all claims between the State and the Defendants, except for issues pending before the court pertaining to the discoverability or production of documents for which the Defendants reserve their rights of appeal.

B. State of Minnesota's Release and Discharge. Upon Final Approval, the State of Minnesota shall release and forever discharge all Defendants and their present and former parents, subsidiaries (whether or not wholly owned) and affiliates, and their respective divisions, organizational units, officers, directors, employees, representatives, insurers, suppliers, agents, attorneys and distributors (and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing) from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including civil penalties, as well as costs, expenses and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have, as follows:

a. for past conduct, as to any Claims relating to the subject matter of this action which have been asserted or could be asserted now or in the future in this action or a comparable Federal action by the State; and

b. for future conduct, only as to 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 for health care costs allegedly associated with use of or exposure to Tobacco Products;

(such past and future Claims hereinafter referred to as the "Released Claims"); provided, however, that the foregoing shall not operate as a release of any person, party or entity (whether or not a signatory to this Agreement) as to any of the obligations undertaken in this Agreement in connection with a monetary breach or default of this Agreement.

The State of Minnesota hereby covenants and agrees that it shall not hereafter sue or seek to establish civil liability against any person or entity covered by the release provided under Paragraph III.B based, in whole or in part, upon any of the Released Claims, and the State of Minnesota agrees that this covenant and agreement shall be a complete defense to any such civil action or proceeding.

C. Settling Defendants' Release and Discharge. Upon Final Approval, Settling Defendants shall release and forever discharge the State of Minnesota (including any of its past, present or future administrators, representatives, employees, officers, attorneys, agents, representatives, officials acting in their official capacities, agencies, departments, commissions, and divisions, and whether or not any such person or entity participates in the settlement) from any and all manner of civil claims, demands, actions, suits and causes of action, damages whenever incurred, liabilities of any nature whatsoever, including costs, expenses, penalties and attorneys' fees, known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory, arising out of or in any way related to, in whole or in part, the subject matter of the litigation of this lawsuit, that Settling Defendants (including any of their present and former parents, subsidiaries, divisions, affiliates, officers, directors, employees, witnesses (fact or expert), representatives, insurers, agents, attorneys and distributors and the predecessors, heirs, executors, administrators, successors and assigns of each of the foregoing, and whether or not any such person participates in the settlement), whether directly, indirectly, representatively, derivatively or in any other capacity, ever had, now has or hereafter can, shall or may have.

D. Limited Most-Favored Nation Provision. In partial consideration for the monetary payments to be made by the Settling Defendants pursuant to this Settlement Agreement, the State of Minnesota agrees that if the Settling Defendants enter into any future pre-verdict settlement agreement of other similar litigation brought by a non-federal governmental plaintiff on terms more favorable to such non-federal governmental plaintiff than the terms of this Settlement Agreement (after due consideration of relevant differences in population or other appropriate factors), the terms of this Settlement Agreement shall not be revised except as follows: to the extent, if any, such other pre-verdict settlement agreement includes terms that provide (a) for joint and several liability among the Settling Defendants with respect to monetary payments to be made pursuant to such agreement; (b) a guarantee by the parent company of any of the Settling Defendants or other assurances of payment or creditors' remedies with respect to monetary payments to be made pursuant to such agreement; or (c) for the implementation of non-economic tobacco-related public health measures different from those contained in this Settlement Agreement, then this Settlement Agreement shall, at the option of the Office of the Attorney General of the State of Minnesota, be revised to include terms comparable to such terms.

**IV. DEFENDANTS' ASSURANCES**

A. Settling Defendants agree not to directly or indirectly, including through any third party or affiliate:

1. Oppose the passage of those future Minnesota legislative proposals or administrative rules intended by their terms to reduce tobacco use by children listed on Schedule B. (The foregoing does not prohibit Settling Defendants from resisting enforcement of, or suing for declaratory or injunctive relief with respect to any such legislation or rule on any grounds.)

2. Facially challenge the enforceability or constitutionality of existing Minnesota laws or rules relating to tobacco control, including, but not limited to, Minnesota Statutes Section 461.17 regarding the disclosure of certain ingredients in cigarettes; Minnesota Statutes Sections 461.12, et. seq., and 609.685 regarding the sale of tobacco to minors; Minnesota Statutes Section 325F.77 regarding the distribution of samples; and Minnesota Statutes Section 144.411 et. seq. regarding clean indoor air.

3. Support in Congress or any forum, legislation, rules or policies which would preempt, override, or abrogate or diminish the State's rights or recoveries under this Agreement. Except as specifically provided in the foregoing sentence, nothing in this Agreement shall be deemed to restrain the parties from advocating terms of any national settlement or taking any other positions on issues relating to tobacco. The State and its attorneys specifically reserve the right to continue to litigate or advocate for additional document disclosure beyond that ordered by the Ramsey County District Court, in any forum outside of Minnesota.

4. Settling Defendants' obligation to produce documents in discovery pertaining to enactment or repeal of, or opposition to, state legislation or state executive action relating to tobacco in Minnesota is extended beyond August 17, 1994, to the date of this Agreement, with Settling Defendants required to produce these documents within thirty (30) days of the date of this Agreement.

B. Disclosure of Payments Likely to Affect Public Policy.

1. Each Settling Defendant shall disclose to the Office of the Attorney General and the Office of the Governor, at the times and in the manner provided below, information about the following payments:

a. Any payment to a "lobbyist" or "principal" within the meaning of Minnesota Statutes, Section 10A.01, subdivisions 11 and 28, if Settling Defendant knows or has reason to know that the payment will be used, directly or indirectly, to influence legislative or administrative action, or the official action of state or local government in Minnesota in any way relating to Tobacco Products or their use.

b. Any payment to a third party, if the Settling Defendant knows the payment is partly in consideration for the third party attending, offering testimony at, or participating before a state or local government hearing in Minnesota in any way relating to Tobacco Products or their use; and

c. Any payment (other than a "political contribution" under Minn. Stat. § 10.01, subd. 7, or 2 USC § 431(8)(A)) to, or for the benefit of, a state or local official in Minnesota, whether made directly by a defendant or indirectly through an employee acting in the scope of his employment, affiliate, lobbyist, or other agent acting under the substantial control of a defendant.

2. Disclosures required under this section shall be filed with the Office of the Attorney General and with the Office of the Governor on the first day of January, April, July and October of each year for any and all payments made through the first day of the previous month and shall be transmitted in electronic format or such format as the attorney general may require, with the following information:

a. The name, address, telephone number and e-mail address of the recipient.

b. The amount of each payment described in Paragraph B(1).

c. The aggregate amount of all payments described in Paragraph B(1) to the recipient in the calendar year.

3. Information filed under this section is "public data" within the meaning of the Minnesota Government Data Practices Act.

C. Settling Defendants agree to discontinue all Billboards and Transit Advertisements of Tobacco Products in the State. Settling Defendants shall use their best efforts in cooperation with the State to identify all such Billboards that are located within 1000 feet of any public or private school or playground in the State, and shall provide the State with a preliminary list of the location of all Billboards and stationary Transit Advertisements within 30 days from the date hereof, such list to be finalized within an additional 15 days. Settling Defendants shall, at the earlier of the expiration of applicable contracts or four months from the date the final list is supplied to the State, remove all Billboards and Transit Advertisements for Tobacco Products from within the State, leaving the space unused or used for advertising unrelated to Tobacco Products; or at the option of the State of Minnesota, will allow the State, at its expense, to substitute for the remaining term of the contract, alternative advertising intended to discourage the use of Tobacco Products by children and their exposure to second-hand smoke. The parties also agree to secure the expedited removal of up to 50 Billboards or stationary Transit Advertisements for Tobacco Products designated by the State within 30 days after their designation. Each Settling Defendant which has Billboard advertising in the State shall provide the Court and the Attorney General, or his designee, with the name of a contact person to whom the State may direct inquiries during the time such Billboards and Transit Advertisements are being eliminated, from whom the State may obtain periodic reports as to the progress of their elimination and who will be responsible for ensuring that appropriate action is taken to remove any Billboards that have not been timely eliminated.

D. Settling Defendants shall not make, in the connection with any motion picture made in the United States, or cause to be made any payment, direct or indirect, to any person to use, display, make reference to, or use as a prop any cigarette, cigarette package, advertisement for cigarettes, or any other item bearing the brand name, logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products.

E. On and after December 31, 1998, Settling Defendants shall permanently cease marketing, licensing, distributing, selling or offering, directly or indirectly, including by catalogue or direct mail, in the State of Minnesota, any service or item (other than tobacco products or any item of which the sole function is to advertise tobacco products) which bears the brand name (alone or in conjunction with any other word), logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia of product identification identical or similar to, or identifiable with, those used for any brand of domestic tobacco products.

F. Settling Defendants and the Law Firm of Robins, Kaplan, Miller & Ciresi L.L.P. ("RKM&C") have reached a separate agreement for the payment of the State's costs and attorneys fees. In consideration for said agreement, RKM&C has released the State from its obligation to pay costs and attorneys fees under the Special Attorney Appointment dated May 23, 1994.

## V. MISCELLANEOUS PROVISIONS

A. Representations of Parties. The respective parties hereto hereby represent that this Settlement 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. The State represents that all of its outside counsel that have represented it in this action are, by and through their authorized representatives, signatores to this Settlement Agreement.

B. Court Approval. The Parties agree to submit this Settlement Agreement to the Court for its review and approval on Friday, May 8, 1998. If the Court declines to approve this Settlement

Agreement, the Blue Cross Settlement Agreement, the form of State Escrow Agreement, and the form of Blue Cross Escrow Agreement, the matter will be immediately submitted to the jury. If the Court, as a condition of approval or otherwise, requires any change in the Agreements which any signatory is unwilling to make, the case will be immediately submitted to the jury. If before the Court approves the Agreements, any third-party seeks to intervene for the purpose of opposing the Settlement Agreement, the Blue Cross Settlement Agreement, the State Escrow Agreement, and the Blue Cross Escrow Agreement, any Party at its sole election, may withdraw from this Agreement, after first giving notice to the Court and all of the Parties before the jury is dismissed, and submit the case to the jury. If the Court approves the Settlement Agreement as submitted, the Agreement will be final and binding upon all Parties.

In the event that there is a challenge to any provision of this Settlement Agreement by anyone other than the Attorney General of the State of Minnesota as of the date of this Agreement, BCBS or Settling Defendants ("a third-party challenge") after Final Approval, any amounts required to be paid by Settling Defendants pursuant to this Settlement Agreement shall be paid into escrow pursuant to the State Escrow Agreement. If, as a result of such a challenge, any material term of Sections II, III, IV of this Settlement Agreement is modified or rendered unenforceable, the parties shall negotiate an equivalent or comparable substitute term or other appropriate credit or adjustment. In the event that the parties are unable to agree on such a substitute term or appropriate credit or adjustment, then the parties will submit the issue to the Court for resolution, subject to any available appeal rights. In the event that any third-party challenge is made after December 31, 1998, any payments due under Paragraph II.B. shall be made to the State according to the terms of this Settlement Agreement, and only those payments due under Paragraph II.D. shall be placed into escrow as provided above.

In the event that the Court determines that there has been a failure of consideration legally sufficient to warrant termination of this Settlement Agreement, then this Settlement Agreement may be terminated by the party adversely affected. In the event of such termination, the action will be reinstated and all decisions of the trial court, and any party's appeal or other rights with respect thereto, will have the same force and effect as if this Settlement Agreement had never been entered into.

C. Obligations Several, Not Joint. All obligations of the Settling Defendants pursuant to this Settlement Agreement are intended to be and shall remain several, and not joint.

D. Headings. The headings of the paragraphs of this Settlement Agreement are not binding and are for reference only and do not limit, expand or otherwise affect the contents of this Settlement Agreement.

E. No Determination or Admission. This Settlement Agreement and any proceedings taken hereunder are 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 any wrongdoing whatsoever on the part of any party hereto or any person covered by the releases provided under paragraphs III.B. and C. hereof. The Settling Defendants specifically disclaim and deny any liability or wrongdoing whatsoever with respect to the allegations and claims asserted against them in this action and enter into this Settlement Agreement solely to avoid the further expense, inconvenience, burden and uncertainty of litigation.

F. Non-Admissibility. The settlement negotiations resulting in this Settlement Agreement have been undertaken by the parties hereto in good faith and for settlement purposes only, and neither this Settlement Agreement nor any evidence of negotiations hereunder shall be offered or received in evidence in this action, or any other action or proceeding, for any purpose other than in an action or proceeding arising under this Settlement Agreement.

G. Amendment; Waiver. This Settlement Agreement may be amended only by a written instrument executed by the Attorney General and the Settling Defendants. 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 of this Settlement Agreement shall not be deemed to be or construed as a waiver of any other breach, whether prior, subsequent or contemporaneous, of this Settlement Agreement.

H. Notices. All notices or other communications to any party to this Settlement Agreement shall be in writing (and shall include telex, telecopy or similar writing) and shall be given to the respective parties hereto at the following addresses. 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 paragraph.

For the State of Minnesota:

Hubert H. Humphrey III
Attorney General
102 State Capitol
St. Paul, MN 55155
Fax: 612.297.4193

with copies to:

Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.
2800 LaSalle Plaza
800 LaSalle Avenue
Minneapolis, MN 55402-2015
Fax: 612.339.4181

Chief Deputy Attorney General
State of Minnesota
102 State Capitol
St. Paul, MN 55155
Fax: 612.297.4193

For Philip Morris Incorporated:

Martin J. Barrington
Philip Morris Incorporated
120 Park Avenue
New York, NY 10017-5592
Fax: 212.907.5399

With a copy to:

Meyer G. Koplow
Wachtell, Lipton, Rosen & Katz
51 West 52nd Street
New York, NY 10019
Fax: 212.403.2000

For R.J. Reynolds Tobacco Company:

Charles A. Blixt
General Counsel
R.J. Reynolds Tobacco Company
401 North Main Street
Winston-Salem, NC 27102
Fax: 910.741.2998

With a copy to:

Arthur F. Golden
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017
Fax: 212.450.4800

For Brown & Williamson Tobacco Corporation:

F. Anthony Burke
Brown & Williamson Tobacco Corporation
200 Brown & Williamson Tower
401 South Fourth Avenue
Louisville, KY 40202
Fax: 502.568.7297

With a copy to:

Stephen R. Patton
Kirkland & Ellis
200 East Randolph Dr.
Chicago, IL 60601
Fax: 312.861.2200

For Lorillard Tobacco Company:

Arthur J. Stevens
Lorillard Tobacco Company
714 Green Valley Road
Greensboro, NC 27408
Fax: 910.335.7707

I. Cooperation. The parties hereto agree to use their best efforts and to cooperate with each other to cause this Settlement Agreement 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 therewith. Consistent with the foregoing, the parties hereto agree that they will not directly or indirectly assist or encourage any challenge to this Settlement Agreement by any other person. All parties hereto agree to support the integrity and enforcement of the terms of this Settlement Agreement.

J. Governing Law. This Settlement Agreement shall be governed by the laws of the State of Minnesota, without regard to the conflicts of law rules of such state.

K. Construction. None of the parties hereto shall be considered to be the drafter of this Settlement Agreement or 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.

L. Severability. Subject to the provisions of Paragraph V.B., the terms of this Agreement are severable. If any term of this Agreement is found to be unlawful, the remaining terms shall remain in full force and effect, and the parties agree to negotiate a substitute term of equivalent value.

M. Intended Beneficiaries. This action was brought by the State of Minnesota, through its Attorney General, and by Blue Cross to recover certain monies and to promote the health and welfare of the people of Minnesota. No portion of this Settlement Agreement shall provide any rights to, or be enforceable by, any person or entity that is neither a party hereto nor a person encompassed by the releases provided in paragraphs III.B. and C. of this Settlement Agreement. Except as expressly provided in this Settlement Agreement, no portion of this Settlement Agreement shall bind any non-party or determine, limit or prejudice the rights of any such person or entity. None of the rights granted or obligations assumed under this Settlement Agreement by the parties hereto may be assigned or otherwise conveyed without the express prior written consent of all of the parties hereto.

N. Counterparts. This Settlement Agreement may be executed in counterparts. Facsimile or photocopied signatures shall be considered as valid signatures as of the date hereof, although the original signature pages shall thereafter be appended to this Settlement Agreement.

IN WITNESS WHEREOF, the parties hereto, through their fully authorized representatives, have agreed to this Comprehensive Settlement Agreement and Release as of this 8th day of May, 1998.

STATE OF MINNESOTA, acting by and through Hubert H. Humphrey III, its duly elected and authorized Attorney General

By: */s/ Hubert H. Humphrey III*
Hubert H. Humphrey III
Attorney General

*/s/ Lee E. Sheehy*
Lee E. Sheehy
Chief Deputy Attorney General

*/s/ Eric A. Johnson*
Eric A. Johnson
Executive Assistant to the Attorney General

*/s/ Thomas F. Pursell*
Thomas F. Pursell
Senior Counsel to the Attorney General

*/s/ D. Douglas Blanke*
D. Douglas Blanke
Director of Consumer Policy

COUNSEL TO THE STATE OF MINNESOTA

By: */s/ Michael V. Ciresi*
Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.

PHILIP MORRIS INCORPORATED

By: */s/ Meyer G. Koplow*
Meyer G. Koplow
Counsel

By: */s/ Martin J. Barrington*
Martin J. Barrington
General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By: */s/ D. Scott Wise*
D. Scott Wise
Counsel

By: */s/ Charles A. Blixt*
Charles A. Blixt
General Counsel

BROWN & WILLIAMSON TOBACCO CORPORATION

By: */s/ Stephen R. Patton*
Stephen R. Patton
Counsel

By: */s/ F. Anthony Burke*
F. Anthony Burke
Vice President and General Counsel

LORILLARD TOBACCO COMPANY

By: */s/ Arthur J. Stevens*
Arthur J. Stevens
Senior Vice President & General Counsel

**SCHEDULE A**

AMOUNTS PAYABLE BY SETTLING DEFENDANTS ON OR BEFORE SEPTEMBER 5, 1998 PURSUANT TO PARAGRAPH II.B. OF THE SETTLEMENT AGREEMENT

| Date | 9/5/98 |
|---|---|
| Settling Defendants | |
| Philip Morris Incorporated | $ 163,200,000 |
| R.J. Reynolds Tobacco Company | $ 16,320,000 |
| Brown & Williamson Tobacco Corporation | $ 42,960,000 |
| Lorillard Tobacco Company | $ 17,520,000 |
| Total Amount | $ 240,000,000 |

## SCHEDULE B

### Potential Future Legislation to Reduce Tobacco Use by Children

- Legislation to expand the self-service-sale restrictions of the youth access to tobacco law and to remove the current exception for sales of cigars.

- Legislation to clarify the current youth access law provision on vending machines, making clear that machines equipped with automatic locks or that use tokens are vending machines within the meaning of the law.

- Legislation providing enhanced or coordinated funding for enforcement efforts under sales-to-minors provisions of the criminal code or the youth access statute and ordinances.

- Legislation to encourage or support the use of technology to increase effectiveness of age-of-purchase laws, such as, without limitation, the use of programmable scanners or scanners to read drivers' licenses.

- Legislation or rules restricting the wearing, carrying or display of tobacco indicia in school-related settings, including, without limitation, in school facilities, on school premises, or in connection with school-sponsored activities.

- Legislation to create or stiffen non-monetary incentives for youth not to smoke, such as expansion of youth community service programs.

**APPENDIX A**

**FORMULA FOR CALCULATING**

**STATE OF MINNESOTA VOLUME ADJUSTMENTS**

Any payment that by the terms of the Settlement Agreement is to be adjusted pursuant to this Appendix (the "Applicable Base Payment") shall be adjusted pursuant to this Appendix in the following manner:

(A) in the event the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in 1997 (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 multiplied by the ratio of the Actual Volume to the Base Volume, and the resulting product shall be divided by 0.98; and

(ii) if a reduction of the Applicable Base Payment results from the application of subparagraph (B)(i) of this Appendix, but the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products for the Applicable Year (the "Actual Net Operating Profit") is greater than the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997 (the "Base Net Operating Profit") (such Base Net Operating Profit being adjusted upward by the greater of the rate of 3% per annum or the actual total percent change in the Consumer Price Index, in either instance for the period between January 1, 1998 and the date on which the payment at issue is made), then the amount by which the Applicable Base Payment is reduced by the application of subparagraph (B)(i) shall be reduced (but not below zero) by 2.55% of 25% of such increase in such profits. For purposes of this Appendix, “net operating profits from domestic sales of Tobacco Products” shall mean net operating profits from domestic sales of Tobacco Products as reported to the United States Securities and Exchange Commission (“SEC”) for the Applicable Year or, in the case of a Settling Defendant that does not report profits to the SEC, as reported in financial statements prepared in accordance with generally accepted accounting principles and audited by a nationally recognized accounting firm. The determination of the Settling Defendants’ aggregate net operating profits from domestic sales of Tobacco Products shall be derived using the same methodology as was employed in deriving such Settling Defendants’ aggregate net operating profits from domestic sales of Tobacco Products in 1997. Any increase in an Applicable Base Payment pursuant to this subparagraph B(ii) shall be payable within 120 days after the date that the payment at issue was required to be made.

(C) “Applicable Year” means (i) with respect to the payments made pursuant to paragraph II.D of the Settlement Agreement, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made; and (ii) with respect to all other payments made pursuant to this Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

**STATE OF MINNESOTA** **DISTRICT COURT**

**COUNTY OF RAMSEY** **SECOND JUDICIAL DISTRICT**

THE STATE OF MINNESOTA,
BY HUBERT H. HUMPHREY III,
ITS ATTORNEY GENERAL,

**Case Type: Other Civil**
**Court File No. C1-94-8565**

and

BLUE CROSS AND BLUE SHIELD
OF MINNESOTA,

Plaintiffs,

vs.

**CONSENT JUDGMENT**

PHILIP MORRIS INCORPORATED, R.J. REYNOLDS TOBACCO COMPANY, BROWN & WILLIAMSON TOBACCO CORPORATION, B.A.T. INDUSTRIES P.L.C., BRITISH-AMERICAN TOBACCO COMPANY LIMITED, BAT (U.K. & EXPORT) LIMITED, LORILLARD TOBACCO COMPANY, THE AMERICAN TOBACCO COMPANY, LIGGETT GROUP, INC., THE COUNCIL FOR TOBACCO RESEARCH-U.S.A., INC., and THE TOBACCO INSTITUTE, INC.,

Defendants.

WHEREAS, the State of Minnesota, by its Attorney General, Hubert H. Humphrey III, and Blue Cross and Blue Shield of Minnesota filed their Complaint herein on August 17, 1994, and their Second Amended Complaint on January 6, 1998;

**EXHIBIT A**

WHEREAS, Defendants have contested the claims in the Plaintiffs' Complaint and Second Amended Complaint;

WHEREAS, the parties recognize that Congress is considering national tobacco legislation and have agreed to settle this case on a basis which acknowledges possible federal legislation, but which guarantees to the people of Minnesota the relief granted herein;

WHEREAS, Settling Defendants, in the Settlement Agreement and Stipulation for Entry of Consent Judgment, have waived as specified therein their right to challenge the terms of this Consent Judgment as being superseded or preempted by future Congressional enactments; and

WHEREAS, the Attorney General believes the entry of this Consent Judgment is appropriate and in the public interest;

NOW THEREFORE, IT IS HEREBY ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

## I. JURISDICTION AND VENUE

The Court has jurisdiction over the subject matter of this action and over the Settling Defendants under Minn. Stat. §§ 8.31, 325D.15, 325D.45, 325D.58, 325F.70 and 484.01 (1994). Venue is proper in Ramsey County pursuant to Minn. Stat. §§ 325D.65 and 542.09 (1994) in that Settling Defendants do business in Ramsey County.

## II. DEFINITIONS

The definitions set forth in the Settlement Agreement and Stipulation for Entry of Consent Judgment ("Settlement Agreement") are incorporated by reference herein.

## III. APPLICABILITY

This Consent Judgment applies only to Settling Defendants 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 and penalties in Sections XD. and E. herein for a violation of this Consent Judgment shall apply only to Settling Defendants, and shall not be imposed or assessed against any employee, officer or director of Settling Defendants or other person or entity as a consequence of such a violation, and there shall be no jurisdiction under this Consent Judgment to do so.

## IV. EFFECT ON THIRD PARTIES

This Consent Judgment is not intended to and does not vest standing in any third party with respect to the terms hereof, or create for any person other than the parties hereto a right to enforce the terms hereof.

## V. INJUNCTIVE RELIEF

Settling Defendants are permanently enjoined from:

A. On and after December 31, 1998, marketing, licensing, distributing, selling or offering, directly or indirectly, including by catalogue or direct mail, in the State of Minnesota, any service or item (other than tobacco products or any item the sole function of which is to advertise tobacco products) which bears the brand name (alone or in conjunction with any other word), logo, symbol, motto, selling message, recognizable color or pattern of colors, or any other indicia or product identification identical or similar to, or identifiable with, those used for any domestic brand of tobacco products.

B. Making any material misrepresentation of fact regarding the health consequence of using any tobacco product, including any tobacco additives, filters, paper or other ingredients. Nothing in this paragraph shall limit the exercise of any First Amendment right or any defense or position which persons bound by this Consent Judgment may assert in any judicial, legislative, or regulatory forum.

C. Entering into any contract, combination or conspiracy between or among themselves, which has the purpose or effect of: (1) limiting competition in the production or distribution of information about the 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, marketing, or development of new products.

D. Taking any action, directly or indirectly, to target children in Minnesota in the advertising, promotion, or marketing of cigarettes, or taking any action the primary purpose of which is to initiate, maintain or increase the incidence of underage smoking in Minnesota.

## VI. DISSOLUTION OF DEFENDANT COUNCIL FOR TOBACCO RESEARCH

Settling Defendants represent that they have the authority to effectuate the following and will do so within 90 days of this Agreement: The Council for Tobacco Research-U.S.A. Inc. shall cease all operations except as necessary to comply with existing grants or contracts and to continue its defense of other lawsuits and will be disbanded and dissolved within a reasonable time period thereafter. To the extent not required elsewhere in this Consent Judgment, the Council for Tobacco Research shall forward all smoking and health research in its possession or control to the Food and Drug Administration subject to appropriate confidentiality protection required by contracts between the Council for Tobacco Research and any third party. Defendants shall preserve all other records of the Council for Tobacco Research which relate in any way to issues raised in this or any other Attorney General lawsuit. Defendants may not reconstitute the Council for Tobacco Research or its function in any form.

## VII. PUBLIC ACCESS TO DOCUMENTS AND COURT FILES

A. The Court's previous Protective Orders are hereby dissolved with respect to all documents, including the 4A and 4B indices and the privilege logs, which have been produced to the Plaintiffs and for which Defendants have made no claim of privilege or Category II trade secret protection. Such documents shall be made available to the public at the Depository, in the manner provided as follows:

1. The public shall be given access to all non-privileged documents contained in the Minnesota Depository, including all documents set forth in Paragraph VII.A. above.

2. Plaintiffs and Settling Defendants shall meet with representatives of the current Minnesota Depository administrators, Smart Legal Assistance and Merrill Corporation, and/or other appropriate persons, to discuss staffing issues and the procedures that should be implemented to continue the operation of the Minnesota Depository, thereby to ensure broad and orderly access to these documents.

3. Category II documents shall be returned to the Defendants as soon as practical, provided that Defendants, upon receiving appropriate assurances of trade secret protection from the Food and Drug Administration, shall forward a copy of the Category II documents bearing the Bates numbers from this action to said agency. Plaintiffs shall retain the Bates stamp numbers of all Category II documents produced in this case.

B. The documents produced in this case are not "government data" under the Minnesota Government Data Practices Act.

C. For documents upon which a privilege was claimed and found not to exist, including any briefs, memoranda and other pleadings filed by the parties which include reference to such documents, Plaintiffs may seek court approval to make such documents available to the public, provided that any such request be made to the Court within 45 days of the date of entry of this Consent Judgment.

D. Defendant British-American Tobacco Company Limited shall maintain and operate the Guildford Depository for a period of ten years. Defendant British-American Tobacco Company Limited shall have the option of maintaining such depository at its current location or at an appropriate alternative location. All documents, except those identified in Paragraph VII.A.3 above, which were selected by plaintiffs from the Guildford Depository in response to the Plaintiffs' discovery requests shall be moved to and retained at the Minnesota Depository.

E. The Minnesota Depository shall be maintained and operated at Settling Defendants' sole expense, in the manner set forth above for ten years after the date hereof, or such longer period as may be provided in federal legislation for a national document depository. At the end of such period, or sooner, at the State's discretion, the documents shall be transferred to the State Archives or other appropriate state body, where they shall remain available for historical and research purposes. The parties and the Depository staff shall cooperate with the State Archivist or such other state officials as may be involved in transferring the documents to the custody of the State.

F. Settling Defendants shall provide to the State for the Depository a copy of all existing CD-ROMs of documents produced in this action that do not contain any privileged or work-product documents or information, to be placed in the Depository.

G. Defendants shall produce to the Depository all documents produced by such defendants in other United States smoking and health litigation but not previously produced in Minnesota, within 30 days of their production such the other litigation, provided Defendants do not claim privilege with respect to such documents, and provided such documents are not subject to any protective order.

**VIII. EQUITABLE RELIEF: NATIONAL RESEARCH; DEPOSIT OF FUNDS.**

A. In furtherance of the equitable relief sought by the State, pursuant to the Court's equitable powers to shape appropriate injunctive relief, in light of the public health interests demonstrated by the evidence in this case, and pursuant to the agreement of the parties:

1. Consistent with the Prayer for Relief in the State's Complaint and Amended Complaints that the Defendants fund cessation programs in the State of Minnesota, the amount due in December, 1998 ($102 million), pursuant to the Settlement Agreement, Section II.D, shall be deposited into a separate cessation account and used to offer smoking cessation opportunities to Minnesota smokers, and shall be administered as ordered by the Court.

2. In addition to other money paid under this Consent Judgment and the Settlement Agreement and Stipulation for Entry of Consent Judgment, each Settling Defendant shall pay pro rata in proportion to its Market Share, on or before June 1, 1998, and no later than June 1 of each succeeding year through and including June 1, 2007, its share of

$10 million into a national research account, to be administered as ordered by the Court. The parties envision that approximately 70% of the $100 million total will be used for research grants relating to the elimination of tobacco use by children, and 30% for program implementation, evaluation and other tobacco control purposes; provided, however, the administrator of the national research account may, in its discretion, change the allocation.

3. The State shall submit a plan for the administration and authorized uses of the funds payable under this section within 45 days of the date of entry of this Consent Judgment.

4. Monies payable under this section and Section V.B. of the Settlement Agreement shall be deposited in interest bearing accounts at a bank to be designated by the Commissioner of Finance. Settling Defendants' payment of the amounts set forth above are Settling Defendants' sole obligation under this section.

B. Except as specified in this section and Section V.B of the Settlement Agreement, all monies payable under Sections II.B. and D. of the Settlement Agreement between the parties shall be deposited into the general fund of the State of Minnesota.

## IX. FINAL DISPOSITION

This Consent Judgment resolves all claims set forth in the State's Second Amended Complaint against Defendants, which are hereby dismissed with prejudice, and shall constitute the final disposition of this action.

## X. MISCELLANEOUS PROVISIONS

A. Jurisdiction of this case is retained for the purpose of enforcement and enabling the continuing proceedings contemplated herein. Any party to this Consent Judgment may apply to this

Court at any time for such further orders and directions as may be necessary or appropriate for the construction and enforcement of this Consent Judgment.

B. This Consent 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 personal jurisdiction or any liability or any wrongdoing whatsoever on the part of any Defendant. The Defendants specifically disclaim any liability or wrongdoing whatsoever with respect to the claims and allegations asserted against them in this action and Settling Defendnats have stipulated to entry of this Consent Judgment solely to avoid the further expense, inconvenience, burden and risk of litigation.

C. Except as provided in Section III.D. of the Settlement Agreement and Stipulation for Entry of Consent Judgment, this Consent Judgment shall not be modified 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 Section III of this Consent Judgment shall in no event be subject to modification. Changes in the economic conditions of the parties shall not be grounds for modification. It is intended that Settling Defendants will comply with this Consent Judgment as originally entered, even if Settling Defendants' obligations hereunder are greater than those imposed under current or future law. Therefore, a change in law that results, directly or indirectly, in more favorable or beneficial treatment of any one or more of the Settling Defendants shall not support modification of this Consent Judgment.

D. In enforcing this Consent Judgment the Attorney General shall have the discovery powers of Minn. Stat. § 8.31 (1996), as amended. Any Settling Defendant which violates this Consent Judgment shall be subject to contempt and to the remedies provided in Minn. Stat. § 8.31 (1996), as amended. In addition, in any proceeding which results in a finding that a Settling

Defendant violated this Consent Judgment, the responsible Settling Defendant or Settling Defendants shall pay the State's costs and attorneys' fees incurred in such proceeding.

E. The remedies in this Consent Judgment are cumulative and in addition to any other remedies the State may have at law or equity. Nothing herein shall be construed to prevent the State from bringing any action for conduct not released hereunder, even though that conduct may also violate this Consent Judgment.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: May 8,1998

/s/ *Kenneth J. Fitzpatrick*
KENNETH J. FITZPATRICK
Judge of District Court

**JUDGMENT**

Pursuant to the foregoing Consent Judgment, judgment is hereby entered accordingly.

Dated: May 19, 1998

/s/
Court Administrator

**STATE OF MINNESOTA** | **DISTRICT COURT**

**COUNTY OF RAMSEY** | **SECOND JUDICIAL DISTRICT**

THE STATE OF MINNESOTA,
BY HUBERT H. HUMPHREY III,
ITS ATTORNEY GENERAL,

**Case Type: Other Civil**
**Court File No. C1-94-8565**

and

BLUE CROSS AND BLUE SHIELD
OF MINNESOTA,

Plaintiffs,

vs.

PHILIP MORRIS INCORPORATED,
R.J. REYNOLDS TOBACCO COMPANY,
BROWN & WILLIAMSON TOBACCO
CORPORATION, B.A.T. INDUSTRIES
P.L.C., BRITISH-AMERICAN TOBACCO
COMPANY LIMITED, BAT (U.K. &
EXPORT) LIMITED, LORILLARD
TOBACCO COMPANY, THE AMERICAN
TOBACCO COMPANY, LIGGETT GROUP,
INC., THE COUNCIL FOR TOBACCO
RESEARCH-U.S.A., INC., and THE
TOBACCO INSTITUTE, INC.,

Defendants.

AGREEMENT OF
AMENDMENT TO SETTLEMENT AGREEMENT

THIS AGREEMENT OF AMENDMENT TO SETTLEMENT AGREEMENT (this "Agreement") is made as of the date hereof, by and among the parties hereto, as indicated by their signatures below, to settle and resolve with finality certain issues arising out of Appendix A to the Settlement Agreement.

WHEREAS, on May 8, 1998, the State of Minnesota and the Settling Defendants entered into a settlement agreement (the "Settlement Agreement") with respect to this action;

WHEREAS, certain disputes have arisen between the parties concerning the meaning of the term "net operating profits" as used in Appendix A to the Settlement Agreement (the "NOP Issue") and as to certain other issues arising out of such Appendix A; and

WHEREAS, the parties have agreed to settle and resolve with finality the NOP Issue and certain other issues between them arising out of Appendix A to the Settlement Agreement;

NOW THEREFORE, in consideration of their mutual agreement to the terms of this Agreement, and such other consideration as described herein, the sufficiency of which is hereby acknowledged, the parties hereto, acting by and through their authorized agents, memorialize and agree as follows:

1. Unless otherwise defined herein, all capitalized terms in this Agreement shall have the same definition and meaning as in the Settlement Agreement.

2. The provisions of this Agreement supplement and amend the terms of the Settlement Agreement, which shall remain in full force and effect except insofar as they are expressly revised by the provisions of this Agreement. The terms of the Settlement Agreement that are not expressly revised or amended by the provisions of this Agreement shall be fully applicable to the terms hereof. The respective parties hereto hereby represent that this Agreement has been duly authorized and, upon execution by the

signatories below, will constitute a valid and binding contractual obligation, enforceable in accordance with its terms, of each of the parties hereto.

3. Appendix A to the Settlement Agreement is hereby permanently amended nunc pro tunc by deleting it in its entirety and replacing it with new Appendix A in the form attached as Exhibit A hereto.

4. The Settling Defendants shall, on or before June 11, 2001, severally transfer to the account designated by the wire instructions set forth in Exhibit B hereto the aggregate amount of $29,025,087 (the "Total Payment Amount") pursuant to the terms hereof. The Total Payment Amount shall be allocated among and severally paid by the Settling Defendants as follows: Philip Morris Incorporated: $17,344,811; Lorillard Tobacco Company: $11,680,276. Included in calculating the Total Payment Amount are the following amounts: (A) an amount reflecting the resolution of the NOP Issue with respect to Applicable Year 1999 and Applicable Year 2000 equal to $37,795,112 (the "NOP Issue Amount") (which includes the Lorillard Investment Income Amount described in paragraph 5 of this Agreement); and (B) certain credits due to Philip Morris Incorporated and Lorillard Tobacco Company. The parties hereto agree that payment of the NOP Issue Amount (as included within the calculation of, and paid as an element of, the Total Payment Amount) pursuant to this Agreement constitutes timely payment under subparagraph (B)(ii) of Appendix A to the Settlement Agreement (as amended hereby) with respect to Applicable Year 1999 and Applicable Year 2000. The following amounts shall be credited against the respective payments due to the State of Minnesota pursuant to the Settlement Agreement on December 31, 2001 from R. J. Reynolds Tobacco Company and Brown and Williamson Tobacco Corporation as follows: R. J. Reynolds

Tobacco Company: $3,161,762; Brown and Williamson Tobacco Corporation: $2,647,737.

5. The parties hereto finally and irrevocably agree that calculation of "net operating profits" as that term is used in Appendix A to the Settlement Agreement (as amended hereby) shall exclude investment income from "net operating profits" for both 1997 and for the Applicable Year. The parties absolutely and unconditionally release and forever discharge any Claim or argument that calculation of "net operating profits" as that term is used in Appendix A to the Settlement Agreement (as amended hereby), should or does include investment income in "net operating profits" for either 1997 or for the Applicable Year. Notwithstanding the agreement stated in the preceding two sentences, the parties understand and agree that included in the Total Payment Amount is an amount equal to $851,400 (the "Lorillard Investment Income Amount") representing the total additional amount that would be due to the State of Minnesota pursuant to subparagraph (B)(ii) of Appendix A to the Settlement Agreement (as amended hereby) with respect to Applicable Year 1999 and Applicable Year 2000 if Lorillard Tobacco Company's investment income for those years and for 1997 were to be included in the calculation of "net operating profits" instead of (as provided in subparagraph (B)(ii) of Appendix A) excluded from such calculation.

6. The parties hereto agree that they will use their best efforts and cooperate with each other to cause this Agreement to become and remain fully 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, the parties hereto agree that they will not directly or indirectly assist

or encourage any challenge to this Agreement by any person, will oppose any such challenge, and will support the integrity and enforcement of the terms of this Agreement. This Agreement is not intended to be and shall not in any event be argued, construed or deemed to be, or represented or caused to be represented as, an admission or concession as to the accuracy of the amount of Base Volume or Actual Volume. The terms of this Agreement are nonseverable, and the terms of Appendix A to the Settlement Agreement (as amended hereby) shall be deemed to be material for purposes of paragraphs V(B) and V(L) of the Settlement Agreement (or any similar provision of any subsequent amendment to the Settlement Agreement).

IN WITNESS WHEREOF, the parties, through their fully authorized representatives, have agreed to this Agreement of Amendment to Settlement Agreement as of this 1st day of June, 2001.

STATE OF MINNESOTA, acting by and through
Mike Hatch, its duly elected and authorized
Attorney General

By: ______________________________
Mike Hatch
Attorney General

COUNSEL TO THE STATE OF MINNESOTA

By: ______________________________
Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.

or encourage any challenge to this Agreement by any person, will oppose any such challenge, and will support the integrity and enforcement of the terms of this Agreement. This Agreement is not intended to be and shall not in any event be argued, construed or deemed to be, or represented or caused to be represented as, an admission or concession as to the accuracy of the amount of Base Volume or Actual Volume. The terms of this Agreement are nonseverable, and the terms of Appendix A to the Settlement Agreement (as amended hereby) shall be deemed to be material for purposes of paragraphs V(B) and V(L) of the Settlement Agreement (or any similar provision of any subsequent amendment to the Settlement Agreement).

IN WITNESS WHEREOF, the parties, through their fully authorized representatives, have agreed to this Agreement of Amendment to Settlement Agreement as of this 1st day of June, 2001.

STATE OF MINNESOTA, acting by and through
Mike Hatch, its duly elected and authorized
Attorney General

By:______________________________
Mike Hatch
Attorney General

COUNSEL TO THE STATE OF MINNESOTA

By:______________________________
Michael V. Ciresi
Robins, Kaplan, Miller & Ciresi L.L.P.

PHILIP MORRIS INCORPORATED

By: ______________________________

Meyer G. Koplow
Counsel

By: ______________________________

Denise F. Keane
Senior Vice President and General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By: ______________________________

D. Scott Wise
Counsel

By: ______________________________

Charles A. Blixt
Executive Vice President and General Counsel

PHILIP MORRIS INCORPORATED

By:______________________________
Meyer G. Koplow
Counsel

By:______________________________
Denise F. Keane
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Counsel

R.J. REYNOLDS TOBACCO
COMPANY

By:______________________________
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R.J. REYNOLDS TOBACCO COMPANY

By:______________________________

D. Scott Wise
Counsel

By: Charles A. Blixt

Charles A. Blixt
Executive Vice President and General Counsel

BROWN & WILLIAMSON TOBACCO
CORPORATION

By: Stephen R. Patton

Stephen R. Patton
Counsel

By:______________________________

F. Anthony Burke
Vice President and General
Counsel

LORILLARD TOBACCO COMPANY

By:______________________________

Ronald Milstein
Vice President and General
Counsel

BROWN & WILLIAMSON TOBACCO CORPORATION

By:________________________________

Stephen R. Patton
Counsel

By:________________________________

F. Anthony Burke
Vice President and General Counsel

LORILLARD TOBACCO COMPANY

By:________________________________

Ronald Milstein
Vice President and General Counsel

BROWN & WILLIAMSON TOBACCO
CORPORATION

By:________________________________
Stephen R. Patton
Counsel

By:________________________________
F. Anthony Burke
Vice President and General
Counsel

LORILLARD TOBACCO COMPANY

By:________________________________
Ronald Milstein
Vice President and General
Counsel

# APPENDIX A

## FORMULA FOR CALCULATING

## STATE OF MINNESOTA VOLUME ADJUSTMENTS

Any payment that by the terms of the Amended Settlement Agreement is to be adjusted pursuant to this Appendix (the "Applicable Base Payment") shall be adjusted pursuant to this Appendix in the following manner:

(A) in the event the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in the Applicable Year (as defined hereinbelow) (the "Actual Volume") is greater than the aggregate number of units of Tobacco Products sold domestically by the Settling Defendants in 1997 (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 (1) 1 (one) minus (2) the ratio of the Actual Volume to the Base Volume; and

(ii) if a reduction of the Applicable Base Payment results from the application of subparagraph (B)(i) of this Appendix, but the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products for the Applicable Year (the "Actual Net Operating Profit") is greater than the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997 (the "Base Net Operating Profit") (such Base Net Operating Profit being adjusted upward by the greater of the rate of 3% per annum or the actual total percent change in the Consumer Price Index, in either instance for the period between January 1, 1998 and the date on which the payment at issue is made), then the amount by which the Applicable Base Payment is reduced by the application of subparagraph (B)(i) shall be reduced (but not below zero) by 2.55% of 25% of such increase in such profits. For purposes of this Appendix, the term "net operating profits" shall mean: (1) operating income before goodwill amortization, trademark amortization, minority interest, net interest expense, non-operating income and expense, general corporate expenses and income taxes, and excluding extraordinary items and the cumulative effect of changes in method of accounting; but (notwithstanding any of the foregoing) not excluding charges or expenses incurred or accrued in connection with any settlement of a tobacco and health case (including, but not limited to, "up-front" settlement payments), restructuring charges, restructuring related charges, discontinued operations and casualty losses; (all as reported to the United States Securities and Exchange Commission ("SEC") for the Applicable Year (either independently by the Settling Defendant or as part of consolidated financial statements reported to the SEC by an affiliate of such Settling Defendant) or, in the case of a Settling Defendant that does not report such information 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); minus (2) the amount determined by clause (1) above multiplied by a percentage equal to the sum of (a) the maximum marginal federal corporate income tax rate (such rate being 35% as of May 1, 2001) in effect on December 31 of the year for which net operating profits are being determined, plus (b) 4.472 percentage points. Notwithstanding the foregoing, the Settling Defendants' aggregate total amount of restructuring charges, restructuring related charges and discontinued operations included for purposes of clause (1) of the preceding sentence shall not in any Applicable Year exceed the Annual Restructuring Cap (as defined and provided in paragraph (D) below). Applying the foregoing definition, the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997 were $3,115,100,000. The determination of the Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products shall be derived using the same methodology as was employed in deriving such Settling Defendants' aggregate net operating profits from domestic sales of Tobacco Products in 1997. Any increase in an Applicable Base Payment pursuant to this subparagraph B(ii) shall be payable within 120 days after the date that the payment at issue was required to be made.

(C) "Applicable Year" means (i) with respect to the payments made pursuant to paragraph II(D) of the Settlement Agreement, the calendar year ending on the date on which the payment at issue is due, regardless of when such payment is made; and (ii) with respect to all other payments made pursuant to this Settlement Agreement, the calendar year immediately preceding the year in which the payment at issue is due, regardless of when such payment is made.

(D) The Settling Defendants' aggregate total amount of restructuring charges, restructuring related charges and discontinued operations (collectively, "Restructuring Charges") that shall be included for purposes of subparagraph (B)(ii) of this Appendix shall be determined as follows:

(i) for calculations with respect to Applicable Year 1999 and Applicable Year 2000, the amount of the Annual Restructuring Cap shall equal $200 million; for calculations with respect to Applicable Year 2001 and each Applicable Year thereafter, the amount of the Annual Restructuring Cap shall be adjusted upward from $200 million by the actual total percent change in the Consumer Price Index for the period between January 1, 2001 and December 31 of the Applicable Year;

(ii) in no event shall the Settling Defendants' aggregate total amount of Restructuring Charges included in calculating net operating profits for any Applicable Year pursuant to subparagraph (B)(ii) of this Appendix exceed the Annual Restructuring Cap for such Applicable Year;

(iii) if the Settling Defendants' aggregate total amount of Restructuring Charges actually accrued with respect to any Applicable Year exceeds the Annual Restructuring Cap for such Applicable Year, the amount of such actually accrued Restructuring Charges in excess of such Annual Restructuring Cap ("Excess Restructuring Charges") shall be excluded from calculating net operating profits for such Applicable Year (but such Excess Restructuring Charges may be included in calculating net operating profits for the two Applicable Years immediately following such Applicable Year, as provided below);

(iv) if the Settling Defendants' aggregate total amount of Restructuring Charges actually accrued with respect to any Applicable Year is less than the Annual Restructuring Cap for such Applicable Year, then, in addition to such Restructuring Charges actually accrued with respect to such Applicable Year (if any), the calculation of net operating profits for such Applicable Year pursuant to subparagraph (B)(ii) of this Appendix shall include (subject to subparagraph (D)(ii) hereof) a part (or all) of the Excess Restructuring Charges (if any) actually accrued by the Settling Defendants with respect to the two Applicable Years immediately preceding such Applicable Year, determined as follows:

(a) first, the Excess Restructuring Charges actually accrued by the Settling Defendants with respect to the earlier of such two preceding Applicable Years (and not previously included in calculating net operating profits for the later of such two preceding Applicable Years) (if any) shall be so included; provided that, if all Excess Restructuring Charges actually accrued with respect to such earlier Applicable Year cannot be so included without violating subparagraph (D)(ii) hereof, then only that part of such Excess Restructuring Charges that may be so included without violating subparagraph (D)(ii) hereof shall be included (with the remainder of Excess Restructuring Charges actually accrued with respect to such earlier Applicable Year being permanently excluded from calculating net operating profits for any other Applicable Year);

(b) second, if all of the Excess Restructuring Charges described in the preceding subparagraph (a) can be so included in calculating net operating profits without violating subparagraph (D)(ii) hereof (or if no such Excess Restructuring Charges exist), then the Excess Restructuring Charges actually accrued by the Settling Defendants with respect to the later of such two preceding Applicable Years (if any) shall also be so included in calculating net operating profits for such Applicable Year; provided that, if all Excess Restructuring Charges actually accrued with respect to such later Applicable Year cannot be so included without violating subparagraph (D)(ii) hereof, then only that part of such Excess Restructuring Charges that may be so included without violating subparagraph (D)(ii) hereof shall be included (with the remainder of Excess Restructuring Charges actually accrued with respect to such later Applicable Year subject to inclusion in calculating net operating profits for the immediately following Applicable Year, as provided in subparagraph (iv)(a) hereof).

## WIRE INSTRUCTIONS

Bank: Wells Fargo
ABA Routing #: 091000019
Account #: 821327
Account: State of Minnesota General Account

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## APPENDIX B

## GLOBAL INSIGHT REPORT

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# A Forecast of
# U.S. Cigarette
# Consumption
# (2011-2030) for the
# Tobacco Securitization Authority

Submitted to:

**Tobacco Securitization Authority**

Prepared by:

**IHS Global Insight (USA), Inc.**

**November 17, 2011**


**James Diffley**
Senior Director

Global Insight, Inc.
800 Baldwin Tower
Eddystone, PA 19022

**(610) 490-2642**




The Source for Critical Information and Insight™

## Executive Summary

IHS Global Insight has developed a cigarette consumption model based on historical U.S. data between 1965 and 2010. 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 2011 through 2030. Our forecast indicates that total consumption in 2030 will be 163 billion cigarettes, a 46% decline from the 2010 level. From 2011 through 2030 the average annual rate of decline is projected to be 3.0%.

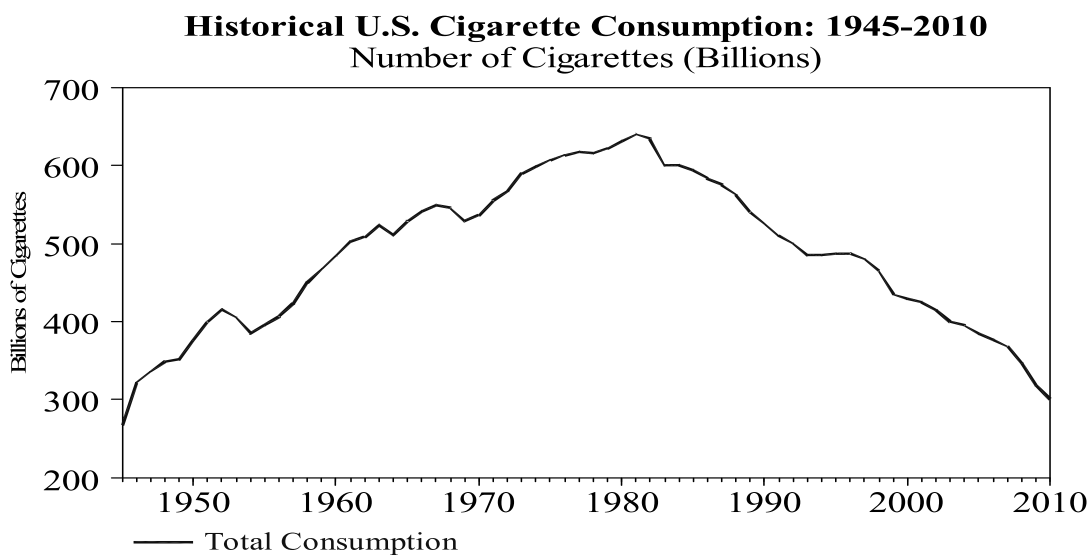
Our model was constructed based on widely accepted economic principles and IHS Global Insight's considerable experience in building econometric forecasting models. A review of the economic research literature indicates that our model is consistent with the prevalent consensus among economists concerning 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 forecasts contained in this report are 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.**

## Historical Cigarette Consumption

People have used tobacco products for centuries. Tobacco was first brought to Europe from America in the late 15th century and became America's major cash crop in the 17th and 18th centuries[1]. Prior to 1900, tobacco was most frequently used in pipes, cigars and snuff. With the widespread production of manufactured cigarettes (as opposed to hand-rolled cigarettes) in the United States in the early 20th century, cigarette consumption expanded dramatically. Consumption is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories[2] as reported by the Bureau of Alcohol Tobacco and Firearms. The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption grew from 2.5 billion in 1900 to a peak of 640 billion in 1981[3]. Consumption declined in the 1980s and 1990s, reaching a level of 465 billion cigarettes in 1998, and decreased to less than 400 billion cigarettes in 2003[4] and an estimated 300 billion in 2010[5]. Cigarette consumption has now declined through three decades, reversing four decades of increases from the 1940s.




Following the release of the Surgeon General's Report in 1964, cigarette consumption continued to increase until 1981. On a per capita basis consumption per person had begun to decline in 1965, but population growth of 1.9% per year offset this decline until 1981.

---

[1] *Source*: "Tobacco Timeline," Gene Borio (1998).

[2] Bureau of Alcohol, Tobacco and Firearms reports as categories such as transfer to export warehouses, use of the U.S., and personal consumption/experimental.

[3] *Source*: "Tobacco Situation and Outlook". U.S. Department of Agriculture-Economic Research Service. September 1999 (USDA-ERS).

[4] *Source*: USDA-ERS. April 2005.

[5] *Source*: US Tobacco and Tax Bureau

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 recent declines are correlated with large price increases in 1998 and 1999 following the Master Settlement Agreement ("MSA") and previously settled state agreements, including the Minnesota Agreement. 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 2.0%. The rate of decline accelerated dramatically beginning in 2008, with a 4.2% decline for that year, 8.3% in 2009, and 5.3% in 2010.

The following table sets forth United States domestic cigarette consumption for the thirteen years ended December 31, 2010[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 Minnesota Agreement signed in May 1998 between the Settling Defendants and the State of Minnesota are computed based on sales (which in practice have been measured by shipments) in or to the fifty United States and the District of Columbia. The Minnesota Agreement excludes shipments to Puerto Rico, and roll-your-own tobacco, and includes smokeless tobacco products produced by the Settling Defendants. 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. Data for 2008 to 2010 is derived from reports by the the National Association of Attorneys General in its determination of MSA payments.

**U.S. Cigarette Consumption**

| Year Ended December 31, | Consumption (Billions of Cigarettes) | Percentage Change |
|---|---|---|
| 2010 | 301 | -5.27 |
| 2009 | 318 | -8.28 |
| 2008 | 346 | -4.22 |
| 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 |

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 Minnesota Agreement

The Minnesota Agreement with the cigarette manufacturers includes three major cigarette manufacturers, Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. Payments under the agreement are determined by the U.S. shipments of only those three manufacturers (the "Settling Defendants"). In addition, shipments to Puerto Rico and other territories are excluded, and smokeless tobacco products are included. (Smokeless tobacco products are converted on a weight basis to cigarette equivalents at the rate of 0.12 ounces per cigarette). The smokeless products covered by the Minnesota Agreement include only those produced by the Settling Defendants, and represent a small fraction of the total U.S. smokeless market. They are currently immaterial relative to the reported cigarette volumes. The following table presents the volumes shipped by the Settling Defendants subject to the Minnesota Agreement, which differ from consumption presented in the previous table. The annual compound rate of decline from 2001 to 2010 was 4.3%.

**Domestic Cigarette Shipments by the Settling Defendants (Minnesota Agreement)**

| Year Ended December 31, | Billions of Cigarettes | Percentage Change |
|---|---|---|
| 2010 | 256 | -3.86% |
| 2009 | 266 | -10.10% |
| 2008 | 296 | -4.09% |
| 2007 | 309 | -4.55% |
| 2006 | 323 | -1.46% |
| 2005 | 328 | -2.11% |
| 2004 | 335 | -1.58% |
| 2003 | 341 | -5.73% |
| 2002 | 361 | -4.88% |
| 2001 | 380 | |

## The U.S. Cigarette Industry

The domestic cigarette market is an oligopoly in which, according to reports of the manufacturers, the three leading manufacturers accounted for 84.4% of U.S. shipments in 2010, an increase from 83.9% in 2009, but a decline from 85.6% in 2008, and 86.7% in 2007. These top companies are the Settling Defendants, Philip Morris, Reynolds American Inc. (following the merger of RJ Reynolds and Brown & Williamson in 2004), and Lorillard. These companies commanded 46.4%, 25.5%, and 12.5%, respectively of the domestic market in 2010[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 2010 the federal government received $17.2 billion in excise tax revenue from tobacco sales. In addition, state and local governments also raised significant revenues, $15.7 billion in 2009 from excise taxes. Cigarettes constitute the majority of these sales, which also include cigars and other tobacco products.

[7] IHS Global Insight calculation based on industry shipments data.

## Survey of the Economic Literature on Smoking

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

## Incidence of Smoking

Approximately 45.3 million American adults were current smokers in 2010, representing approximately 19.3% of the population age 18 and older, according to a Centers for Disease Control and Prevention ("CDC") study[8] released in 2011. This year marked the first significant decline since 2005. This survey defines "current smokers" as those persons who have smoked at least 100 cigarettes in their lifetime and who smoked every day or some days at the time of the survey. Although the percentage of adults who smoke (incidence) declined from 42.4% in 1965 to 25.5% in 1990 and 24.1% in 1998, the incidence rate has declined relatively slowly through the following decade. The decline had accelerated between 2002, when the incidence rate was 22.5%, to 2004, when incidence dropped to 20.9%, though it remained as high as 20.6% in 2009.

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.

## Youth Smoking

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

[8] *Source*: CDC. Morbidity and Mortality Weekly Report. "Tobacco Use Among Adults – United States, 2010". September, 2011.
[9] *Source*: CDC. Morbidity and Mortality Weekly Report. "Quitting Smoking Among Adults – United States, 2001-2010". November 11, 2011.

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 2009, the prevalence was 19.5%.[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 slightly lower in 2010 than in 2009, 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 (%) | 2009 (%) | 2010 (%) | '91-'10 Change (%) |
|---|---|---|---|---|
| 8th | 14.3 | 6.5 | 7.1 | -50.3% |
| 10th | 20.8 | 13.1 | 13.6 | -34.6% |
| 12th | 28.3 | 20.1 | 19.2 | -32.2% |

The 2009 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 estimated that approximately 69.7 million Americans age 12 and older were current cigarette smokers (defined by this survey to mean they had smoked cigarettes at least once during the 30 days prior to the interview). The survey found that an estimated 11.6% of youths age 12 to 17 were current cigarette smokers in 2009, up from 10.4% in 2006, but down from 11.9% in 2004 and 13.0% in 2002. The National Youth Tobacco Survey of the CDC found that 5.2% of middle school students were smokers in 2009, a prevalence unchanged from 2006.

In 2006, New Jersey raised the minimum legal age to purchase cigarettes from 18 to 19 years. Three other states, Alabama, Alaska, and Utah, and three New York counties also 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.[11] (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.

[10] *Source*: CDC. Morbidity and Mortality Weekly Report. "Youth Risk Behavior Survey ---United States, 2009". October 2010.
[11] Chalpouka FJ,Warner KE:P.5.

## Nicotine Replacement Products

Nicotine replacement products, such as Nicorette Gum and Nicoderm patches, are used to aid those who are attempting to quit smoking. Before 1996, these products were only available with a doctor's prescription. Currently, they are available as over-the-counter products. 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.[12] 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. It is unclear whether it offers a significant advantage over those other products.[13] 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.[14]

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," Nevertheless the FDA said on October 24th that it will continue to evaluate the risk of mood changes and other psychiatric events associated with its use. In September 2011, the New England Journal of Medicine reported positive smoking cessation efficacy and safety tests for

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[12] Hu et al. "Cigarette consumption and sales of nicotine replacement products". TC Online. Tobacco Control. http:\\tc.bmjjournals.com.

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

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

Cytisine, an inexpensive compound long sold inexpensively 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 2101. Nabi Biopharmaceuticals had successfully completed its Phase IIB clinical trials for NicVAX, a vaccine to prevent and treat nicotine addiction. It triggers antibodies that bind with Nicotine molecules. But after Fast Track Designation from the FDA, the drug failed its initial Phase III trials in 2009. In September 2011 the second Phase III trial failed as well. The Xenova Group is set to begin Phase II testing of its similar vaccine, Ta-Nic. And positive results were reported in July 2006 by Somaxon Pharmaceuticals from a pilot Phase II study of Nalmefene. Nalmefene has been used for over 10 years for the reversal of opioid drug effects. The company is seeking to develop it as a treatment for impulse control disorders. In 2008, Evotec AG announced it would launch a Phase II study of EVT 302, a drug intended to ease smoker's cravings and nicotine withdrawal symptoms after cigarette deprivation. 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. 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 have also gained in popularity in recent years. 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 D.C. District 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 nicotine. 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.

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. And Ohio County, WV is one of a number of counties which are discussing banning e-cigarette use in indoor public places.

## 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.[15] Their results suggest that workplace smoking bans reduce smoking prevalence by 5 percentage points and reduce consumption by smokers nearly 10%. The authors also found a positive correlation between hours worked and the impact on smokers in workplaces that have smoking bans. The more hours per day that a smoker spends working in an environment where there are smoking restrictions, the greater is the decline in the quantity of cigarettes consumed by that smoker.

## Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more 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 affect current levels of consumption.

***General Population Growth.*** Global Insight forecasts that the United States population will increase from 311 million in 2010 to approximately 371 million in 2030. This forecast is consistent with the Bureau of the Census forecast based on the 2010 Census.

***Price Elasticity of Demand & Price Increases.*** Cigarette price elasticities from recent conventional research studies have generally fallen within an interval of -0.3 to -0.5. Based on IHS Global Insight's multivariate regression analysis using data from 1965 to 2010, 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%.

[15] *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.

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

Severe budget shortfalls following the 2001 recession led at least 30 states to consider cigarette excise tax increases in 2002. Ultimately 20 states and New York City imposed excise tax increases that year. These increases ranged from $0.07 per pack in Tennessee to $1.42 per pack in New York City. They averaged $0.47 per pack, and, when weighted by the state population, boosted the nationwide average retail price by $0.18. This increased the population-weighted average state excise tax to over $0.60 per pack. The trend continued in 2003, as state fiscal difficulties persisted. Excise tax increases were enacted in 13 states, pushing the average price per pack to over $3.80. This was followed by eleven state tax increases in 2004, including Minnesota, and eight in 2005. The increase in Minnesota was not a tax increase, but rather the imposition of a "Health Impact Fee" which has the same effect on consumer prices. This report considers any such fees as equivalent to excise taxes.

In 2006 Texas passed a budget that raised the state excise tax by $1.00 in January 2007. Also in 2006 six other states raised excise taxes, bringing weighted average state excise tax to $1.04 per pack. In 2007 Connecticut, Delaware, Iowa, Indiana, Maryland, New Hampshire, Tennessee, and Wisconsin each increased excise taxes. These actions pushed the average state excise tax to $1.12 in January 2008. New York State in April 2008 enacted an increase of $1.25 per pack, and the District of Columbia and Massachusetts have each increased their excise tax by $1.00 per pack. These increases raised the weighted average excise tax to $1.23 on July 1, 2008. By year-end eight states had raised taxes.

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 at the end of 2009. In 2010, Hawaii, New Mexico, New York, South Carolina, Utah, and Washington, raised taxes. In July 2011, excise tax increases went into effect in Connecticut, Hawaii, and Vermont. The average state tax rate is currently $1.46.

The federal excise tax had remained constant, at $0.39 per pack, from 2002 until 2009. But 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 sponsored by 14 Democrats would raise the excise tax to $2.01 per pack, and also increase taxes on other tobacco products.

During much of the period following the MSA and other state settlement agreements, 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 and other state settlement agreements. 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 September 2011 was $6.80 per pack.

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

Premium brands are typically $0.50 to $1.00 more expensive per pack than discount brands, allowing a margin for consumers to switch to less costly discount brands in the event of price increases. The increasing availability of cigarette outlets on Indian reservations, where sales are exempt from taxes, provides another opportunity for consumers to reduce the cost of smoking. Similarly, Internet sales of cigarettes grew rapidly, though credit card companies and shippers including the US 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 and Minnesota agreements, volume adjustments to payments are based on the quantity (and not the price or type) of cigarettes shipped by the Settling Defendants. The availability of lower price alternatives lessens the negative impact of price increases on cigarette volumes generally, though only, under the Minnesota Agreement, to the extent that they are manufactured by the Settling Defendants. .

***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.[16] However, a few studies found cigarette consumption decreases as disposable income increases.[17] 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.

[16] Ippolito, et al.; Fuji.
[17] Wasserman, et al.; Townsend et al.

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

***Health Warnings.*** Categorical variables also have been used to capture the effect of different time periods on cigarette consumption. For example, some researchers have identified the United States Surgeon General's Report in 1964 and subsequent mandatory health warnings on cigarette packages as turning points in public attitudes and knowledge of the health effects of smoking. The Cigarette Labeling and Advertising Act of 1965 required a health warning to be placed on all cigarette packages sold in the United States beginning January 1, 1966. The Public Health Smoking Act of 1969 required all cigarette packages sold in the United States to carry an updated version of the warning, stating that it was a Surgeon General's warning, beginning November 1, 1970. The Comprehensive Smoking Education Act of 1984 led to even more specific health warnings on cigarette packages. The Family Smoking Prevention and Tobacco Control Act ("FSPTCA") requires that cigarette packages have larger and more visible graphic health warnings. Effective September 22, 2012 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, 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…."

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.[18]

The most comprehensive bans, extending to restaurants and bars, have been enacted since 1998 in 38 states and a number of large cities. Restrictions which cover all workplaces,

[18] *Source*: American Lung Association. "State Legislated Actions on Tobacco Issues". 2002.

restaurants, and bars cover 47.9% of the U.S. In 2011 Kansas and Michigan became the most recent states to adopt these bans in public places.

The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of October 7, 2011, there were 3,397 municipalities with indoor smoking restrictions. Of these, 755 local governments required workplaces to be 100% smoke-free, and 100% smoke-free conditions were required for restaurants by 771 governments, and for bars by 634. 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.[19]

Based on the regression analysis using data from 1965 to 2010, 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. estimate that U.S. workers in smoke-free workplaces from 1993 to 2001 decreased their average daily consumption by 2.6 cigarettes.[20] 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.[21] 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 an additional 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, and Santa Monica have also established extensive outdoor restrictions, as have Davis County and the City of Murray in Utah. 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.

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[19] *Source:* American Nonsmokers' Rights Foundation. http://www.no-smoke.org. October 2011.
[20] 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
[21] Tauras, John A. "Smoke-Free Air Laws, Cigarette Prices, and Adult Cigarette Demand" Economic Inquiry, April 2006.

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-family detached homes. Oakland, Pasadena, Richmond, Santa Monica, and Thousand Oaks are among 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. 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. In July 2011 the San Antonio Housing Authority announced a ban, effective in January 2012, on smoking in its 6,175 rental units. A similar ban was instituted in 2011 in Everett, WA public housing.

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 100 municipalities which have banned smoking on beaches, and 470 who have banned smoking in municipal parks.

At least 500 colleges nationwide now prohibit smoking everywhere on campus. In June 2011 the University of Michigan became the latest to establish such a ban. In June 2008, New York State enacted legislation which prohibits smoking in all college dorms. Connecticut and Illinois have also enacted that prohibition. California, Colorado, Illinois, Maryland, Michigan, Nevada, Texas, and Virginia have banned smoking in 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 New York and many 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.*** 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. 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 2011, and Reynolds American has enjoyed similar gains with one of its smokeless products, Camel Snus. The Minnesota Agreement includes the volume of smokeless tobacco products sold by the original settling defendants. Through 2010 that volume has been a very small fraction of the U.S. smokeless market, and immaterial as part of the total tobacco product volume under the Agreement.

In 2009, according to SAMHSA's National Survey on Drug Use & Health, 3.5% 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. Smokeless consumption in the U.S, in 2010 reached over 1.3 billion cans,

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.[22] 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.[23] A 2010 study concluded however that young males who used smokeless tobacco products were more likely to be concurrent smokers.[24] 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.

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[22] Foulds, Ramstrom, Burke, and Fagerstrom. "Effect of Smokeless Tobacco (Snus) on Smoking and Public Health in Sweden". Tobacco Control. Vol. 12, 2003.
[23] 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.
[24] 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.

***Nicotine Dependence.*** Nicotine is widely believed to be an addictive substance. The Surgeon General[25] and the American Medical Association[26] (AMA) both have concluded that nicotine is an addictive drug which produces dependence. The American Psychiatric Association has determined that cigarette smoking causes nicotine dependence in smokers and nicotine withdrawal in those who stop smoking. The American Medical Association Council on Scientific Affairs found that one-third to one-half of all people who experiment with smoking become smokers.

***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% (29.6% in 2010) of total cigarette sales. 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.

Thus far in 2011 the FDA's Tobacco Products Scientific Advisory Committee ("TPSAC") has 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 2011. 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

[25] *Source:* Surgeon General's 1988 Report. "The Health Consequences of Smoking – Nicotine Addiction".
[26] *Source*: Council on Scientific Affairs. "Reducing the Addictiveness of Cigarettes". Report to the AMA House of Delegates. June 1998.

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.

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.[27] More recent survey research has found that smokers were more likely to say they wanted to quit after having seen such graphic images. The FDA has mandated that such images will appear on cigarette packages beginning in 2012, though the manufacturers have sued the agency to prevent this requirement. 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**.**

## 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 Global Insight's standard population growth forecast, we projected actual cigarette consumption (in billions of cigarettes) out to 2030. It should also be noted that since our entire dataset

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

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 2010 on the variables described above, we developed the following regression equation.

log (per capita consumption) = 54.1

- 0.024 * trend

- 0.223 * log (cigarette price)

- 0.104 * log (cigarette price last year)

+ 0.274 * log (per capita disposable income)

- 0.001 * percentage of U.S. with strong indoor smoking ban

- 0.002 * percentage of U.S. with strong indoor smoking ban last year.

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 2010 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. 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

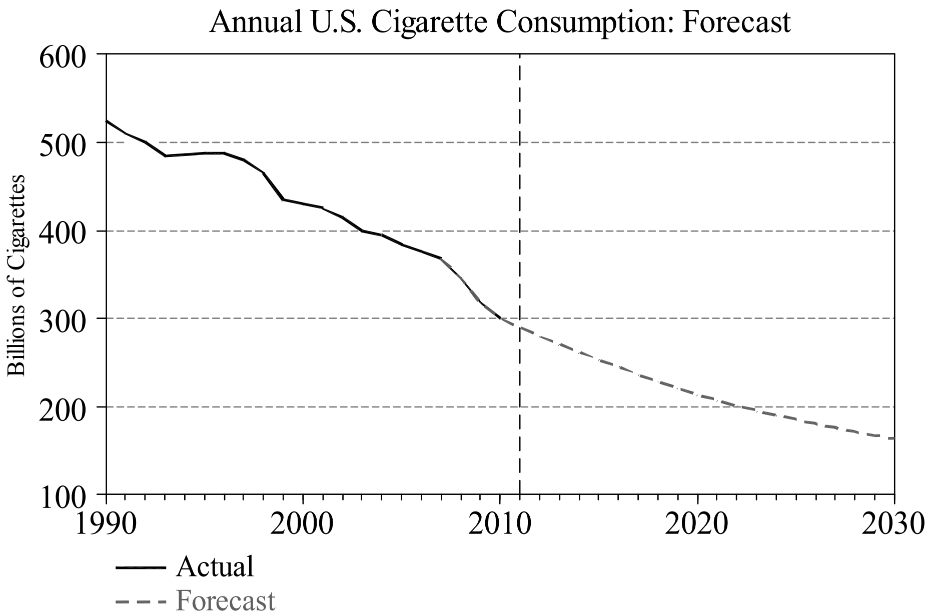
Our forecast is based on assumptions regarding the future path of the explanatory variables in the regression equation. Projections of U.S. population and real per capita personal disposable income are standard IHS Global Insight forecasts. Annual population growth is projected to average 0.8%, and real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

The projection of the real price of cigarettes is based upon its past behavior with an adjustment for the shock to prices due to the 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, and $6.62 in 2010 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 2.0% per year over the long term. The average real increase over the 30 years ending 1998 was 1.48% per year.

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 over 4% in 2008 and by over 8% in 2009. In 2010 cigarette shipments, as reported by MSAI, fell by 3.8%, to 303.7 billion, though this annual comparison is influenced by inventory movements in 2009 and 2010. Year-end data from the Tobacco and Tax Bureau show a steeper, 5.4% decline, to 300.5 billion. The National Association of

Attorneys General, in its determination of MSA payments for 2010 reports a market size, including roll-your-own tobacco, of 304.3 billion sticks, slightly larger than the 303.8 billion derived in this report from year end TTB data. (Roll-your-own tobacco, not included under the Minnesota Agreement, had represented as much as 3% of tobacco volume under the MSA, but has declined in volume by 70% since 2008, after federal excise taxes were substantially increased.)

In the first three quarters of 2011, MSAI reports shipments of 221.4 billion cigarettes, a 3.7% decline from the first three quarters of 2010. Through August 2011 TTB reports a shipment decline of 1.9% from 2010. For the Settling Defendants under the Minnesota Agreement, first three quarters shipments totaled 187.4 billion, a 3.6% decline from 2010. We project a full year 2011 decline of 3.8%, to 289 billion for the U.S. market, and to 246 billion for the Settling Defendants, in 2011.

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 2011 through 2030 the average annual rate of decline is projected to be 3.0%. The fraction of the cigarette market accounted for by the three participating manufacturers under the Minnesota Agreement has been relatively unchanged since 2003, and consequently our forecast projects that the growth, or decline, rate of the cigarette volume subject the Minnesota Agreement is equal to that of U.S. cigarette consumption. The total volume of cigarettes under the Minnesota Agreement in the U.S. is projected to fall from 256 billion in 2010 to 246 billion in 2011, 238 billion in 2012, and to 139 billion in 2030.

## Forecast Volume of Cigarettes

| | Total Consumption | Minnesota Settling Defendants | Decline Rate |
|---|---|---|---|
| | *(billions)* | *(billions* | *(%)* |
| **2011** | 289.4 | 246.1 | -3.8% |
| **2012** | 279.9 | 238.0 | -3.3% |
| **2013** | 270.8 | 230.3 | -3.2% |
| **2014** | 262.1 | 222.9 | -3.2% |
| **2015** | 253.6 | 215.7 | -3.2% |
| **2016** | 245.2 | 208.5 | -3.3% |
| **2017** | 236.7 | 201.3 | -3.4% |
| **2018** | 228.6 | 194.4 | -3.4% |
| **2019** | 221.0 | 187.9 | -3.4% |
| **2020** | 213.8 | 181.8 | -3.2% |
| **2021** | 207.2 | 176.2 | -3.1% |
| **2022** | 201.1 | 171.0 | -3.0% |
| **2023** | 195.4 | 166.2 | -2.8% |
| **2024** | 190.2 | 161.7 | -2.7% |
| **2025** | 185.2 | 157.5 | -2.6% |
| **2026** | 180.6 | 153.5 | -2.5% |
| **2027** | 176.1 | 149.8 | -2.5% |
| **2028** | 171.8 | 146.1 | -2.5% |
| **2029** | 167.5 | 142.4 | -2.5% |
| **2030** | 163.3 | 138.9 | -2.5% |

For comparative purposes we have calculated the volume of total cigarette consumption under two alternative annual rates of decline, 5% and 7%. Under these scenarios consumption in 2030 falls to 92 billion, and 60 billion respectively. These calculations are simple arithmetic examples, and are neither forecasts nor projections.

**Alternative Constant Rate Decline Projections**

| | *Cigarettes (billions)* | *Decline Rate (%)* | *Cigarettes (billions)* | *Decline Rate (%)* |
|---|---|---|---|---|
| **2010** | 255.88 | | 255.88 | |
| **2011** | 243.09 | -5.00 | 237.97 | -7.00 |
| **2012** | 230.93 | -5.00 | 221.31 | -7.00 |
| **2013** | 219.39 | -5.00 | 205.82 | -7.00 |
| **2014** | 208.42 | -5.00 | 191.41 | -7.00 |
| **2015** | 198.00 | -5.00 | 178.01 | -7.00 |
| **2016** | 188.10 | -5.00 | 165.55 | -7.00 |
| **2017** | 178.69 | -5.00 | 153.96 | -7.00 |
| **2018** | 169.76 | -5.00 | 143.19 | -7.00 |
| **2019** | 161.27 | -5.00 | 133.16 | -7.00 |
| **2020** | 153.21 | -5.00 | 123.84 | -7.00 |
| **2021** | 145.55 | -5.00 | 115.17 | -7.00 |
| **2022** | 138.27 | -5.00 | 107.11 | -7.00 |
| **2023** | 131.36 | -5.00 | 99.61 | -7.00 |
| **2024** | 124.79 | -5.00 | 92.64 | -7.00 |
| **2025** | 118.55 | -5.00 | 86.16 | -7.00 |
| **2026** | 112.62 | -5.00 | 80.13 | -7.00 |
| **2027** | 106.99 | -5.00 | 74.52 | -7.00 |
| **2028** | 101.64 | -5.00 | 69.30 | -7.00 |
| **2029** | 96.56 | -5.00 | 64.45 | -7.00 |
| **2030** | 91.73 | -5.00 | 59.94 | -7.00 |

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# APPENDIX C

## PROPOSED FORM OF OPINION OF TRANSACTION COUNSEL

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November __, 2011

Tobacco Securitization Authority
Department of Management and Budget
400 Centennial Office Building
658 Cedar Street
St. Paul, MN 55155

| $74,685,000<br>Tobacco Securitization Authority<br>Minnesota Tobacco Settlement Revenue Bonds<br>Taxable Series 2011A | $682,270,000<br>Tobacco Securitization Authority<br>Minnesota Tobacco Settlement Revenue Bonds<br>Tax-Exempt Series 2011B |
|---|---|

Ladies and Gentlemen:

We have acted as Transaction Counsel in connection with the issuance and sale by the Tobacco Securitization Authority, a body corporate and politic and a public instrumentality of the State of Minnesota (the "Authority"), of its Minnesota Tobacco Settlement Revenue Bonds, Taxable Series 2011A (the "Series 2011A Bonds") and Minnesota Tobacco Settlement Revenue Bonds, Tax-Exempt Series 2011B (the "Series 2011B Bonds") in the aggregate principal amounts of $74,685,000 and $682,270,000, respectively (collectively, the "Bonds"). The Bonds are issued as fully registered bonds without coupons, are dated the date of delivery thereof, bear interest semiannually on March 1 and September 1 of each year, commencing March 1, 2012, at the rates per annum, mature on the dates, are subject to redemption and are secured as set forth in the Indenture, dated as of November 1, 2011 (the "Master Indenture"), between the Authority and U.S. Bank National Association, as trustee (the "Trustee"), and the Series 2011 Supplement, dated as of November 1, 2011 (collectively with the Master Indenture, the "Indenture"), between the Authority and the Trustee. Capitalized terms used in this letter, but not defined, are used as defined in the Indenture.

The Bonds are authorized and issued under and pursuant to the Constitution and laws of the State of Minnesota (the "State") and a resolution (the "Resolution") adopted by the Authority on October 26, 2011, and are issued pursuant to the Indenture. The Resolution authorizes the issuance of the Bonds and the execution and delivery of the Indenture and the Purchase and Sale Agreement, dated as of November 1, 2011 (the "Sale Agreement"), between the Authority and the State. The Bonds are issued to provide the Authority with the funds to purchase from the State all of the State's right, title and interest in and to the Pledged Settlement Payments.

The Authority has covenanted in the Indenture and in the hereinafter-described Tax Compliance Certificate, and the State has covenanted in the Sale Agreement, to comply with all necessary provisions of the Internal Revenue Code of 1986, as amended (the "Code"), to preserve the exclusion of interest on the Series 2011B Bonds from gross income for federal income tax purposes. Noncompliance by the Authority or the State with such restrictions may cause the interest on the Series 2011B Bonds to be subject to federal income taxation retroactive to their date of issue.

In connection with the issuance of the Bonds, we have examined the following:

(a) Minnesota Statutes, Section 16A.98 (the "Act");

(b) the Resolution;

(c) an executed counterpart of the Sale Agreement;

(d) an executed counterpart of the Indenture;

(e) an executed counterpart of the Tax Compliance Certificate, dated the date hereof, of the Authority;

(f) the forms of Bond No. RA-1 and Bond No. RB-1; and

(g) such other proceedings, opinions, records, documents, Code provisions and statutes as we deemed necessary and appropriate in rendering this opinion.

Based on the foregoing and in connection with the issuance of the Bonds, we are of the opinion that:

(1) The Authority is duly organized and existing under the Act as a body corporate and politic and a public instrumentality of the State of Minnesota.

(2) The Authority has the power to enter into the Indenture and the Sale Agreement, and to issue the Bonds for the purposes and in the manner and to apply the proceeds of the sale of the Bonds as set forth in the Indenture.

(3) The Sale Agreement has been duly authorized, executed and delivered by the Authority and, assuming due authorization, execution and delivery by the State, represents a valid and binding agreement of the Authority and the State, enforceable in accordance with its terms.

(4) The Indenture has been duly authorized, executed and delivered by the Authority and, assuming due authorization, execution and delivery by the Trustee, represents the valid and binding agreement of the Authority and the Trustee, enforceable in accordance with its terms.

(5) The Indenture creates the valid pledge of and security interest in the Pledged Settlement Payments and other Collateral that it purports to create, which pledge and security interest constitutes a first priority pledge and security interest. Pursuant to the Act, such pledge is valid and binding against all parties at the time the pledge is made and, upon filing a copy of the Indenture in the records of the Authority, no action is necessary to perfect such pledge and security interest in the Collateral as it exists on the date of this letter.

(6) The claim of the Trustee (as assignee and pledgee of the Authority) upon the Pledged Settlement Payments required to be paid, beginning on July 1, 2013, to the Authority pursuant to the Sale Agreement is valid and enforceable.

(7) The Bonds are in proper form and have been executed by proper officers of the Authority. The Bonds constitute valid and legally binding special limited obligations of the Authority payable, as to principal and interest, as provided by the Indenture. Pursuant to the Act, the State is not liable on the Bonds and no Bond or any Related Contract of the Authority shall constitute an indebtedness or an obligation of the State or any subdivision thereof within the meaning of any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but shall be payable solely from the Collateral. No owner of any Bond or provider of any Related Contract shall have the right to compel the exercise of the taxing power of the State to pay any principal installment, redemption premium, if any, or interest on the Bonds or to make any payment due under any Related Contract.

The obligations of the parties and the enforceability of the provisions contained in the Sale Agreement and the Indenture relating to the parties may be subject to general principles of equity which permit the exercise of judicial discretion and are subject to bankruptcy, insolvency, reorganization, moratorium or similar laws relating to or affecting creditors' rights generally.

It is also our opinion that, assuming compliance by the Authority and the State with the covenants referred to in the third paragraph of this letter, the interest on the Series 2011B Bonds is excluded from gross income for federal income tax purposes and is not a special preference item for purposes of the federal alternative minimum tax imposed on individuals and corporations. Interest on the Series 2011B Bonds, however, must be included in the "adjusted current earnings" of certain corporations (i.e., alternative minimum taxable income as adjusted for certain items, including those items that would be included in the calculation of a corporation's earnings and profits under Subchapter C of the Code) and such corporations are required to include in the calculation of alternative minimum taxable income 75% of the excess of each such corporation's adjusted current earnings (which includes tax-exempt interest) over its alternative minimum taxable income (determined without regard to this adjustment and prior to reduction for certain net operating losses).

The accrual or receipt of interest on the Series 2011B Bonds may otherwise affect the federal income tax liability of the recipient. The extent of these other tax consequences will depend upon the recipient's particular tax status or other items of income or deduction. We express no opinion regarding any such consequences. Purchasers of the Series 2011B Bonds, particularly purchasers that are corporations (including S corporations and foreign corporations operating branches in the United States), property or casualty insurance companies, banks, thrifts or other financial institutions or certain recipients of Social Security or Railroad Retirement benefits, taxpayers otherwise entitled to claim the earned income credit or taxpayers who may be deemed to have incurred (or continued) indebtedness to purchase or carry tax-exempt obligations are advised to consult their tax advisors as to the tax consequences of purchasing or holding the Bonds.

It is further our opinion that the interest on the Series 2011B Bonds (a) is excludable from taxable net income of individuals, estates or trusts for Minnesota income tax purposes; (b) is includable in taxable income of corporations and financial institutions for purposes of the Minnesota franchise tax; and (c) is not a specific preference item for purposes of the Minnesota alternative minimum tax applicable to individuals, estates and trusts.

The interest on the Series 2011A Bonds is includable in gross income for federal income tax purposes, in taxable net income of individuals, trusts and estates for Minnesota income tax purposes and in the income of corporations and financial institutions for purposes of the Minnesota franchise tax. We express no other opinion regarding federal, state or other tax consequences to holders of the Series 2011A Bonds.

In order to ensure compliance with Treasury Circular 230, taxpayers holding the Bonds are hereby notified that: (a) any discussion of U.S. federal tax issues in this opinion is not intended or written by us to be relied upon, and cannot be relied upon, by taxpayers for the purpose of avoiding penalties that may be imposed on taxpayers under the Code; (b) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (c) taxpayers should seek advice based on their particular circumstances from an independent tax advisor.

Very truly yours,

[To be signed and delivered at Closing by Kutak Rock LLP]

## APPENDIX D

## DEFINITIONS AND SUMMARY OF THE INDENTURE

*The following summary describes certain terms of the 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. Copies of the Indenture may be obtained upon written request to the Trustee at Mailstation: EP MN WS3C, 60 Livingston Avenue, St. Paul, Minnesota 55107. See "SECURITY FOR THE SERIES 2011 BONDS" and "THE SERIES 2011 BONDS" for further descriptions of certain terms and provisions of the Series 2011 Bonds.*

### Definitions.

In addition to the terms defined elsewhere in the Indenture or in the Official Statement, 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 Costs of Issuance Account, the Lump Sum Account, the Rebate Account and the Residual Account, and any subaccounts within such accounts and any accounts established by Series Supplement, all of which will be established and held by the Trustee.

"*Act"* means Minnesota Statutes, Section 16A.98, as the same may be amended from time to time.

"*Authorized Denomination*" will have the meaning set forth therefor in the applicable Series Supplement.

"*Authorized Officer*" means: (a) in the case of the Authority, the Chair and his successors in office or any other officer as may be designated as an "authorized officer" by the members of the Authority, or their designees (b) 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; and (c) in the case of the State, means the Commissioner of Management and Budget, or his or her designee.

"*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 Related Contracts.

"*Bondholders*" or "*Holders*" or similar terms mean the registered owners of the Bonds registered as to principal and interest or as to principal only, as shown on the books of the Trustee.

"*Bonds*" means all obligations issued pursuant to the Indenture.

**"***Business Day*" means any day other than (a) a Saturday or a Sunday or a legal holiday or (b) a day on which banking institutions in St. Paul, Minnesota or New York, New York, are required or authorized by law, regulation or executive order to be closed.

"*Capitalized Interest Subaccount*" means the Subaccount of the Debt Service Account so designated and established pursuant to the Indenture.

"*Closing Date*" means the date of issuance by the Authority of the Series 2011 Bonds.

"*Code*" or "*Tax Code*" means the Internal Revenue Code of 1986, as amended.

"*Collateral*" has the meaning set forth under the heading "Security and Pledge" below.

"*Consent Judgment*" means the Consent Judgment of the Minnesota District Court, Second Judicial District, dated May 8, 1998, as the same has been and may be corrected, amended or modified, in the action styled as The State of Minnesota, By Hubert H. Humphrey, III, Its Attorney General, and Blue Cross and Blue Shield of Minnesota v. Philip Morris Incorporated, et al.

"*Corporate Trust Office*" means the office of the Trustee at which the corporate trust business of the Trustee related hereto will, at any particular time, be principally administered, which office is, at the date of the Indenture, located as follows: U.S. Bank National Association, Mailstation: EP-MN-WS3C, 60 Livingston Avenue, St. Paul, Minnesota 55107.

"*Costs of Issuance*" means those costs 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 Authority in accordance with the Sale Agreement.

"*Costs of Issuance Account*" means the Account so designated and established pursuant to the Indenture.

"*Debt Service*" means interest, redemption premium, principal and Sinking Fund Installments due on Outstanding Bonds.

"*Debt Service Account*" means the Account so designated and established pursuant to the Indenture.

“*Debt Service Reserve Account*” means the Account so designated and established pursuant to the Indenture.

“*Debt Service Reserve Requirement*” means for each Series of Bonds, the amount specified in the Series Supplement authorizing the issuance of such Series.

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

“*Defeasance Collateral*” means money and, to the extent permitted by the Public Funds Investment Act, (a) direct obligations of, or obligations the principal of and the interest on which are unconditionally guaranteed by, the United States of America and which are entitled to the full faith and credit thereof, and (b) obligations issued by United States of America government agencies or instrumentalities, as to which the full and timely payment of the principal of, premium, if any, and the interest on which is fully and unconditionally guaranteed as a full faith and credit obligation of the United States of America (including any securities described in (a) or (b) issued or held in book entry form on the books of the Department of the Treasury of the United States of America).

“*Defeased Beneficiaries*” means, when 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 Related Contracts), the holders of said Bonds and such Beneficiaries.

“*Defeased Bonds*” means Bonds that remain in the hands of their Holders, but are deemed no longer Outstanding as specified in under the Indenture.

“*Distribution Date*” means (a) each March 1 and September 1, commencing March 1, 2012, or if such date is not a Business Day, the following Business Day, (b) each additional Distribution Date selected by the Authority or the Trustee following an Event of Default, and (c) each Distribution Date, to the extent so characterized in a Supplemental Indenture.

“*DTC*” means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and includes any nominee of DTC in whose name any Bonds are then registered.

“*Eligible Investments*” means and includes any of the following securities, to the extent permitted under the Public Funds Investment Act:

(a) governmental bonds, notes, bills, mortgages, and other evidences of indebtedness provided the issue is backed by the full faith and credit of the issuer or the issue is rated among the top two quality rating categories by a nationally recognized rating agency. Such obligations include guaranteed or insured issues of (i) the United States, its agencies, its instrumentalities, or organizations created and regulated by an act of Congress and (ii) the states and their municipalities, political subdivisions, agencies or instrumentalities.

(b) bonds, notes, debentures, transportation equipment obligations, or any other longer term evidences of indebtedness issued or guaranteed by a corporation organized under the laws of the United States or any state thereof, provided that obligations will be rated among the top two quality categories by a nationally recognized rating agency.

(c) bankers acceptances, certificates of deposit, deposit notes, commercial paper, mortgage securities and asset backed securities, repurchase agreements and reverse repurchase agreements, guaranteed investment contracts, savings accounts, and guaranty fund certificates, surplus notes, or debentures of domestic mutual insurance companies if they conform to the following provisions:

(i) bankers acceptances and deposit notes of United States banks are limited to those issued by banks rated in the highest two quality categories by a nationally recognized rating agency;

(ii) certificates of deposit are limited to those issued by (A) United States banks and savings institutions that are rated in the top two quality categories by a nationally recognized rating agency or whose certificates of deposit are fully insured by federal agencies; or (B) credit unions in amounts up to the limit of insurance coverage provided by the National Credit Union Administration;

(iii) commercial paper is limited to those issued by United States corporations and rated in the highest two quality categories by a nationally recognized rating agency;

(iv) mortgage securities will be rated in the top two quality categories by a nationally recognized rating agency;

(v) collateral for repurchase agreements and reverse repurchase agreements is limited to letters of credit and securities identified in the Indenture as "Eligible Investments." Any agreement to lend securities must be concurrently collateralized with cash or securities with a market value of not less than 102 percent of the market value of the loaned securities at the time of the agreement. Only securities identified in the Indenture as "Eligible Investments," but excluding those under clause (d), may be accepted as collateral or offsetting securities.

(vi) guaranteed investment contracts are limited to those issued by insurance companies or banks rated in the top three quality categories by a nationally recognized rating agency or to alternative guaranteed investment contracts where the underlying assets comply with the requirements of this section;

(vii) savings accounts are limited to those fully insured by federal agencies; and

(viii) asset backed securities will be rated in the top two quality categories by a nationally recognized rating agency.

(d) regional and mutual funds through bank sponsored collective funds and open-end investment companies registered under the Federal Investment Company Act of 1940, and closed-end mutual funds listed on an exchange regulated by a governmental agency.

"*Event of Default*" means any one of the following:

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

(f) the Authority fails to observe or perform any other provision of the Indenture, which failure is not remedied within 60 days after written notice thereof is given to the Authority by the Trustee or to the Authority and the Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding. In the case of a Default under this subsection (b), if the Default cannot be corrected within the said 60-day period and is diligently pursued until the Default is corrected, it will not constitute an Event of Default if corrective action is instituted by the Authority within said 60-day period and diligently pursued until the Default is corrected;

(g) the State fails to observe or perform its covenants which are included in Section 5.07 of the Indenture or in Article IV of the Sale Agreement, which failure is not remedied within 60 days after written notice thereof is given to the Authority and the State by the Trustee or to the Authority and the Trustee by the Holders of at least 25% in principal amount of the Bonds then Outstanding; or

(h) 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 Authority and, if instituted against the Authority, are not dismissed within 60 days after such institution.

"*Federal Bankruptcy Code*" means the Bankruptcy Reform Act of 1978, as amended, codified as Title 11, United States Code, as it has been and will be amended from time to time and any successor federal statute.

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

"*Financing Costs*" means (a) Costs of Issuance, (b) capitalized interest, (c) the capitalization of initial Operating Expenses of the Authority, (d) the funding of the Debt Service Reserve Account and any other debt service reserves, (e) fees and costs for Related Contracts, and (f) any other fees, discounts, expenses and costs of any kind whatsoever related to issuing, securing and marketing the Bonds, including, without limitation, any net original issue discount.

"*Fiscal Year*" means the twelve (12) month period commencing July 1 of each year and ending on June 30 of the succeeding year.

"*Fitch*" means Fitch Ratings, Inc.; references to Fitch are effective so long as Fitch is a Rating Agency.

"*Funds*" means funds or accounts established under the Indenture and by Series Supplement.

"*Indenture*" means the Indenture, dated as of November 1, 2011, by and between Tobacco Securitization Authority and U.S. Bank National Association, as trustee, as amended and supplemented.

"*Junior Payments*" means (a) termination payments and loss amounts on Related Contracts, (b) amounts due under Related Contracts and not payable as Debt Service, (c) operating expenses, including litigation expenses, if any, incurred by the Authority, incurred in the previous Fiscal Year in excess of the applicable Operating Cap or reasonably expected to be incurred in the current or next succeeding Fiscal Years in excess of the applicable Operating Cap for such Fiscal Years, (d) principal of and interest on any subordinate Bonds issued under the Indenture as set forth in the Supplemental Indenture authorizing the issuance of such Bonds, and (e) any other Junior Payments so identified in or by reference to the Indenture or any Supplemental Indenture.

"*Lump Sum Account*" means the Account so designated and established pursuant to the Indenture.

"*Lump Sum Payment*" means a lump sum payment received by the Trustee as a payment from a Settling Defendant which results in, or is due to, a release of that Settling Defendant from all of its obligations due on or after the Closing Date under the Minnesota Agreement.

"*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.

"*Maturity Date*" means the stated maturity date of each Serial Bond and Term Bond.

"*Minnesota Agreement*" means the Settlement Agreement and Stipulation for Entry of Consent Judgment, dated May 8, 1998, between the State of Minnesota, By Hubert H. Humphrey, III, Its Attorney General, and Blue Cross and Blue Shield of Minnesota, on the one hand, and Philip Morris Incorporated, et al. on the other hand, as amended by the Agreement of Amendment to Settlement Agreement, dated as of June 1, 2001, by and among the parties thereto.

"*Officer's Certificate*" means a certificate signed by an Authorized Officer of the Authority in accordance with the Act.

"*Operating Account*" means the Account so designated and established pursuant to the Indenture.

"*Operating Cap*" means $100,000 in the year ending June 30, 2014 inflated annually in each following Fiscal Year by the greater of (x) 3% and (y) the percentage increase in the Consumer Price Index for all Urban Consumers as published by the Bureau of Labor Statistics for November of the prior year.

"*Operating Expenses*" means all operating and administrative expenses incurred by the Authority, and all operating and administrative expenses incurred by the State's Department of Management and Budget and related (as set forth in a certificate of an Authorized Officer of the Authority) to such Office's activities on behalf of or in assistance to the Authority, 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 by or for the Trustee, any Paying Agents, professional consultants and fiduciaries, costs incurred to preserve the tax-exempt status of any Tax-Exempt Bonds, costs of the Authority and the State's Department of Management and Budget related to the enforcement rights with respect to the Indenture, the Sale Agreement or the Bonds or other contracts or agreements in which the Authority has an interest or enforcement right and all other Operating Expenses of the Authority or the State's Department of Management and Budget so identified in the Indenture.

"*Outstanding*" means, with respect to Bonds, all Bonds issued under the Indenture, excluding: (a) Bonds that have been exchanged or replaced, or delivered to the Trustee for credit against a principal payment; (b) Bonds that have been paid; (c) Bonds that have become due and for the payment of which money has been duly provided; (d) Bonds for which (i) there has been irrevocably set aside sufficient Defeasance Collateral timely maturing and bearing interest, to pay or redeem them and (ii) any required notice of redemption will have been duly given in accordance with the Indenture or irrevocable instructions to give notice will have been given to the Trustee; (e) Bonds the payment of which will have been provided for pursuant to the Indenture; and (f) 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 Authority, 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.

"*Partial Lump Sum Payment*" means a lump sum payment received by the Trustee as a payment from a Settling Defendant which results in, or is due to, a release of that Settling Defendant from a portion of its obligations due on or after the Closing Date under the Minnesota Agreement.

"*Paying Agent*" means each Paying Agent designated from time to time pursuant to the Indenture.

"*Payment Default*" means the occurrence of an Event of Default where principal or Sinking Fund Installments of or interest on any Bond has not been paid, when due.

"*Pledged Accounts*" means the Pledged Revenues Account, the Debt Service Account, the Debt Service Reserve Account and the Lump Sum Account all of which will be established and held by the Trustee as segregated trust accounts, and any additional Accounts designated in a Supplemental Indenture as a Pledged Account.

"*Pledged Revenues*" means (a) the Pledged Settlement Payments, (b) to the extent set forth in the applicable Series Supplement or other Supplemental Indenture, payments made to the Authority or Trustee under Related Contracts, and (c) all fees, charges, payments, investment earnings and other income and receipts (including Bond proceeds, but only to the extent deposited in the Debt Service Reserve Account and the Capitalized Interest Subaccount) paid or payable to the Authority or the Trustee for the account of the Authority or the Beneficiaries; provided that Residual Revenues do not constitute Pledged Revenues.

"*Pledged Revenues Account*" means the account so designated and established for the purposes of the Indenture pursuant to the Indenture and comprises the Tobacco Settlement Recovery Account and the Tobacco Settlement Revenues Subaccount under the Act.

"*Pledged Settlement Payments*" means (i) the "pledged tobacco revenues," as defined in the Act, which for purposes of the Sale Agreement and the Indenture consist of all "tobacco settlement revenues," as defined in the Act, paid or payable to the State on and after July 1, 2013 and required to be made, pursuant to the terms of the Minnesota Agreement, by Settling Defendants to the State, and the State's rights to receive such tobacco settlement revenues, consisting of the annual payments payable to the State under the Minnesota Agreement (and all adjustments thereto), and (ii) the Lump Sum Payments and Partial Lump Sum Payments, if any, whenever received that are allocable to such annual payments that are payable on or after July 1, 2013.

"*Pro Rata*" means, for an allocation of available amounts to any payments of interest or principal to be made pursuant to the Indenture, the application of a fraction of such available amounts (a) the numerator of which is equal to the amount due to each respective Holder to whom such payment is owing and (b) the denominator of which is equal to the total amount due to all Holders to which such payment is owing.

"*Public Funds Investment Act*" means the Minnesota Statutes, Section 11A.24, as the same may be amended from time to time.

"*Rating Agency*" means each nationally recognized statistical rating organization that has, at the request of the Authority, a rating in effect for any of the Bonds.

"*Rebate Account*" means the Account so designated and established pursuant to the Indenture.

"*Record Date*" means the last Business Day of the calendar month preceding a Distribution Date; and the Authority or the Trustee may in its discretion establish special record dates for the determination of the Holders of Bonds for various purposes hereof, 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.

"*Related Contracts*" means the "related bond facilities," as defined in the Act, which for purposes of the Indenture consists of contracts entered into by the Authority 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, interest rate savings or market diversification, including any bond insurance, letters of credit and liquidity facilities, investment agreements and forward delivery agreements with respect to Eligible Investments.

"*Residual Account*" means the Residual Account as so designated and established for the purposes of the Indenture pursuant to the Indenture and constitutes the Tobacco Settlement Residual Subaccount for purposes of the Act.

"*Residual Certificate*" means an instrument in the form of an exhibit to the Indenture.

“*Residual Revenues*” means all Pledged Revenues that are in excess of the deposit requirements set forth in Section 4.03(c)(i)-(vi) of the Indenture (as described under clauses (i) – (vi) of the heading “Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues”), and, accordingly, no longer constitute Pledged Revenues.

“*Sale Agreement*” means the Purchase and Sale Agreement, dated as of November 1, 2011, by and between the Authority and the State, as amended, supplemented and in effect from time to time.

“*S&P*” means Standard & Poor’s Ratings Services, a Division of the McGraw-Hill Companies, Inc.; references to S&P are effective so long as S&P is a Rating Agency.

“*Securities Depository*” means DTC or another securities depository specified by Series Supplement, or if the incumbent Securities Depository resigns from its functions as depository of the Bonds or the Authority discontinues use of the incumbent Securities Depository, then any other securities depository designated in an Officer’s Certificate of the Authority.

“*Serial Bonds*” means the Bonds so specified in a Series Supplement.

“*Series*” means all Bonds so identified in a Series Supplement, regardless of variations in class, maturity, interest rate or other provisions, and any Bonds thereafter delivered in exchange or replacement therefor.

“*Series Supplement*” means a Supplemental Indenture, or a supplement thereto, executed pursuant to the Indenture.

“*Series 2011 Bonds*” means, collectively, the Authority’s Series 2011A Bonds and Series 2011B Bonds, initially dated their date of delivery, including any Bonds issued in exchange or replacement therefor.

“*Series 2011A Bonds*” means the Authority’s $74,685,000 Minnesota Tobacco Settlement Revenue Bonds, Taxable Series 2011A.

“*Series 2011B Bonds*” means the Authority’s $682,270,000 Minnesota Tobacco Settlement Revenue Bonds, Tax-Exempt Series 2011B.

“*Series 2011 Supplement*” means the Series Supplement, dated as of November 1, 2011, authorizing the Series 2011 Bonds.

“*Settling Defendant*” means a Participating Manufacturer, as defined in the Act.

“*Sinking Fund Installment*” means a scheduled amount set forth in the applicable Series Supplement for required amortization prior to maturity of a Term Bond.

“*Sinking Fund Installment Date*” means the date scheduled for the payment of a particular Sinking Fund Installment.

"*Special Conditions*" means, with respect to a consolidation or merger by the Authority with or into any other person, or a conveyance or transfer of all or substantially all of its properties or assets, the following conditions:

(a) an entity will survive such event, and such entity will be organized and existing under the laws of the United States, the State or any state and will 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 Authority in the Indenture;

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

(c) the Authority has received an opinion of Transaction 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 Authority has delivered to the Trustee an Officer's Certificate and an opinion of Counsel to the effect that such transaction complies with the Indenture and that all conditions precedent to such transaction have been complied with.

"*State*" means the State of Minnesota.

"*Supplemental Indenture*" means a Series Supplement or supplement hereto adopted 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.

"*Tax Certificate*" means the Tax Certificate executed by the Authority and the State at the time of issuance of each Series of Tax-Exempt Bonds, each as originally executed and as each may be amended or supplemented from time to time with the term thereof.

"*Tax-Exempt Bonds*" means all Bonds so identified in the Series Supplement relating to such Bonds.

"*Taxable Bonds*" means all Bonds so identified in the Series Supplement relating to such Bonds.

"*Term Bonds*" means the Bonds so specified in a Series Supplement.

**"***Tobacco Settlement Bond Proceeds Fund***"** means the Fund so designated and established in the State Treasury in accordance with Subdivision 1(p) of the Act.

**"***Tobacco Settlement Recovery Account***"** means the Account so designated and established outside the State Treasury in accordance with Subdivision 1(q) of the Act and referred to in the Indenture as the Pledged Revenues Account.

"*Tobacco Settlement Residual Subaccount*" means the Subaccount so designated and established within the Tobacco Settlement Recovery Account in accordance with Subdivision 1(s) of the Act and referred to in the Indenture as the Residual Account.

"*Tobacco Settlement Revenues Subaccount*" means the Subaccount so designated and established within the Tobacco Settlement Recovery Account in accordance with Subdivision 1(r) of the Act and referred to in the Indenture as the Pledged Revenues Account.

"*Transaction Counsel*" means a nationally recognized bond counsel as may be appointed by the Attorney General of the State at the request of the Authority pursuant to the Act for a specific purpose under the Indenture.

"*Trustee*" means U.S. Bank National Association, until a successor will become such pursuant to the applicable provisions of the Indenture and, thereafter, "Trustee" will mean the successor Trustee.

"*Written Notice,*" "*written notice*" or "*notice in writing*" means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission and electronic mail transmission.

**Members and Officers Not Liable on Bonds**

No member or officer of the Authority or any person executing Bonds, the Residual Certificate, the Related Contracts, or other obligations of the Authority will be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance or execution and delivery thereof, or will be liable for any other debt or obligation of the Authority.

PURSUANT TO THE ACT, THE STATE IS NOT LIABLE ON BONDS OF THE AUTHORITY AND NO BOND OR ANY RELATED CONTRACT OF THE AUTHORITY WILL CONSTITUTE AN INDEBTEDNESS OR AN OBLIGATION OF THE STATE OR ANY SUBDIVISION THEREOF WITHIN THE MEANING OF ANY CONSTITUTIONAL OR STATUTORY LIMITATION OR PROVISION OR A CHARGE AGAINST THE GENERAL CREDIT OR TAXING POWERS, IF ANY, OF ANY OF THEM BUT WILL BE PAYABLE SOLELY FROM THE COLLATERAL. NO OWNER OF ANY BOND OR PROVIDER OF ANY RELATED CONTRACT WILL HAVE THE RIGHT TO COMPEL THE EXERCISE OF THE TAXING POWER OF THE STATE TO PAY ANY PRINCIPAL INSTALLMENT OF, REDEMPTION PREMIUM, IF ANY, OR INTEREST ON THE BONDS OR TO MAKE ANY PAYMENT DUE UNDER ANY RELATED CONTRACT. (Section 1.03)

**Separate Accounts and Records**

The parties to the Indenture represent and covenant, each for itself, that: (a) the Authority 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 Authority 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 Authority has paid and will pay its liabilities and losses from its separate assets. In furtherance of the foregoing, the Authority has compensated and will compensate all consultants, independent contractors and agents from its own funds for services provided to it by such consultants, independent contractors and agents. (Section 1.04)

**Security and Pledge**

Pursuant to the Indenture, the Authority will assigns 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 Authority's right, title and interest, whether now owned or hereafter acquired, in, to and under all of the following property constituting the "Collateral": (a) the Pledged Revenues (including all Pledged Settlement Payments), (b) all rights to receive the Pledged Revenues and the proceeds of such rights, (c) the Pledged Accounts and assets thereof (including Related 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 Authority under the Sale Agreement including the representations, warranties and covenants of the State in the Sale Agreement, 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 Residual Revenues, (ii) the rights of the Authority pursuant to provisions for consent or other action by the Authority, notice to the Authority, indemnity or the filing of documents with the Authority, or otherwise for its benefit and not for that of the Beneficiaries, (iii) any right or power reserved to the Authority 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, any other property or interest explicitly excluded from Collateral pursuant to the terms of the related Series Supplement; nor does this Section preclude the Authority's enforcement of its rights under and pursuant to the Sale Agreement for the benefit of the Beneficiaries as provided in the Indenture. The Residual Revenues and the proceeds of the Bonds, other than the amounts deposited in the Debt Service Reserve 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. In accordance with the Indenture, the Trustee will promptly after receipt of Pledged Settlement Payments and after fully funding the deposits required by the Indenture as described in clauses (i) – (vi) of the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues", but in any event not later than February 15 of each year, transfer any portion thereof representing Residual Revenues to the Residual Account. Under the Indenture, the foregoing Collateral is pledged and a security interest in the Indenture is granted by the Authority to secure the payment of Bonds and Related 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 Authority will 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, will 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 thereby made will have priority over any or all other obligations and liabilities of the Authority secured by the Pledged Revenues. The Authority will not incur any obligations, except as authorized by the Indenture, secured by a lien on the Pledged Revenues or the Pledged Accounts equal or prior to the lien of the Indenture. Notwithstanding anything to the contrary in the Indenture or the Residual Certificate, the Trustee will not make any transfers to the Residual Account unless and until the deposits required by the Indenture as described in clauses (i) – (vi) of the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues," have been made in full. The Authority will implement, protect and defend this assignment and pledge by all appropriate legal action, the cost thereof to be an Operating Expense. (Section 2.01)

**Defeasance**

When (a) there is held by or for the account of the Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities as will provide sufficient funds to pay or redeem all or any portion of Outstanding Bonds in accordance with their terms and all or any portion of obligations to the Defeased Beneficiaries (including parties to Related Contracts) (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 will have been duly given in accordance with the Indenture or irrevocable written instructions to give notice will have been given to the Trustee, and (c) all the rights under the Indenture of the Fiduciaries have been provided for, then upon written notice from the Authority to the Trustee, such Defeased Beneficiaries will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien of the Indenture, the security interests created by the Indenture with respect to such Defeased Beneficiaries (except in such funds and investments) will terminate, and the Authority and the Trustee will execute and deliver such instruments as may be necessary to discharge the Trustee's lien and security interests created under the Indenture 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 will be irrevocably set aside for that purpose, subject to certain provisions of the Indenture, and money held for defeasance will 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 Tax-Exempt Bonds of a Series and maturity, the Trustee will choose by lot the particular Bond or Bonds of such Series and maturity to be so paid or redeemed. When such provision for payment is made for less than all the Taxable Bonds of a Series, the Trustee will pay or redeem the Bonds of such Series Pro Rata as to principal, among maturities and within a maturity. Upon defeasance of all Outstanding Bonds and Beneficiaries, the lien of the Indenture will be extinguished, the Indenture will be deemed terminated and 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 will be distributed to, or upon the order of, the owner of the Residual Certificate.

The Trustee will, if so directed by the Authority, apply any moneys or Defeasance Collateral that are held by an escrow agent pursuant to an escrow agreement to the open market purchase of Bonds that have previously been defeased but remain unpaid; provided, however, that if Bonds have been defeased to a date prior to their applicable Maturity Date, the open market purchase may only occur prior to the publication of a notice of redemption for such Bonds. It will be a condition to any such open market purchase that the Trustee will receive (a) a certificate of a nationally recognized firm of independent certified public accountants or other professionals expert in verifying bond defeasance escrows showing that the moneys and Defeasance Collateral remaining on deposit in the applicable escrow account after the purchase of such Bonds will be sufficient to pay or redeem in accordance with their terms all of the remaining defeased Bonds and (b) a Transaction Counsel's opinion to the effect that (i) any redemption or sale of Defeasance Collateral will not adversely affect the exclusion of the interest on the remaining defeased Bonds from the gross income of the Holders thereof for federal income tax purposes and (ii) that such redemption or sale otherwise complies with the terms of the Indenture. Upon completion of any open market purchase, the Trustee will immediately thereafter cancel all Bonds so purchased. (Section 2.02)

**Bonds of the Authority**

By Series Supplement complying procedurally and in substance with the Indenture, and including with any consent of the Authority Representative required by the terms of the related Series Supplement, the Authority may authorize, issue, sell and deliver (i) the Series 2011 Bonds; and (ii) Refunding Bonds from time to time in such principal amounts as the Authority will determine, and establish such escrows therefor as it may determine. (Section 3.01)

**Accounts**

The following Accounts and subaccounts are established by the Indenture and will be held and maintained by the Trustee: Pledged Revenues Account; Operating Account; Debt Service Account and, within the Debt Service Account, the Capitalized Interest Subaccount; Debt Service Reserve Account; Lump Sum Account; Costs of Issuance Account; Residual Account; and Rebate Account. The Authority may also by Supplemental Indenture create additional Accounts and sub-accounts within any Account. Amounts in the foregoing Accounts may be invested by the Trustee in Eligible Investments pursuant to the Indenture. (Section 4.01)

**Application of Pledged Revenues and Residual Revenues.**

Effective on the Closing Date, the Commissioner will direct the payment of all Pledged Settlement Payments to the Trustee on behalf of the Authority. Any Pledged Settlement Payments received by the Authority will be promptly (and no event later than two Business Days after receipt) transferred to the Trustee. Unless otherwise specified in the Indenture, all Pledged Settlement Payments will be deposited in the Pledged Revenues Account. All Pledged Settlement Payments that have been identified by an Officer's Certificate as consisting of Partial Lump Sum Payments or Total Lump Sum Payments received by the Trustee will be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Lump Sum Account.

*Deposit of Pledged Revenues.* No later than five Business Days following each deposit of Pledged Settlement Payments to the Pledged Revenues Account (but in no event later than the next Distribution Date and except as provided in clause (vii) below), the Trustee will withdraw Pledged Revenues on deposit in the Pledged Revenues Account and transfer such amounts as follows and in the following order of priority; provided, however, that investment earnings on amounts in the Funds and Accounts (other than the Debt Service Reserve Account, investment earnings on which will be retained in the Indenture until the amounts on deposit in the Indenture are at least equal to the Debt Service Reserve Requirement, and on the fifth Business Day preceding each Distribution Date amounts on deposit in the Debt Service Reserve Account in excess of the Debt Service Reserve Requirement may, at the direction of the Authority, be deposited directly to the Debt Service Account) will be deposited directly to the Debt Service Account; and provided, further, that upon the occurrence of a Payment Default, Pledged Revenues will be transferred as set forth in clauses (i), (ii), (iv) and (vi) below and then all remaining Pledged Revenues will be applied to make Extraordinary Prepayments in accordance with the Indenture (as described under the heading "Extraordinary Prepayment" below):

(i) to the Operating Subaccount, the amount required to pay (A) Trustee fees and expense (including reasonable attorney's fees, if applicable) reasonably expected to be due during the next Fiscal Year and (B) an amount specified by Officer's Certificate for Operating Expenses of the Authority (provided that such amounts paid pursuant to this clause will not exceed the Operating Cap and Operating Expenses will not include any termination payments or loss amounts on Related Contracts);

(ii) to the Debt Service Account an amount sufficient to cause the amount in the Indenture (together with the amount, if any, then on deposit in the Capitalized Interest Subaccount allocable to the next succeeding Distribution Date, any Partial Lump Sum Payment to be applied to the payment of interest allocable to the next succeeding Distribution Date, and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next Distribution Date) to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due on the next succeeding Distribution Date;

(iii) to the Debt Service Account, exclusive of the amount on deposit in the Indenture under clause (ii) above, an amount sufficient to cause the amount in the Indenture (together with any Partial Lump Sum Payment to be applied to the payment of principal or Sinking Fund Installments on the next succeeding March 1 and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the next succeeding March 1 to the extent not counted for purposes of clause (ii) above), to equal the principal and Sinking Fund Installments due on the next succeeding March 1;

(iv) to the Debt Service Account, exclusive of the amounts deposited in the Indenture pursuant to clauses (ii) and (iii) above, an amount sufficient to cause the amount on deposit in the Indenture (together with any Partial Lump Sum Payment to be applied to the payment of interest on the second succeeding Distribution Date and the amount, if any, then on deposit in the Capitalized Interest Subaccount allocable to the second succeeding Distribution Date and interest and earnings reasonably expected by the Authority to be received on investments in the Debt Service Account on or prior to the second succeeding Distribution Date to the extent not counted for purposes of clause (ii) or (iii) above) to equal interest (including interest at the stated rate on the principal of Outstanding Bonds and on overdue interest, if any) due on the second succeeding Distribution Date;

(v) to replenish the Debt Service Reserve Account until the amount on deposit in the Indenture equals the Debt Service Reserve Requirement;

(vi) in the amounts and to the Funds and Accounts established by Series Supplement for Junior Payments; and

(vii) no later than February 15 of each year, to the Residual Account, the Residual Revenues.

On the first Business Day of the calendar month preceding a month in which a Distribution Date occurs, the Trustee will compare (A) the liquidation value of the aggregate amount on deposit in the Pledged Accounts (other than amounts set aside for the payment of Bonds) to (B) the principal amount of and accrued interest (if any) on Bonds that will remain Outstanding after the application of amounts described below on such Distribution Date, and if the amount in clause (A) is greater than the amount described in clause (B) as of such Distribution Date, then the Authority will direct the Trustee to liquidate the investments in the Pledged Accounts and will withdraw from the Pledged Accounts an amount sufficient to, and will, retire the Bonds in full on such Distribution Date.

*Application of Pledged Revenues*. Unless a Payment Default will have occurred, 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 Operating Subaccount, to the parties entitled thereto, to pay the expenses of Authority described in the definition of Operating Expenses, in the amount specified in an Officer's Certificate of the Authority;

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

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

(iv) from the Funds and Accounts therefor, to make Junior Payments.

If a Payment Default has occurred, the Trustee will apply the Pledged Revenues in accordance with the priorities and purposes set forth in clauses (c) (i), (ii), (iv) and (vi) under the heading "Deposit of Pledged Revenues" above and then to make Extraordinary Prepayments in accordance with the Indenture, as described under the heading "Extraordinary Prepayment" below.

*Deposit and Application of Residual Revenues*. In accordance with the Indenture, as described in clause (vii) under the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues" after making the deposits required by clauses (i)-(vi) under such heading, the Trustee will deposit the Residual Revenues, comprising the balance of the Pledged Revenues, in the Residual Account. Promptly, and in no event more than five Business Days after the deposit of such funds in the Residual Account, the Residual Revenues will be transferred to the registered owner of the Residual Certificate.

Whenever the moneys on deposit in the Debt Service Reserve Account will exceed the applicable Debt Service Reserve Requirement, such excess may be, in the discretion of the Authority, transferred by the Trustee to the Debt Service Account or, if approved by an opinion of Transaction Counsel as not in violation of the terms of the Indenture or adversely affecting the federal tax exemption applicable to Tax-Exempt Bonds, to any Fund or Account specified by the Authority in an Officer's Certificate. (Section 4.03)

**Lump Sum Account**

In accordance with the Indenture, the Trustee will transfer all Pledged Revenues that constitute Partial Lump Sum Payments and Lump Sum Payments to the Lump Sum Account. To the extent that amounts represent a Lump Sum Payment, the Trustee will invest such amount in Defeasance Collateral, pursuant to the Indenture, to pay or redeem a Pro Rata portion of each maturity of Outstanding Bonds in accordance with their terms. To the extent that the amounts represent a Partial Lump Sum Payment, such amounts will be held by the Trustee in the Lump Sum Account and transferred to the Debt Service Account at the times and in the amounts necessary to pay the principal or Sinking Fund Installments of the Bonds on the respective Distribution Dates covered by such Partial Lump Sum Payment. Upon the occurrence of a Payment Default, any Partial Lump Sum Payment will be applied to make Extraordinary Prepayments in accordance with the Indenture, as described under the heading "Extraordinary Prepayment" below. All amounts on deposit in the Lump Sum Account will be held in trust and invested in accordance with the provisions of the Indenture. (Section 4.05)

**Related Contracts**

The Authority may enter into, amend or terminate, as it determines to be necessary or appropriate, Related Contracts, and may by Series Supplement or other Supplemental Indenture provide for the receipt of payments under the Indenture as Pledged Revenues, and provide for the payment of amounts due from the Authority under the Indenture as Junior Payments. (Section 4.06)

**Redemption of the Bonds.**

The Authority may redeem Bonds at its option in accordance with their terms and the terms of the applicable Series Supplement. When Bonds are called for redemption, the accrued interest thereon will become due on the redemption date. To the extent not otherwise provided, the

Authority will 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 will, at the option of the Authority, be applied to or credited against any sinking fund requirement the principal amount of any Bonds subject to redemption therefrom that have been defeased, purchased or redeemed and not previously so applied or credited.

When a Bond is to be redeemed prior to its Maturity Date, the Trustee will give notice in the name of the Authority, which notice will identify the Bonds to be redeemed, state the date fixed for redemption and state that such Bonds will be redeemed at the Corporate Trust Office of the Trustee or a Paying Agent. The notice will further state that on such date there will become due and payable upon each Bond to be redeemed the redemption price thereof, together with interest accrued to the redemption date, and that money therefor having been deposited with the Trustee or Paying Agent on or prior to the redemption date, from and after such date, interest thereon will cease to accrue. The Trustee will give 20 days' notice (or such shorter period permitted by DTC so long as DTC remains the registered owner of the Bonds) by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Bonds which are to be redeemed, at their addresses shown on the registration books of the Authority. Such notice may be waived by any Holder of Bonds to be redeemed. Failure by a particular Holder to receive notice, or any defect in the notice to such Holder, will not affect the redemption of any other Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by Written Notice by the Authority to the Trustee no later than five days prior to the date specified for redemption. The Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons, as notice of such redemption was given as described above.

Unless otherwise specified in the Indenture or by Series Supplement if less than all the Outstanding Tax-Exempt Bonds of like Series and Maturity Date are to be redeemed, the particular Tax-Exempt Bonds to be redeemed will be selected by the Trustee by such method as it will deem fair and appropriate and which may provide for the selection for redemption of portions (equal to any Authorized Denominations) of the principal of Bonds of a denomination larger than the minimum Authorized Denomination. When such provision for payment is made for less than all the Taxable Bonds of a Series, the Trustee will pay or redeem the Bonds of such Series Pro Rata as to principal, among maturities and within a maturity.

To the extent set forth in the applicable Series Supplement, the Bonds will be subject to redemption from Sinking Fund Installments. (Section 4.07)

**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 Authority 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; provided, however, that amounts on deposit in the Residual Account will be held in Eligible Investments which mature overnight until released from such accounts in accordance with the subheadings "Deposit of Pledged Revenues: and "Deposit and Application of Residual

Revenues," respectively. Specifically, Eligible Investments will mature or be redeemable at the option of the Authority in an amount and at such times sufficient to make payments under clauses (i) through (vi) under the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues" and described under "Extraordinary Payment" on the applicable Distribution Dates. Investments will be held by the Trustee in the respective Funds and Accounts and will be sold or redeemed to the extent necessary to make payments or transfers from each Fund or Account. The Trustee will not be liable for any losses on investments made at the direction of the Authority. The Trustee may conclusively rely upon the Authority's written instructions as to both the suitability and legality of the directed investments. Ratings of Eligible Investments will be determined at the time of purchase of such Eligible Investments and without regard to ratings subcategories. The Trustee may make any and all such investments through its own investment department or that of its affiliates or subsidiaries, and may charge its ordinary and customary fees for such trades, including cash sweep account fees. In the absence of investment instructions from the Corporation, the Trustee will not be responsible or liable for keeping the moneys held by it under the Indenture fully invested in Eligible Investments.

Although the Authority recognizes that it may obtain a broker confirmation or written statement containing comparable information at no additional cost, the Authority agrees under the Indenture that confirmations of Eligible Investments are not required to be issued by the Trustee for each month in which a monthly statement is rendered. No statement need be rendered for any fund or account if no activity occurred in such fund or account during such month.

On the tenth Business Day immediately preceding each Distribution Date, the Trustee will 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 will be applied as provided under the Indenture.

In computing the amount in a Fund or Account, the value of Eligible Investments will be determined by the Trustee at least as frequently as the third Business Day preceding each Distribution Date and will 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*, 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*, 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 Authority and the Trustee.

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

In respect of Defeasance Collateral held for Defeased Bonds, the provisions of the Indenture summarized under the heading "Investments" will be effective only to the extent it is consistent with other applicable provisions of the Indenture or any separate escrow agreement. (Section 4.08)

**Rebate**

The Trustee will 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 the fifth paragraph under this heading, all money at any time deposited in the Rebate Account will 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 Authority nor any Bondholder will have any rights in or claim to such money in the Rebate Account. All amounts deposited into or on deposit in the Rebate Account will be governed by the rebate provisions and the tax covenants contained in the Indenture and by the Tax Certificate. The Trustee will be deemed conclusively to have complied with such provisions if it follows such directions of the Authority, and will have no liability or responsibility to enforce compliance by the Authority with the terms of the Tax Certificate.

Upon the Authority's written direction, an amount will 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 will equal the Rebate Requirement. Computations of the Rebate Requirement will be furnished by or on behalf of the Authority in accordance with the Tax Certificate. The Trustee will supply to the Authority all information required to be provided in the Tax Certificate to the extent such information is reasonably available to the Trustee.

The Trustee will have no obligation to rebate any amounts required to be rebated pursuant to the rebate provisions of the Indenture, other than from money held in the Operating Account or the Rebate Account created under the Indenture.

At the written direction of the Authority, the Trustee will invest all amounts held in the Rebate Account in Eligible Investments, subject to the restrictions set forth in the Tax Certificate. Money will not be transferred from the Rebate Account except as provided in the next paragraph. The Trustee will not be liable for any consequences arising from such investment.

Upon receipt of the Authority's written directions, the Trustee will remit part or all of the balances in the Rebate Account to the United States, as directed in writing by the Authority. In addition, if the Authority 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 Authority's written directions; provided, however, that only money in excess of the Rebate Requirement may, at the written direction of the Authority, 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 Tax-Exempt Bonds and payment and satisfaction of any Rebate Requirement, or after provision has been made therefor satisfactory to the Trustee, will be withdrawn and deposited in the Pledged Revenues Account.

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 will survive the defeasance or payment in full of the Tax-Exempt Bonds. (Section 4.10)

**Contract; Obligations to Beneficiaries**

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

The Authority covenants under the Indenture 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, (A) agreements with Holders of Bonds pledging particular collateral for the payment thereof and (B) the rights of Beneficiaries under Related Contracts. The obligation of the Authority to pay principal or Sinking Fund Installments, interest and redemption premium, if any, to the Holders of Bonds will be absolute and unconditional, will be binding and enforceable in all circumstances whatsoever, and will not be subject to setoff, recoupment or counterclaim. The Authority will pay its Operating Expenses.

In addition, the Authority 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 Authority 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 Authority in accordance with their terms. (Section 5.01)

**Enforcement**

Subject to the provisions of the Indenture, the Trustee will 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 Authority will covenant under the Indenture that: (a) the Authority 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 Authority on Tax-Exempt Bonds will be excludable from gross income for federal income tax purposes pursuant to §103(a) of the Code; and (b) no funds of the Authority will 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 Authority will periodically, at such times as may be required to comply with the Code, pay as an Operating Expense the amount, if any, required by the Code to be rebated or paid as a related penalty. Without limiting the foregoing, the Authority agrees that it will comply with the provisions of the Tax Certificate which are incorporated in the Indenture by reference. Notwithstanding any other provisions of the Indenture, the Authority's tax covenants will survive the defeasance or other payment of the Tax-Exempt Bonds. (Section 5.03)

**Accounts and Reports**

The Authority will make the following covenants under the Indenture:

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

(j) annually, within 30 days after public release of the State's Comprehensive Annual Financial Report, cause to be delivered 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. (Section 5.04)

**Ratings**

Unless otherwise specified by Series Supplement, the Authority will pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Bonds from at least one Rating Agency. (Section 5.05)

**Affirmative Covenants**

The Authority will covenant and agree under the Indenture as follows:

*Punctual Payment*. The Authority will 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 Authority will keep in full effect its existence, rights and franchises as a body corporate and politic and public instrumentality of the State under the Act and any other applicable laws of the State.

*Protection of Collateral*. The Authority will from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (a) maintain or preserve the lien and security interest (and the priority thereof) of the Indenture; (b) perfect, publish notice of or protect the validity of any grant made or to be made by the Indenture; (c) preserve and defend title to the 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 Judgment, the Indenture, the Act or the Sale Agreement or the performance by any party under the Indenture; (d) cause the Trustee to enforce the Sale Agreement; (e) pay any and all taxes levied or assessed upon all or any part of the collateral; or (f) carry out more effectively the purposes of the Indenture.

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

*Notice of Events of Default*. The Authority will give the Trustee and Rating Agencies prompt written notice of each Event of Default under the Indenture. (Section 5.06)

**Agreement with the State**

Pursuant to the Act, the State pledges and agrees with the Authority, and the owners of the Bonds by reason of the inclusion in the Indenture by the Authority, as agent of the State, of this pledge and agreement, that the State will (a) irrevocably direct the Commissioner to transfer all Pledged Settlement Payments directly to the Trustee as the assignee of the Authority, (b) diligently enforce its right to collect all money due from the Settling Defendants under the Minnesota Agreement, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General, provided, however, (i) that the remedies available to the Authority and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (b) will be limited to injunctive relief, and (ii) that the State will be deemed to have diligently enforced the covenant of the State set forth in Section 4.01(a) of the Sale Agreement so long as there has been no judicial determination by a court of competent jurisdiction in the State that the State has failed to diligently enforce such covenant, (c) in any materially adverse way, neither amend the Minnesota Agreement or take any other action that would (i) impair the Authority's right to receive Pledged Settlement Payments, or (ii) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Bondholders, or (iii) 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 Sale Agreement or the Indenture will be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, 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 (d) not amend, supersede or repeal the Minnesota Agreement or the Act, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Bondholders. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, in the Indenture, in the Bonds or in the Act will be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the Minnesota Agreement or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the Minnesota Agreement. (Section 5.07)

**Negative Covenants**

The Authority will covenant and agree under the Indenture as follows:

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

*No Setoff*. The Authority will 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 Authority will not terminate its existence or dissolve or liquidate in whole or in part.

*Limitation of Liens*. The Authority will 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 by the Indenture, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture and any lien securing Bonds) to be created on or extend to or otherwise arise upon or burden the collateral or any part thereof or any interest in the Indenture 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 Authority will not consolidate or merge with or into any other person, or convey or transfer all or substantially all of its properties or assets, unless the Special Conditions are met.

*No Other Business*. The Authority will not engage in any business other than financing, purchasing, owning and managing the Pledged Settlement Payments sold by the State to the

Authority 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 Authority will not issue, incur, assume, guarantee or otherwise become liable, directly or indirectly, for any indebtedness secured by the Pledged Settlement Payments except the Bonds. The Residual Certificate and Related Contracts are not indebtedness within the meaning of this covenant.

*Guarantees, Loans, Advances and Other Liabilities*. Except as otherwise contemplated by the Indenture and the Sale Agreement and any other sale agreement with the State, the Authority 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 Authority will not, directly or indirectly, make payments to or distributions from the Pledged Accounts except in accordance with the Indenture.

*Restriction of Bankruptcy*. In accordance with the Act, the Authority will have no authority to file a voluntary petition, under or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may, from time to time be in effect and neither any public officer nor any organization, entity, or other person will authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute, as may, from time to time be in effect. The State acknowledges that clause (c)(iii) under "Agreement with the State" applies to the foregoing provision. (Section 5.08)

**Prior Notice**

The Authority will give each Rating Agency thirty (30) days' prior written notice of each issue of Bonds other than the Series 2011 Bonds, with a copy of the proposed Series Supplement, and of each Supplemental Indenture, amendment to the Sale Agreement, Related Contract or defeasance or redemption of Bonds. (Section 5.09)

**Pledged Settlement Payments**

The State has provided through the Minnesota Agreement, the Consent Judgment and the Sale Agreement for (i) the Authority's ownership and receipt of the Pledged Settlement Payments, (ii) the receipt or other application of the net proceeds of the Bonds (not including Refunding Bonds) and (iii) the resulting benefits to the people of the State. The Authority acknowledges under the Indenture that the Minnesota Agreement, the Consent Judgment 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 Minnesota Agreement, the Consent Judgment and the Sale Agreement constitute important security provisions of the Bonds, the Authority 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 Minnesota Agreement, the Consent Judgment or the Sale Agreement, the Holders of the Bonds may have suffered damage, the extent of the remedy for which is set forth in the Indenture and the Act, and will be determined in the course of any action taken pursuant hereto; and the Authority 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 claim to the effect that no such damage has been suffered. (Section 6.01)

**Resignation or Removal of the Trustee**

The Trustee may resign at any time on not less than 30 days' written notice to the Authority, the Holders and each of the Rating Agencies. The Trustee will promptly certify to the Authority that it has sent written notice to all Holders and such certificate will be conclusive evidence that such notice was mailed as required by the Indenture. Upon receiving such notice of resignation, the Authority will 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 will be delivered to each of the Holders, the resigning Trustee and the successor Trustee. The Trustee may be removed by the Authority or by a Majority in Interest of Outstanding Bonds, upon written notice to the Trustee, if rated below investment grade by S&P's and each successor Trustee will have an investment grade rating from S&P. The Trustee may also be removed by written notice from the Authority if no Default has occurred or from a Majority in Interest of the Holders of the Outstanding Bonds to the Trustee and the Authority. No such resignation or removal will take effect until a successor has been appointed and has accepted the duties of 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 thereof 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 will with due care terminate its activities under the Indenture and a successor may, or in the case of the Trustee will, be appointed by the Authority. The Authority will notify the Holders and the Rating Agencies of the appointment of a successor Trustee in writing within 20 days from the appointment. The Authority 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 Section 7.04 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 under this section will 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 an investment grade rating from S&P or otherwise as approved by the Rating Agencies. Any such successor Trustee will notify the Authority of its acceptance of the appointment and, upon giving such notice, will become Trustee, vested with all the property, rights, powers and duties of the Trustee under the Indenture, without any further act or conveyance. Such successor Trustee will execute, deliver, record and file such instruments as are required to confirm or perfect its succession under the Indenture and any predecessor Trustee will from time to time execute, deliver, record and file such instruments as the incumbent Trustee may reasonably require to confirm or perfect any succession under the Indenture. (Section 7.05)

**Nonpetition Covenant.**

Notwithstanding any prior termination of the Indenture, no Fiduciary will, prior to the date which is one year and one day after the termination of the Indenture, acquiesce, petition or otherwise invoke or cause the Authority to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against the Authority under any federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Authority or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Authority. (Section 7.06)

**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 in the Indenture expressly provided) if made in the following manner, but the Authority or the Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any 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 Authority 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 Holder with a corporate seal affixed and attested by a person purporting to be its secretary or an assistant 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 will not be construed in limitation of the rights of the Authority and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in the Indenture. Notwithstanding any other provisions of the Indenture, any payment to the registered owner of a Bond will satisfy the Authority'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 of the Bonds Outstanding will, in its own name by action or proceeding in accordance with the law:

(i) enforce all rights of the Holders and require the Authority 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 Authority 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 will the principal of any Bond be accelerated and declared due and payable in advance of its stated maturity.

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

Upon the occurrence of a Payment Default or a failure actually known to an Authorized Officer of the Trustee to make any other payment required by the Indenture within seven days after the same becomes due and payable, the Trustee will give written notice thereof to the Authority. The Trustee will 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 of the Outstanding Bonds. The Trustee will proceed for the benefit of the Holders in accordance with the written direction of a Majority in Interest of the Outstanding Bonds. The Trustee will not be required to take any remedial action (other than the giving of notice) unless indemnity satisfactory to the Trustee is furnished for any expense or liability to be incurred in the Indenture. 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" provision of the Indenture to the contrary notwithstanding, the remedies available to the Trustee for any breach of the pledges and agreements of the State set forth in the Indenture and described in clause (b) under the heading "Agreement with State" will be limited to injunctive relief. (Section 9.02)

**Extraordinary Prepayment**

Upon the occurrence of a Payment Default, on each Distribution Date thereafter, any amounts remaining on deposit in the Pledged Revenues Account after making the deposits required by the Indenture as described in clauses (i), (ii), (iv) and (vi) under the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues," will be applied, together with any amounts on deposit in the Debt Service Reserve Account, to the mandatory redemption of the Outstanding Bonds, Pro Rata as to principal, among maturities and within a maturity, at a redemption price of 100% of the principal amount thereof, plus accrued interest to the redemption date. (Section 9.03)

**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 Authority, and will do so upon written instruction of the Holders of at least 25% in principal amount of the Outstanding Bonds. (Section 9.04)

**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 in the Indenture 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 in the Indenture 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 Authority 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 9.07)

**Venue and Governing Law**

The venue of every action, suit or special proceeding against the Authority will be laid in the State and will be heard and determined in the Minnesota District Court, Second Judicial District or, if such Court for any reason does not then have jurisdiction, in any State court of competent jurisdiction in Ramsey County, Minnesota, in accordance with the Act. (Section 9.08)

The Indenture will 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 under the Indenture will be determined in accordance with such laws. (Section 10.04)

**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 Authority to (A) provide for earlier or greater deposits into the Funds and Accounts, (B) subject any property to the lien of the Indenture, (C) add to the covenants and agreements of the Authority or surrender or limit any right or power of the Authority, (D) identify particular Bonds for purposes not inconsistent herewith, including credit or liquidity support, serialization and defeasance, (E) cure any ambiguity or defect, (F) protect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of the Indenture under the Trust Indenture Act of 1939, as amended, or (G) authorize Bonds of a Series and in connection therewith determine the matters referred to in the Indenture, including Section 3.01, 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 Authority and the Trustee, (A) to add provisions that are not materially adverse to the Holders, or (B) to adopt amendments that do not take effect unless and until (1) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (2) such amendment is consented to by the Holders of such Bonds in accordance with the further provisions of the Indenture; 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; provided, however, that the Indenture will not be amended so as to (A) extend the maturity of any Bond, (B) reduce the principal or Sinking Fund Installment amount, applicable premium or interest rate of any Bond, (C) make any Bond redeemable other than in accordance with its terms, (D) create a preference or priority of any Bond over any other Bond of the same class or (E) 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 thereby have consented thereto in writing.

Any amendment of the Indenture will be accompanied by a Transaction Counsel's opinion addressed to the Trustee to the effect that the amendment is authorized and permitted by law and by the Indenture and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes.

When the Authority determines that the requisite number of consents have been obtained for an amendment hereto which requires consents, it will 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

Authority 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 (a) to cure any ambiguity, (b) to correct or supplement any provisions in the Sale Agreement, (c) to correct or amplify the description of the tobacco settlement payments sold under the Indenture, (d) to add additional covenants for the benefit of the Authority, or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that will not adversely affect in any material respect the interest of the Holders of Outstanding Bonds; provided that the Trustee receives a Transaction Counsel's opinion addressed to the Trustee to the effect that the amendment is authorized and permitted by law and by the Indenture and does not adversely affect the exclusion of interest on the Tax-Exempt Bonds from gross income for federal income tax purposes. The Sale Agreement may also be amended from time to time by the Authority 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 will 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 will, transmit a notice of such request to each Holder and request directions with respect thereto; and the Trustee (and the Authority, if applicable) will proceed in accordance with such directions (if any), the Indenture and the Sale Agreement. (Section 10.02)

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## APPENDIX E

## DEFINITIONS AND SUMMARY OF THE PURCHASE AND SALE AGREEMENT

*The following summary describes certain terms of the Sale Agreement. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Sale Agreement. Copies of the Sale Agreement may be obtained upon written request to the Trustee at Mailstation: EP MN WS3C, 60 Livingston Avenue, St. Paul, Minnesota 55107.*

### Definitions

Capitalized terms used but not defined in this Appendix E have the meanings given to such terms in Appendix D – "Definitions and Summary of the Indenture." The following terms have the following meanings in this summary, unless the context otherwise requires.

"**Board**" means the members of the Authority pursuant to the Act.

"**Bondholders**" or "**Holders**" mean the registered owners of Outstanding Bonds.

"**Bond Purchase Agreement**" means the Contract of Purchase, by and between the Authority, the State and Barclays Capital Inc., as representative of the Underwriters, in such form as the parties thereto will agree.

"**Calculation Agent**" means PricewaterhouseCoopers LLP or any other firm serving as independent auditor under the Minnesota Agreement.

"**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 Pledged Settlement Payments.

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

"**Transaction Documents**" means the Sale Agreement, the Indenture and the Bond Purchase Agreement.

### Conveyance of Pledged Settlement Payments

The State will irrevocably sell and convey to the Authority, as of the Closing Date, without recourse (subject to certain continuing obligations in the Sale Agreement) in accordance with and subject to the terms of the Sale Agreement, all right, title and interest of the State on the Closing Date in and to the Pledged Settlement Payments. As consideration for such sale and conveyance of the Pledged Settlement Payments by the State to the Authority, the Authority promises under the Sale Agreement to pay and otherwise convey to the State, without recourse, on the Closing Date, the proceeds (net of the Financing Costs) of the Series 2011 Bonds and the Residual Certificate in accordance with and subject to the terms of the Indenture and the Act. As additional consideration for such sale and conveyance, the Authority further promises to pay and otherwise convey to the State, without recourse, on the closing date of any Refunding Bonds issued under the Indenture, the proceeds (net of Financing Costs) of such Refunding Bonds in accordance with and subject to the terms of the Indenture and the Act.

In accordance with the Act, upon execution and delivery of the Sale Agreement, the sale and conveyance and other transfer of the right to receive the Pledged Settlement Payments will for all purposes be a true sale and absolute conveyance of all right, title, and interest therein and not as a pledge or other security interest for any borrowing, valid, binding and enforceable in accordance with the terms of the Sale Agreement and the Indenture will not be subject to disavowal, disaffirmance, cancellation, or avoidance by reason of insolvency of any party, lack of consideration, or any other fact, occurrence or rule of law.

The right of the Authority to receive the Pledged Settlement Payments, on and after the Closing Date, is valid and enforceable, and during the period that Pledged Settlement Payments are payable to the Authority and pledged under the Indenture, the right of the Authority to receive the Pledged Settlement Payments is superior and prior to, the right and claim of the owner of the Residual Certificate to receive the Residual Revenues. Notwithstanding anything to the contrary in the Indenture or the Residual Certificate, the Trustee will not make any deposits to the Residual Account unless and until the deposits required to be made by Section 4.03(c)(i) through (vi) of the Indenture have been paid in full.

From and after the Closing Date all Pledged Settlement Payments required by the Minnesota Agreement to be made to the State will be made to the Trustee in accordance with the provisions of the Indenture. In the event the State will receive any payments or other funds constituting Pledged Settlement Payments after the Closing Date the State will promptly disburse the same to the Authority or the Trustee, as directed. The State, acting through the Commissioner, agrees to execute and deliver to PricewaterhouseCoopers, irrevocable written instructions designating the Pledged Revenues Account as the account to which Pledged Settlement Payments should be deposited in accordance with the Minnesota Agreement. Nothing in the Sale Agreement is intended to limit the rights of the State to enforce the provisions of the Sale Agreement requiring the delivery of the Residual Certificate to the Commissioner for deposit in the General Fund. (Section 2.01)

**Representations of the State**

The State, as seller, makes the following representations on which the Authority is deemed to have relied in acquiring the Pledged Settlement Payments. The representations speak as of the Closing Date, and will survive the sale of the Pledged Settlement Payments to the Authority and the pledge thereof to the Trustee pursuant to the Indenture.

*Power and Authority*. The Commissioner is duly authorized by the Act to assign and sell, the Pledged Settlement Payments on behalf of the State to the Authority. The State has full power and authority to execute and deliver the Sale Agreement and to carry out its terms; and the State has duly authorized such sale and assignment to the Authority by all necessary action; and the execution, delivery and performance of the Sale Agreement has been duly authorized by the State by all necessary action.

*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 Authority, constitutes a legal, valid and binding obligation of the State enforceable in accordance with its terms.

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

*No Violation.* The sale of the Pledged Settlement Payments and the consummation of the transactions contemplated by the Act and the Transaction Documents and the fulfillment of the terms hereof and thereof do not, to the State's knowledge, in any material way conflict with, result in any material breach by the State of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a material default by the State under any indenture, agreement or other instrument to which the State is a party (including the Minnesota Agreement) or by which it will 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.

*No Proceedings.* To the State's knowledge, except as disclosed in the official statement for the Series 2011 Bonds or in a schedule delivered to the Authority, there are no proceedings or investigations pending against the State, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the State: (i) asserting the invalidity of any of the Transaction Documents or the Bonds, (ii) seeking to prevent the issuance of the Bonds or the consummation of any of the transactions contemplated by any of the Transaction Documents, or (iii) seeking any determination or ruling that would affect the validity or enforceability of any of the Transaction Documents, the Act, the Consent Judgment, the Minnesota Agreement or the Bonds.

*Title to Pledged Settlement Payments.* The State is the sole owner of the Pledged Settlement Payments. On and after the Closing Date (i) the State will have no right, title or interest in or to the Pledged Settlement Payments and (ii) the Pledged Settlement Payments will be the property of the Authority, and not of the State, and will be owned, received, held and disbursed by the Authority, without appropriation, and not the State. Pursuant to the Sale Agreement, the Pledged Settlement Payments will be paid directly to the Trustee and the Trustee will deposit the Pledged Settlement Payments in the Pledged Revenues Account and will promptly, and in no event later than five Business Days after receipt thereof, the Trustee will transfer the Pledged Settlement Payments in accordance with an Officer's Certificate delivered pursuant to the Indenture.

*Absence of Liens on Pledged Settlement Payments*. The State has not sold, transferred, assigned, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Pledged Settlement Payments, nor has the State created, or to its knowledge permitted the creation of, any Lien thereon. The State warrants that the Pledged Settlement Payments are free and clear of Liens.

*Assignment to Trustee.* The State acknowledges that the Authority will assign to the Trustee for the benefit of the Bondholders all of its rights and remedies with respect to the breach of any representations and warranties of the State under the Sale Agreement. Upon discovery by the State, or the Authority of a breach of any of the foregoing representations, warranties or covenants that materially and adversely affects the value of the Pledged Settlement Payments or the sale thereof to the Authority under the Sale Agreement, the party discovering such breach will give prompt written notice to the other party and to the Trustee.

The State will not be liable to the Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Trustee to promptly notify the State upon the discovery by a Responsible Officer of the Trustee of a breach of any representation, warranty or covenant contained in the Sale Agreement. (Section 3.01)

**Limitation on Liability**

The State and any officer or employee or agent of the State may rely in good faith on the advice of counsel or on any document of any kind, prima facie properly executed and submitted by any person respecting any matters arising under the Sale Agreement. The State will not be under any obligation to appear in, prosecute or defend any legal action that will not be related to its obligations under the Sale Agreement, and that in its opinion may involve it in any expense or liability.

None of the State, the Authority, or any officer, member, employee, or agent of the Authority, while acting within the scope of their authority, will be subject to any personal liability resulting from exercising or carrying out of any of the Authority's purposes or powers or any of their respective rights or obligations under the Transaction Documents. (Section 3.02)

**Protection of Title; Non-Impairment Covenant**

Pursuant to the Act, the State pledges and agrees with the Authority, and the Authority is authorized to include such pledge and agreement in the Indenture for the benefit of the owners of the Bonds, that the State will (i) irrevocably direct the Commissioner to transfer all Pledged Settlement Payments directly to the Trustee as the assignee of the Authority, (ii) diligently enforce its right to collect all moneys due from the Settling Defendants under the Minnesota Agreement, in each case in the manner and to the extent deemed necessary in the judgment of, and consistent with the discretion of, the Attorney General, provided, however, (A) that the remedies available to the Authority and the Bondholders for any breach of the pledges and agreements of the State set forth in this clause (ii) will be limited to injunctive relief, and (B) that the State will be deemed to have diligently enforced this covenant so long as there has been no judicial determination by a court of competent jurisdiction in the State, that the State has failed to diligently enforce this covenant; (iii) in any materially adverse way, neither amend the Minnesota Agreement or take any other action that would (A) impair the Authority's right to receive Pledged Settlement Payments, or (B) limit or alter the rights vested in the Authority to fulfill the terms of its agreements with the Bondholders, or (C) 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 Sale Agreement or the Indenture will be construed to preclude the State's regulation of smoking, smoking cessation activities and laws, 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 (iv) not amend, supersede or repeal the Minnesota Agreement or the Act, in any way that would materially adversely affect the amount of any payment to, or the rights to such payments of, the Authority or the Bondholders. Notwithstanding these pledges and agreements by the State, nothing in the Sale Agreement, in the Indenture, in the Bonds or in the Act will be construed or interpreted to limit or impair the authority or discretion of the Attorney General to administer and enforce provisions of the Minnesota Agreement or to direct, control and settle any litigation or arbitration proceeding arising from or relating to the Minnesota Agreement.

Upon request of the Authority 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)

**State Tax Covenant**

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 Authority on Tax-Exempt Bonds will be excludable from gross income for federal income tax purposes pursuant to Section 103(a) of the Code; and no funds of the State will at any time be used directly or indirectly to acquire securities, obligations or investment property the acquisition or holding of which would cause any Tax-Exempt Bond to be an arbitrage bond as defined in the Code and any applicable regulations issued thereunder and in furtherance of such covenant will execute and comply with the tax certificate provided by Transaction Counsel. (Section 4.02)

**Covenant to Pay Pledged Settlement Payments**

Simultaneously with the delivery of the Bonds and the purchase of the Pledged Settlement Payments, the State, acting through the Commissioner, will irrevocably cause the Pledged Settlement Payments to be paid directly to the Trustee on behalf of the Authority. The State, acting through the Commissioner, will execute and deliver to the Calculation Agent, irrevocable written instructions designating the Pledged Revenues Account as the account to which Pledged Settlement Payments should be deposited in accordance with the Minnesota Agreement. (Section 4.03)

**Residual Revenues**

As part of the consideration for the sale to the Authority by the State of the Pledged Settlement Payments, the Authority agrees under the Sale Agreement to issue the Residual Certificate. In accordance with the provisions of the Indenture, upon payment in full of the deposits required by Section 4.03(c)(i)-(vi) thereof (as described under clauses (i)-(vi) under the heading "Application of Pledged Settlement Payments and Residual Revenues—Deposit of Pledged Revenues" in

Appendix D—Definitions and Summary of the Indenture), the remaining balance of the Pledged Revenues will be deposited as Residual Revenues in the Residual Account. In accordance with the Indenture, Residual Revenues on deposit in the Residual Account will be transferred promptly (but in no event later than five Business Days after such deposit to the Residual Account) to the owner of the Residual Certificate. (Section 5.02)

**Bonds Not Debt of State**

Pursuant to the Act, the State is not liable on Bonds of the Authority and no Bond or any Related Contract of the Authority will constitute an indebtedness or an obligation of the State or any subdivision thereof within the meaning any constitutional or statutory limitation or provision or a charge against the general credit or taxing powers, if any, of any of them but will be payable solely from the Collateral. No Owner of any Bond or provider of any Related Contract will have the right to compel the exercise of the taxing power of the State to pay any principal installment of, redemption premium, if any, or interest on the Bonds or to make any payment due under any Related Contract. (Section 5.03)

**Restriction on Bankruptcy**

In accordance with the Act, the Authority will have no authority to file a voluntary petition, under or become a debtor or bankrupt under, the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency, or moratorium law or statute as may, from time to time be in effect and neither any public officer nor any organization, entity, or other person will authorize the Authority to become a debtor or bankrupt under the Federal Bankruptcy Code or any other federal or State bankruptcy, insolvency or moratorium law or statute, as may, from time to time be in effect. The State acknowledges that clause (iii)(C) under the heading "Protection of Title; Non Impairment Covenant" applies to this provision. (Section 5.04)

**Amendment**

Except as otherwise provided under "Protection of Title; Non Impairment Covenant", after issuance of the Series 2011 Bonds, the Sale Agreement may be amended by the State and the Authority with the consent of the Trustee, but without the consent of any of the Bondholders: (a) to cure any ambiguity; (b) to correct or supplement any provisions in the Sale Agreement; (c) to correct or amplify the description of the Pledged Settlement Payments; (d) to add additional covenants for the benefit of the Authority; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in the Sale Agreement that will not adversely affect in any material respect the Bonds.

Except as otherwise provided in the preceding paragraph, the Sale Agreement may also be amended from time to time by the State and the Authority with the consent of a Majority in Interest of the Bonds for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions of the Sale Agreement or of modifying in any manner the rights of the Bondholders; but no such amendment will reduce the aforesaid portion of the outstanding amount of the Bonds, the Holders of which are required to consent to any such amendment, without the consent of the Holders of all the Outstanding Bonds.

Prior to the execution of any amendment to the Sale Agreement, the holder of the Residual Certificate and the Trustee will be entitled to receive and conclusively rely upon an Opinion of Counsel stating that the execution of such amendment is authorized or permitted by the Sale Agreement. Without the prior written consent of the holder of the Residual Certificate and the Trustee, which consent may be granted or withheld in such Person's sole discretion, no amendment, supplement or other modification of the Sale Agreement will be entered into or be effective if such amendment, supplement or modification affects the holder of the Residual Certificate or the Trustee's, as applicable, own rights, duties or immunities under the Sale Agreement or otherwise. (Section 6.01)

**Use of the Purchase Price**

In accordance with the Act, the purchase price of the Pledged Settlement Payments payable to the State pursuant to the Sale Agreement corresponding directly or indirectly to the proceeds of the Series 2011 Bonds (net of Financing Costs) will be deposited, on the Closing Date, into the Tobacco Settlement Recovery Account and will be transferred by the Authority to the Commissioner for deposit in the Tobacco Settlement Bond Proceeds Fund. (Section 6.02)

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## APPENDIX F

## BOOK-ENTRY ONLY SYSTEM

*The information in this Appendix F concerning The Depository Trust Company ("**DTC**"), New York, New York, and DTC's book-entry system has been obtained from DTC and the Authority, the State and the Underwriters take no responsibility for the completeness or accuracy thereof. The Authority, the State and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Series 2011 Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2011 Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2011 Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix F. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.*

The Depository Trust Company, New York, NY, will act as securities depository for the Series 2011 Bonds. The Series 2011 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 Subseries 2008B-1 Bond will be issued for each maturity of the Series 2011 Bonds, each in the aggregate principal amount of such maturity, and will be deposited with DTC.

DTC, the world's largest depository, is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Banking Law, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934. DTC holds and provides asset servicing for over 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 Participants are on file with the Securities and Exchange Commission. More information about DTC can be found at www.dtcc.com.

Purchases of Series 2011 Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2011 Bonds on DTC's records. The ownership interest of each actual purchaser of each Subseries 2008B-1 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 2011 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 Series 2011 Bonds, except in the event that use of the book-entry system for the Series 2011 Bonds is discontinued.

To facilitate subsequent transfers, all Series 2011 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 2011 Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not affect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2011 Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2011 Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of Series 2011 Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2011 Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Subseries 2008B-1 Bond documents. For example, Beneficial Owners of the Series 2011 Bonds may wish to ascertain that the nominee holding the Series 2011 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 2011 Bonds of any maturity are being redeemed, DTC's practice is to determine by lot the amount of the interest of each Direct Participant in such maturity to be redeemed.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2011 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 Tobacco Securitization Authority (the "**Authority**") as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts Series 2011 Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Redemption proceeds and principal and interest payments on the Series 2011 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 detailed information from the Authority or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC, the Trustee or the Authority, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of redemption proceeds and principal and interest payments to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Authority or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

DTC may discontinue providing its services as depository with respect to the Series 2011 Bonds at any time by giving reasonable notice to the Authority or the Trustee. Under such circumstances, in the event that a successor depository is not obtained, certificates for the Series 2011 Bonds are required to be printed and delivered.

The Authority may decide to discontinue use of the system of book-entry-only transfers through DTC (or a successor securities depository). In that event, certificates for the Series 2011 Bonds will be printed and delivered to DTC.

THE ABOVE INFORMATION CONCERNING DTC AND DTC'S BOOK-ENTRY SYSTEM HAS BEEN OBTAINED FROM SOURCES THAT THE AUTHORITY BELIEVES TO BE RELIABLE, BUT THE AUTHORITY TAKES NO RESPONSIBILITY FOR THE ACCURACY THEREOF.

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# APPENDIX G

# INDEX OF DEFINED TERMS