

067

IN THE SUPREME COURT  
STATE OF FLORIDA

**FILED**

SID J. WHITE

JUL 27 1998

THE STATE OF FLORIDA, et al. :  
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 Appellants, :  
 :  
 v. :  
 :  
 THE AMERICAN TOBACCO COMPANY, :  
 et al., :  
 :  
 Appellees. :  
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 STATE OF FLORIDA, et al., :  
 :  
 Appellants, :  
 :  
 v. :  
 :  
 AMERICAN TOBACCO COMPANY, et al., :  
 :  
 Appellees, :  
 \_\_\_\_\_ :

CLERK, SUPREME COURT  
By \_\_\_\_\_  
Chief Deputy Clerk

Case Nos. 93,148 &  
93,195

98-1669

District Court of Appeal  
- Fourth District  
Nos. 98-1430 & 98-1747

Circuit Court Case  
No. CL 95-1466 AE

APPELLANTS' INITIAL BRIEF

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TABLE OF CONTENTS

Table of Authorities . . . . . ii

Introduction . . . . . 1

Statement of the Case and Facts . . . . . 1

Summary of Argument . . . . . 8

**ARGUMENT . . . . . 11**

**I. THE MFN ORDER ERRONEOUSLY FAILED TO INCLUDE A NECESSARY  
    TERM AND ALSO IMPROPERLY ADDED TERMS THAT WERE NOT PART  
    OF THE TEXAS AGREEMENT. . . . . 12**

**A. The MFN Order adopted by the trial court  
        failed to include a release of Settling  
        Defendants . . . . . 12**

**B. The trial court improperly added terms to the  
        Florida Settlement Agreement that were not  
        included in the Texas Settlement Agreement 13**

Conclusion . . . . . 18

Certificate of Service . . . . . 19

**TABLE OF AUTHORITIES**

Cases:

Dorson v. Dorson,  
393 So. 2d 632, 633 (Fla. 4th DCA 1981) . . . . . 17

M&C Assoc. v. State Dept. of Transp.,  
682 So. 2d 640 (Fla. 2d DCA 1996) . . . . . 16

Video Super Stores, Inc. v. Mastriana,  
575 So. 2d 326 (Fla. 4th DCA 1991) . . . . . 12

Woodco, Inc. v. B & H Realty Corp.,  
501 So. 2d 1330 (Fla. 3d DCA 1987) . . . . . 12

Other authorities:

Fla. R. App. P. 9.130(a)(3)(C)(ii) . . . . . 1

## INTRODUCTION

Appellants, Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company and United States Tobacco Company (the "Settling Defendants"), appeal a non-final order of the Circuit Court for the Fifteenth Judicial Circuit, Palm Beach County, pursuant to Fla. R. App. P. 9.130(a)(3)(C)(ii). The trial court's order modified certain terms of a settlement between the Settling Defendants and the State of Florida, pursuant to a "Most Favored Nation" provision in the parties' settlement agreement (the "MFN Clause"). The stated justification for the modification was to provide the State of Florida with the benefit of additional terms agreed to by Settling Defendants as part of a later settlement of similar litigation with the State of Texas. In fact, the court's order imposed on both the State of Florida and Settling Defendants new terms, to which neither party had agreed as part of any settlement, far exceeding the court's authority to modify the settlement agreement under the terms of the MFN Clause.

## STATEMENT OF THE CASE AND FACTS

### 1. The Settlement Agreement Between The Parties.

On August 25, 1997, Settling Defendants and the State of Florida entered into an agreement to settle certain claims brought by the State for reimbursement of healthcare costs allegedly incurred as a result of smoking. (Settlement Agreement, State's

App. 56.)<sup>1</sup> In addition to releases by the State and undertakings by Settling Defendants, including commitments to make certain payments to the State, the Settlement Agreement contained two terms that are at issue in the proceedings below that are the subject of this appeal.

The first of these terms was an agreement by Settling Defendants, in section V of the Settlement Agreement, to pay reasonable attorneys' fees to the private counsel that the State had retained on a contingency-fee basis to pursue its lawsuit against the Settling Defendants ("private counsel"). As part of the settlement, Settling Defendants agreed to pay such attorneys' fees in an amount set by arbitrators and "subject to an appropriate annual cap on all such payments and other conditions." (Settlement Agreement, Section V, State's App. 56.) While Section V stated the basic terms of Settling Defendants' agreement to pay counsel's fees, it did not and was not intended to reflect the entire agreement of the parties on that subject. For example, Settling Defendants' payments of fees were expressly conditioned on and subject to an aggregate annual cap of \$500 million on all payments

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<sup>1</sup> Prior to certification to this Court, the Fourth District Court of Appeal consolidated Appellants' appeal, Philip Morris, Inc., et al. v. State of Florida, 4th DCA Case No. 98-1669, along with the State's pending Petition for Writ of Prohibition, 4th DCA Case No. 98-1738, under the State's initial appeal, State of Florida v. The American Tobacco Company, et al., 4th DCA Case No. 98-1430. References to the State's Appendix refer to the Appendix filed in Fourth DCA Case No. 98-1430.

of fees by Settling Defendants on a national basis, in connection with the resolution of tobacco and health litigation. (Affidavit of Arthur F. Golden dated February 2, 1998 ("Golden Affidavit", Appendix Tab 1, p. 1-3). This agreed condition and others were to be included in a side-letter agreement, rather than the settlement agreement itself, and drafts of such letters were exchanged prior to the conclusion of the settlement. No such letter was executed when the settlement was concluded, however, as a result of time pressures to enter into the settlement. (Golden Affidavit, p. 3.)

The second term of the Settlement Agreement that relates directly to the procedures below is the MFN Clause, which provides as follows:

The Settling Defendants agree that if they enter into any future pre-verdict settlement agreement of other litigation brought by a non-federal government plaintiff on terms more favorable to such 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 will be revised so that the State of Florida will obtain treatment at least as relatively favorable as any such non-federal governmental entity.

(State's App. 56 at 13.)

This provision of the Settlement Agreement was invoked as the source of the trial court's authority to issue the order on appeal.

## 2. The Aftermath Of The Settlement.

Shortly after the conclusion of settlement between the State of Florida and Settling Defendants, it became apparent that, notwithstanding Settling Defendants' agreement to pay fees pursuant to arbitration, certain of the State's private counsel intended to seek fees under their contingency-fee contract with the State. These private counsel sought to enforce their contract rights through charging liens filed against all settlement payments. The State sought to quash these liens and, in addition, asked the trial court to compel immediate arbitration of attorneys' fees, notwithstanding the State of Florida's and Settling Defendants' agreement that arbitration would not commence until late 1998. (State's App. 47.) This motion was initially granted, then later vacated on the State's motion. (State's App. 37, 38).

While these matters were being litigated, Settling Defendants separately entered into an agreement with the State of Texas that, in most respects, closely tracked their settlement with the State of Florida. (Texas Settlement Agreement, Appendix Tab 2). As in Florida, Settling Defendants agreed to pay attorneys' fees pursuant to arbitration and subject to a national cap on all such payments. Unlike the Florida agreement, however, the Texas agreement was signed by Texas's private counsel, each of whom expressly agreed to the terms of Settling Defendants' agreement to pay attorneys' fees pursuant to arbitration, which were set forth in a detailed exhibit

to the Texas agreement (the "Texas Exhibit"). As part of the arbitration agreement described in the Texas Exhibit, each Texas private counsel expressly acknowledged that its claim against Settling Defendants with respect to attorneys' fees was limited to payment under the terms of the Texas Exhibit. In addition, the Texas Exhibit included an agreement by Settling Defendants to pay up to \$50 million as an advance on fees to Texas private counsel, conditioned on the State of Texas's continuing agreement to pay an equivalent amount.

Following Settling Defendants' entry into the Texas settlement, one of Florida's private counsel, W.C. Gentry, filed a motion to "incorporate" the terms of the Texas Exhibit under the Florida Settlement Agreement pursuant to the MFN Clause (the "Gentry MFN Proposal"). (State App. 40). Given the continued controversies in Florida with respect to Settling Defendants' agreement to pay attorneys' fees and the essential similarity between the terms of the Texas Exhibit and those agreed to by Settling Defendants with respect to payment of Florida's private counsel (except as to payment of the \$50 million advance, which Settling Defendants were prepared to agree to in Florida on the terms set forth in the Texas Exhibit), Settling Defendants had no objection to incorporation of the Texas Exhibit as part of the Florida settlement - provided that the terms were the same as the terms agreed to in Texas.



The different course of the Florida litigation precluded simple adaptation of the Texas terms, however. In Florida, unlike Texas, the private attorneys were no longer acting collectively, nor were they parties to Settling Defendants' agreement with the State to arbitrate and pay private counsel's fees. Indeed, certain private counsel were openly hostile to the arbitration arrangement. In addition, in Florida, unlike Texas, the State was not prepared to commit to making an advance payment of fees to its private counsel.

In response to the Gentry MFN proposal, the court urged the State, Settling Defendants and private counsel to attempt to come to an agreement as to the effect of the Texas Settlement on the Florida Settlement in light of the Most Favored Nation clause. Accordingly, over a course of several weeks, Settling Defendants negotiated with the State and Mr. Gentry in the hopes of reaching an agreement as to the precise terms of a fee arbitration process for Florida modeled on the Texas Exhibit. Settling Defendants were prepared to make a number of concessions both to the State and to Mr. Gentry. Nothing in the Texas Exhibit was consistent with Settling Defendants' payment of fees under such circumstances. Accordingly, each of the concessions Settling Defendants were prepared to make to the State and Gentry with respect to arbitration of fees was conditioned on the inclusion of two terms in Florida that had no counterparts in the Texas Exhibit: first,

a provision requiring an express waiver and release of all claims by any private counsel that elected to participate in the fee-arbitration process, and second, a provision expressly excusing Settling Defendants from any obligation to pay fees with respect to those private counsel that rejected fee-arbitration on Settling Defendants' terms.

When it became clear that the parties could not agree as to all of the terms that would govern payment of attorneys' fees in Florida, the State, Settling Defendants and Mr. Gentry each submitted a proposed addendum to the Settlement Agreement containing detailed arbitration terms. Although the various proposed addenda were largely consistent with respect to the basic procedures that would govern the arbitration process, they differed in a number of significant respects. The most significant, for purposes of this appeal, was that only the Settling Defendants' proposal attempted to preserve the basic feature of the Texas arbitration process that Settling Defendants would be paying fees pursuant to arbitration only to private counsel who had agreed to such a process.

Ultimately, the Court approved the terms of the fee-arbitration addendum proposed by Mr. Gentry, rejecting the competing proposals of both the State and Settling Defendants in an order dated April 16, 1998. In at least three critical respects, however, the arbitration arrangement imposed on Settling Defendants

by the Court bears no resemblance to the Texas Settlement that ostensibly justified revision of the Settlement Agreement pursuant to the MFN clause. First, it arguably allows private counsel both to accept Settling Defendants' offer with respect to arbitration and to assert further claims against Settling Defendants based on their offer to arbitrate fees. Second, while it roughly tracks the Texas Exhibit insofar as it provides for payment of an advance to private counsel by the State, it also requires Settling Defendants to repay the State for its advance - even though such a term is not a part of the Texas agreement. Finally, the April 16th Order included a provision stating that Settling Defendants will not seek to oppose a request by the State of Florida of additional compensation in an amount of \$250 million, a term that does not appear in the Texas Exhibit.

#### **SUMMARY OF ARGUMENT**

The Settlement agreement - a contract between Settling Defendants and the State of Florida - cannot be revised over the parties' objection except in accordance with the parties' agreed MFN clause. The courts' April 16th Order cannot be justified as a revision to the Florida settlement pursuant to other litigation - the ostensible justification for the order under the Most Favored Nation clause. By consenting to the Most Favored Nation clause, Settling Defendants agreed, prospectively, that they would be subject under the Florida settlement to terms agreed to as part of

subsequent settlements. The terms under which Settling Defendants have been ordered to arbitrate fees in Florida had not been agreed to by Settling Defendants in any other case. The court's order cannot be justified under the Most Favored Nation clause of the settlement agreement.

The MFN Order failed to incorporate a provision necessary to make the Florida settlement consistent with the Texas settlement, and incorporated language in the provisions that was not included in the Texas Settlement Agreement. Because the Texas Settlement Agreement was structured to include Texas' private counsel as signatories, who agreed that this sole recourse against the Settling Defendants for attorneys' fees was through the fee arbitrating process, it was necessary to include a release provision barring Florida's private counsel participating in the arbitration process from asserting additional claims for fees against the Settling Defendants. In addition, the trial court incorrectly included a provision that required Settling Defendants to reimburse the State of Florida for the \$50 million advance payment on attorneys' fees required under the MFN Order. This reimbursement was not a part of the Texas settlement. The trial court also improperly included a provision that barred the Settling Defendants from objecting to any application by the State for \$250 million in additional compensation for its exceptional contribution

to any national legislation. Again, this language was not contained in the Texas Settlement Agreement.

## ARGUMENT

### **I. THE MFN ORDER ERRONEOUSLY FAILED TO INCLUDE A NECESSARY TERM AND ALSO IMPROPERLY ADDED TERMS THAT WERE NOT PART OF THE TEXAS AGREEMENT.**

Pursuant to the Settlement Agreement adopted as an enforceable order of the Court, the Settling Defendants agreed that the terms of the Settlement Agreement could be revised based on certain later settlements with non-federal government plaintiffs. The Settling Defendants and the State of Texas entered into a Settlement Agreement after the Florida settlement. The Texas Settlement Agreement contained certain provisions regarding arbitration of attorneys' fees that established more complete procedures for resolution of disputes in this area that the State of Florida viewed as more favorable to it pursuant to the Most Favored Nation provision quoted previously. After several hearings, the State of Florida, Settling Defendants and private counsel, W.C. Gentry, submitted proposals for the implementation of the Most Favored Nation provision. The trial court adopted and implemented the proposal submitted by private counsel over the objections of all parties to the Settlement Agreement. The proposal submitted by private counsel and ultimately adopted by the trial court was flawed and failed to comply with the express terms of the Settlement Agreement and the intent of the Most Favored Nation provision.

**A. The MFN Order adopted by the trial court failed to include a release of the Settling Defendants.**

The Texas Settlement Agreement, including Exhibit 1 thereto, was executed by the State of Texas, Settling Defendants **and** Private Counsel. In Texas, Private Counsel, as signatories, expressly agreed to participate in the fee arbitration process and expressly agreed that the arbitration process was the exclusive remedy of Private Counsel for the recovery of attorneys' fees as against the Settling Defendants. In contrast, Florida's Private Counsel did not execute the Settlement Agreement and did not agree that the fee arbitration process is their exclusive remedy.<sup>2</sup> In order to incorporate the Texas arbitration provisions into the Florida Settlement Agreement, a release of all claims against Settling Defendants by Florida Private Counsel who participate in the arbitration process should have been included in the MFN Order. Because the Texas private counsel had actually signed the Texas Settlement Agreement, they were bound by its terms, and could look only to the arbitration process to satisfy their claims for fees against Settling Defendants. See Woodco, Inc. v. B & H Realty Corp., 501 So. 2d 1330 (Fla. 3d DCA 1987) and Video Super Stores, Inc. v. Mastriana, 575 So. 2d 326 (Fla. 4th DCA 1991) (settlement not binding on person not a party to agreement).

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<sup>2</sup>In fact, one of Florida's Private Counsel has sued two of the Settling Defendants for tortious interference with the contingency fee contract for the recovery of its attorneys' fees.

In order to make the two agreements function in an equivalent manner, the trial court should have required Florida's Private Counsel who participate in the fee arbitration process to release the Settling Defendants from any further claims for attorneys' fees. If the arbitration provisions were to be incorporated into the Florida agreement, simple logic dictated that participating counsel should be bound by the arbitration process and required to release Settling Defendants from other claims for attorneys' fees. Because the terms of the Texas settlement regarding arbitration were to be incorporated into Florida's agreement, the trial court's failure to include this release was error.

**B. The trial court improperly added terms to the Florida Settlement Agreement that were not included in the Texas Settlement Agreement.**

The purpose of the MFN provision in the Florida Settlement Agreement is to permit the incorporation of certain terms in later settlements into the Florida agreement. The MFN provision is not intended to allow the trial court to rewrite the terms of the Settlement Agreement between the State of Florida and the Settling Defendants. The trial court exceeded its authority under the MFN provision when it included certain provisions in the MFN Order amending the Florida Settlement Agreement that were not contained in the Texas Settlement Agreement. First, the Texas agreement did not provide that Texas' payment of \$50 million as an advance



on attorneys' fees to private counsel would be reimbursed to Texas by the Settling Defendants. Instead, the Texas agreement provided that a \$50 million advance payment on fees would be made by Texas as well as the Settling Defendants, but imposed no obligation on Settling Defendants to reimburse Texas for its \$50 million advance on fees. The Texas settlement provided:

(f) *Advance of Payment of Fees.*

(i) Settling Defendants collectively and the State of Texas each will advance \$50 million to Private Counsel toward payment of attorneys' fees to counsel retained by the State of Texas in this action, such amounts to be credited to the Settling Defendants and the State of Texas, in the amounts of their respective advances, against subsequent payments of attorney's fees. The obligation of Settling Defendants to advance such amount is expressly conditioned on the continuing agreement of the State of Texas to advance an equal amount in accordance with the terms of the Settlement Agreement and this Exhibit. Such advance will be made by Settling Defendants severally and not jointly in proportion to their respective market shares, as set forth in Rider B hereto, within 45 days after the date of the Settlement Agreement and shall be paid to Walter Umphrey on behalf of Private Counsel. The advance to be made by the State of Texas shall be made no later than ten days after Final Approval of the Settlement Agreement or July 10, 1998, whichever is later. If the full amount of the advance to be made by the State of Texas is not paid by such date, the Settling Defendants shall be entitled to a refund of the advance paid by Settling Defendants in an amount equal to the unpaid portion of the State's advance.

(Texas Settlement , Appellants' App. 2, Exhibit 1 at 6)

In contrast, the trial court improperly include the following underlined language in its MFN Order amending the Florida settlement:

(f) *Advance on Payment of Fees.*

(i) Settling Defendants collectively and the State of Florida each will advance \$50 million to Private Counsel toward payment of attorneys' fees to counsel retained by the State of Florida in this action, such amounts to be credited to the Settling Defendants and the State of Florida, in the amounts of their respective advances, against subsequent payments of attorney's fees awarded by the panel. The State of Florida shall be repaid its advance from the first \$50 million paid by Settling Defendants as a result of the panel's award and Settling Defendants shall receive a credit against the next \$50 million awarded. The obligation of Settling Defendants to advance such amounts is expressly conditioned on the continuing agreement of the State of Florida to advance an equal amount. Such advance will be made by Settling Defendants severally and not jointly in proportion to their respective market shares, within 30 days of adoption of this agreement and shall be paid to David Fonvielle, Esquire on behalf of Private Counsel. The advance to be made by the State of Florida shall be made from the escrow account for prepayment of attorneys' fees pursuant to Order of Court. If the full amount of the advance to be made by the State of Florida is not paid, the Settling Defendants shall be entitled to a refund of the advance paid by Settling Defendants in an amount equal to the unpaid portion of the State's advance.

(emphasis added)

(State's App. 1, Exhibit 1 at 6-7 ). This new provision requiring Settling Defendants to reimburse the State of Florida for its advance payment of fees was simply not included in the Texas Settlement Agreement. Under the MFN provision in the Florida Settlement Agreement, the trial court

was without the authority to add a term in Florida that is not included in the Texas agreement.

The trial court also included language in a second provision that cannot be found in the Texas agreement. This second provision reads:

(h) *Application by State in Event of National Legislation.* If legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted, Settling Defendants and the State of Florida contemplate that the State of Florida and any other similar state which has made an exceptional contribution to secure the resolution of these matter may apply to the national panel of independent arbitrators described in subsection (g) for reasonable compensation for its efforts in securing enactment of such legislation. As provided in defendants' 8 K submissions, Settling Defendants will not oppose application of \$250 million by the State of Florida. Any amount awarded to the State of Florida by such panel shall be paid in conjunction with awards to other governmental entities and shall be paid in proportion to the respective unpaid amounts of such awards, subject to a separate annual cap of \$100 million on the total of all such payments to be made by Settling Defendants. (emphasis added)

(State's App. 1, Exhibit 1 at 7-8). The Texas settlement did not include the underlined language, stating that Settling Defendants would not oppose a \$250 million additional award to Florida based on a claim of "exceptional contribution". (Texas settlement, Appellants' App. 2, Exhibit 1 at 7). Again, the trial court exceeded its authority and erred by

adding a new term to the Florida settlement which simply did not appear in the Texas settlement.

Where the parties have entered into a settlement agreement, their rights and duties are merged into that agreement, and its provisions are binding on the trial court as well as the parties. See M&C Assoc. v. State Dept. of Transp., 682 So. 2d 640 (Fla. 2d DCA 1996). This is especially true of settlement agreements, which are highly favored in the law. See Dorson v. Dorson, 393 So. 2d 632, 633 (Fla. 4th DCA 1981). The trial court was simply not free to rewrite the provisions of the Settlement Agreement by adding terms that were not included in the Texas Settlement Agreement.

Based on the foregoing, the trial court erred in (1) failing to require a release of Settling Defendants by Private Counsel participating in fee arbitration, and (2) including language in both paragraphs (f)(i) and (h) that was not part of the Texas agreement.

**CONCLUSION**

This Court should reverse and remand with directions that a release provision be added to the arbitration provisions in the Florida Settlement Agreement, and that the new language in paragraphs (f)(i) and (h) in Exhibit 1 of the MFN Order be stricken.

Respectfully submitted,

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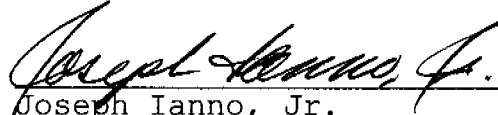
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*Janie  
This is the one  
we talked about.  
Philip Morris  
(98-1669)*

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a true and correct copy of the foregoing has been furnished via U.S. mail to all counsel on the attached service list this 24<sup>th</sup> day of July, 1998.



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IN THE SUPREME COURT  
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	:	
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et al.,	:	
	:	
Appellees.	:	District Court of Appeal
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	:	Nos. 98-1430 & 98-1747
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	:	
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	:	No. CL 95-1466 AH
v.	:	
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Appellees,	:	
	:	

APPENDIX TO APPELLANTS' INITIAL BRIEF

**INDEX**

Tab 1      Affidavit of Arthur Golden  
Tab 2      Texas Settlement Agreement

IN THE CIRCUIT COURT FOR THE FIFTEENTH JUDICIAL CIRCUIT  
IN AND FOR PALM BEACH COUNTY, FLORIDA

-----X  
THE STATE OF FLORIDA, et al. :  
:   
Plaintiffs, :   
: Case No. CL 95-1466 AH  
- vs - :   
:   
THE AMERICAN TOBACCO CO., et al. :   
:   
Defendants. :   
-----X

AFFIDAVIT OF ARTHUR F. GOLDEN

State of New York )  
) ss:  
County of New York )

ARTHUR F. GOLDEN, being first duly sworn, deposes and states:

1. I am over the age of 21, am under no disability and am competent to testify to the matters contained in this Affidavit. I make this Affidavit in support of the motion of Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company and United States Tobacco Company (the "Settling Defendants") seeking reconsideration of the Court's ruling of January 22, 1998 and order of January 29, 1998 compelling arbitration.

2. I was one of the principal negotiators of the Settlement Agreement entered into between the State of Florida and the Settling Defendants and approved by this Court on August 25, 1997 (the "Settlement Agreement"), and this Affidavit is made upon personal knowledge of the understandings reached by the parties in entering into the Settlement Agreement.

3. Section V of the Settlement Agreement, which provides for an arbitration process for payment of attorneys' fees by the Settling Defendants, does

not and was not intended to reflect the entire agreement of the parties as to the procedures and conditions that would govern any arbitration of fees. To the contrary, the Settlement Agreement expressly states that the fee arbitration process described therein is "subject to an appropriate annual cap" and "other conditions." These references indicate and were intended to indicate that certain essential terms of the parties' agreement as to the fee arbitration process are not reflected in the Settlement Agreement. However, the Settling Defendants would not have entered into the Settlement Agreement without having reached a clear and satisfactory agreement as to such essential terms, including the timing of the arbitration process.

4. The parties intended that the essential terms of their agreement as to the fee arbitration process that were not contained in the Settlement Agreement, including terms as to the timing of any such arbitration, would be reflected in a side-letter agreement. To this end, drafts of the side-letter agreement were exchanged prior to and after the date of the Settlement Agreement, and a final side-letter agreement was executed by me on behalf of the Settling Defendants after the date of the Settlement Agreement. A draft of the side-letter agreement proposed by Joseph F. Rice, Esq., one of the principal negotiators for the State of Florida, is attached hereto as Exhibit A. The final side-letter agreement is attached hereto as Exhibit B. The draft and the final versions of the side-letter agreement describe aspects of the arbitration process that were regarded by the Settling Defendants as essential terms of their agreement at the time they entered into the Settlement Agreement.

5. An essential term of the Settling Defendants' agreement was that after execution of the Settlement Agreement there would be an extensive period during which there would be no active proceedings involving the Settling Defendants relating to this lawsuit. For this reason, the Settlement Agreement unambiguously provides that no proceedings would be held on the State's claims for injunctive relief under Count III of the Third Amended Complaint until June 1, 1998 and that trial on such claims would not commence before the first Monday in August, 1998. Also for this reason, the side-letter agreement unambiguously establishes that no proceedings relating to arbitration of attorneys' fees would be initiated until the earlier of November 15, 1998 or the date after which Congress and the President have acted on the June 20, 1997 Proposed Resolution. It was understood by the parties that arbitration proceedings would not be initiated before November 15, 1998 if any proposal to implement the June 20, 1997 Proposed Resolution remained under consideration by Congress and the President.

6. Essential terms of the fee arbitration process that were agreed to by the parties prior to execution of the Settlement Agreement and which are reflected in the draft and final versions of the side-letter agreement include, among others, the following:

- The arbitration process is not to be initiated until the earlier of November 15, 1998 or the date after which Congress and the President have acted on the June 20, 1997 Proposed Resolution.
- The Settling Defendants' payment of any fees awarded by the arbitration panel is to be subject to an aggregate annual cap, on a national basis, of \$500 million on all payments by Settling Defendants of fees awarded in connection with the settlement or resolution of tobacco litigation (including \$250 million in respect of 1997 for fees awarded in connection with settlements entered into during 1997).
- In any fee arbitration proceeding conducted pursuant to the terms of the side-letter agreement, the Settling Defendants will not oppose any request for an award of fees by Florida's private counsel, nor will they express any opinion as to the appropriateness or inappropriateness of any amount proposed for an award.

7. The foregoing terms of the side-letter agreement were fully understood prior to the execution of the Settlement Agreement. The side-letter agreement was not executed contemporaneously with the Settlement Agreement as a result of the exigency of the parties' entry into the Settlement Agreement.

FURTHER AFFIANT SAYETH NOT

*Arthur F. Golden*  
Arthur F. Golden

Subscribed and sworn  
before me this 2nd  
day of February, 1998

*Frances Carl*  
Notary Public

FRANCES CARL  
Notary Public, State of New York  
No. 31-4627800  
Qualified in New York County  
Commission Expires May 31, 1998

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 R. BRIAN JOHNSON  
 K. KATHLEEN KERN (PA ONLY)  
 KRISTY ORUENLOM (IL & SC)  
 ROBERT C. ADAMS (SC, NC & FL)  
 BETH J. LADDAGA  
 E. VIRGIL FALLON (NM ONLY)  
 JERRY HUDSON EVANS

August 25, 1997

## MEMORANDUM OF UNDERSTANDING

Defendants maintain they will make annual payments of up to \$500 million per year to pay attorneys' fees (including \$250 million representing the pro-rated period of 1997 from July 1, 1997 to December 31, 1997, after the Proposed Resolution was signed). In each year the annual payment would be used to pay, or be allocated proportionately among, all unpaid approved legal fees (and certain other similar fees).

Accordingly, it is anticipated that the \$250 million attributable to 1997 will be allocated principally (or perhaps exclusively) to attorneys' fees for those states that have settled with the industry in 1997.

The parties will not seek to have a proceeding before the panel until after Congress acts on the June 20, 1997 Proposed Settlement or November 15, 1998, the earlier of the events.

The mechanism for awarding fees remains as we had discussed on previous occasions. There will be a panel of three arbitrators; all interested parties will be able to submit any material that they wish; there will not be a specified list of things to be considered but the arbitrators will be instructed to consider all information submitted to them; their award will be final and non-appealable.

## Memorandum of Agreement

August 25, 1997

Page 2

The panel shall consider all relevant matters in reaching a decision that fairly provides for full reasonable compensation to the attorneys for their representation of Florida in the tobacco litigation. If a global resolution is adopted by Congress, the panel shall also consider the contributions toward the successful global resolution.

The Companies will not take any position adverse to the size of the fee award to Florida, nor will they express an opinion if asked to do so as to appropriateness or inappropriateness of any proposed amount. Koplou and Golden have agreed that they will appear, if requested, and provide information as to the nature and efficacy of the work of Florida's counsel.

In considering the request for fees under the Florida Settlement Agreement, whether as a result of a global resolution or not, the panel shall award fees that fairly but fully compensate Florida's counsel without consideration of what fees have previously been awarded to counsel for other persons or entities or what may be awarded in the future to counsel in regard to representation of other persons or entities in the tobacco litigation.

The same procedure and annual cap would be used with respect to fee calculations even if the Proposed Resolution is not enacted. In the event that the Proposed Resolution is enacted and contains provisions regulating attorneys' fees, the provisions of the Florida Settlement Agreement and this outline would apply with respect to Florida counsel fees as long as the total to be paid by the Companies in any year does not exceed the \$500 million cap.

It is understood that fees for Mississippi and Florida counsel will be considered and awarded before fees for counsel for any other states or entities.

---

Joseph F. Rice, Esquire

---

Arthur F. Golden, Esquire

---

Meyer G. Koplou, Esquire



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August 29, 1997

Joseph F. Rice, Esq.  
Ness, Motley, Loadholt, Richardson & Poole  
151 Meeting Street, Suite 600  
Post Office Box 1137  
Charleston, SC 29402

Re: State of Florida v. The American Tobacco Company et al.  
Civ. Action No. 95-1466 AH

Dear Joe:

I am writing on behalf of the Settling Defendants to confirm the details of the understanding you, Meyer Koplow and I reached prior to entering into the Settlement Agreement in the above litigation with respect to providing for the payment of fees for the State of Florida's private counsel, in accordance with Paragraph V of the Settlement Agreement. The Settling Defendants will make total annual payments, on a national basis, of up to \$500 million per year to pay attorney's fees (including \$250 million representing the pro-rated period of 1997 from July 1, 1997 to December 31, 1997, after the Proposed Resolution was signed). In each year the annual payment would be used to pay, or be allocated proportionately among, all unpaid approved legal fees (and certain other similar fees). Accordingly, it is anticipated that the \$250 million attributable to 1997 will be allocated principally to attorney's fees for those states that have settled with the industry in 1997.

The mechanism for awarding fees remains as we have discussed on previous occasions. A summary is as follows: There will be a panel of three arbitrators; all interested parties will be able to submit any material that they wish; there will not be a specified list of things to be considered but the arbitrators will be instructed to consider all information submitted to them; their award will be final and non-appealable. Florida's private counsel will not seek to initiate a

EXHIBIT B

Joseph F. Rice, Esq.

August 29, 1997

proceeding before the panel until after Congress and the President act on the June 20, 1997 Proposed Resolution or November 15, 1998, whichever is earlier. Any of Florida's private counsel may choose to participate in this process in lieu of any fees or request for fees for services provided to the State of Florida from any other source.

The panel shall consider all relevant matters in reaching a decision that fairly provides for full reasonable compensation to the attorneys for their representation of Florida in the tobacco litigation. If the Proposed Resolution (or a substantially equivalent federal program) is enacted, the panel shall also consider the contributions toward the legislation.

The Companies will not take any position adverse to the size of the fee award requested by private counsel to Florida, nor will they express an opinion if asked to do so as to appropriateness or inappropriateness of any proposed amount. Koplow and Golden have agreed that they will appear, if requested, and provide information as to the nature and efficacy of the work of Florida's counsel.

In considering the request for fees under the Florida Settlement Agreement, whether as a result of the enactment of the Proposed Resolution or not, the panel shall award fees that fairly but fully compensate Florida's counsel without consideration of what fees have previously been awarded to counsel for other persons or entities or what may be awarded in the future to counsel in regard to representation of other persons or entities in the tobacco litigation.

The same procedure and annual cap would be used with respect to fee calculations even if the Proposed Resolution is not enacted. In the event that the Proposed Resolution is enacted and contains provisions regulating attorneys' fees, the provisions of the Florida Settlement Agreement and this outline would apply with respect to Florida counsel fees as long as the total to be paid by the Companies in any year does not exceed the \$500 million cap.

We agree that it would be appropriate, in view of the order of settlement of these cases, that fees for Mississippi and Florida counsel be considered and awarded before fees are awarded for counsel for any other states or public entities.

Joseph F. Rice, Esq.

3

August 29, 1997

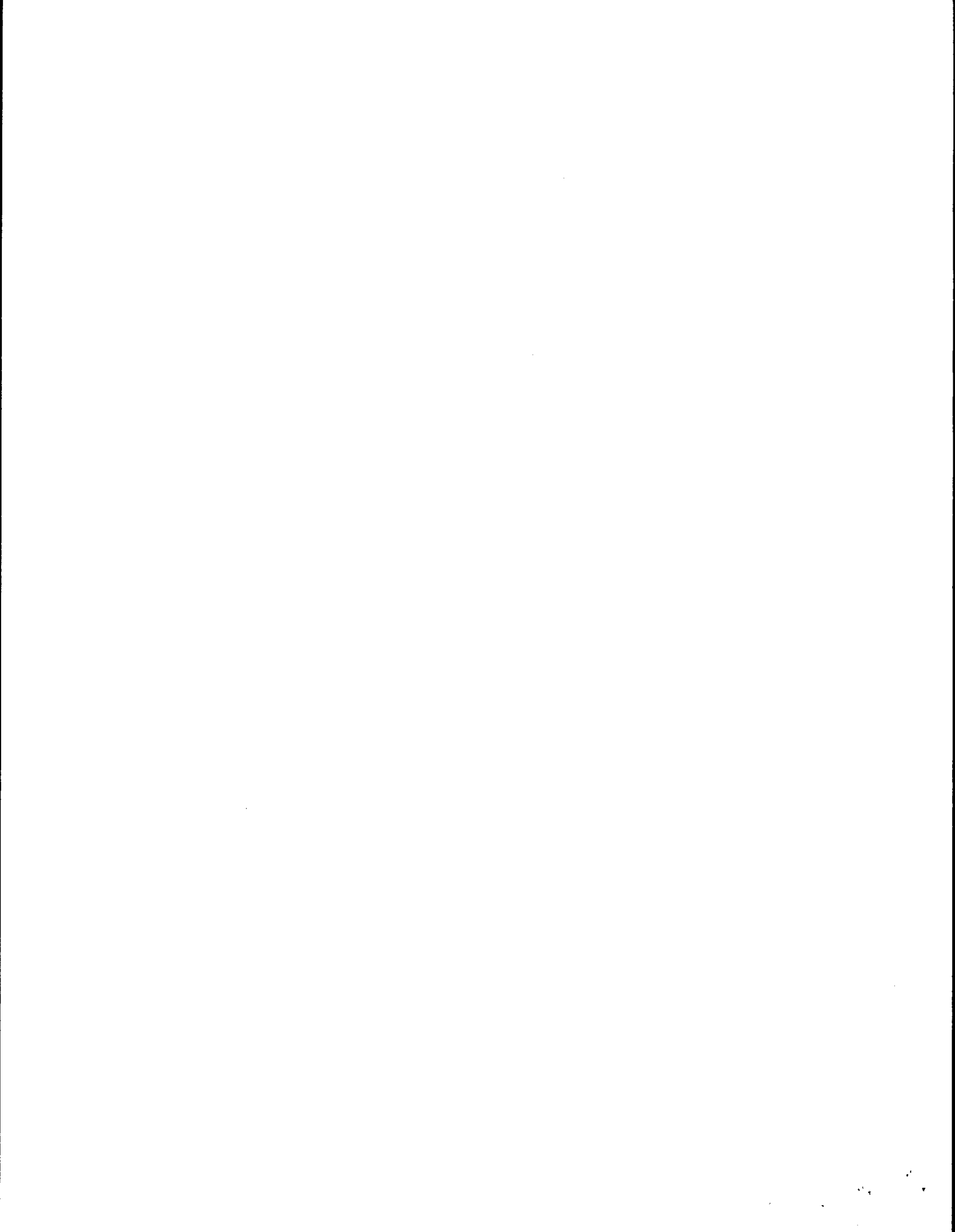
If the foregoing correctly reflects our understanding on this subject, please countersign this letter in the place indicated and return it to me.

Sincerely,

*Arthur F. Golden / CSD*  
Arthur F. Golden

Agreed and accepted:

\_\_\_\_\_  
Joseph F. Rice  
August 29, 1997



IN THE UNITED STATES DISTRICT COURT  
FOR THE EASTERN DISTRICT OF TEXAS,  
TEXARKANA DIVISION

_____	)	
THE STATE OF TEXAS,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	No. 5-96CV-91
	)	
THE AMERICAN TOBACCO	)	
COMPANY, et al.,	)	
	)	
Defendants.	)	
_____	)	

COMPREHENSIVE SETTLEMENT AGREEMENT  
AND RELEASE

THIS COMPREHENSIVE 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 against all parties to this action relating to the subject matter of  
this action which have been or could have been asserted by any of the parties to  
this action.

WHEREAS, the State of Texas, through its Attorney General, Dan  
Morales, commenced this action on March 28, 1996, asserting various claims for  
monetary and injunctive relief on behalf of the State of Texas against certain

tobacco manufacturers and others as Defendants;

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

WHEREAS, the State of Texas, through its Attorney General, the Honorable Dan Morales, and Private Counsel, have had a significant leadership role among the various states in maintaining civil litigation against the tobacco industry and in seeking to forge an unprecedented national resolution of the principal issues and controversies associated with the manufacture, marketing and sale of tobacco products in the United States;

WHEREAS, through the efforts of the State of Texas, Attorney General Morales, Private Counsel and others, a June 20, 1997 Memorandum of Understanding and Proposed Resolution (the "Proposed Resolution") (attached as an Appendix hereto) has been agreed to by members of the tobacco industry, state attorneys general, private litigants and representatives of public health groups, which Proposed Resolution would provide for unprecedented and comprehensive regulation of the tobacco industry while preserving the right of individuals to assert claims for compensation;

WHEREAS, the Proposed Resolution contemplates action by the United States Congress and the President to enact and sign a new federal law with respect

to the tobacco industry, which action the tobacco industry has agreed to support and which will require study and analysis by Congress and the President; and

WHEREAS, trial of this action was scheduled to commence on January 12, 1998 and a continuance of such trial could have prejudiced the State of Texas, the State of Texas and the undersigned Defendants (the "Settling Defendants") have agreed to settle independently the litigation commenced by Attorney General Morales pursuant to financial terms comparable to those contained in the Proposed Resolution, which terms will achieve for Texas immediately and with certainty the financial benefits it would receive pursuant to the Proposed Resolution, should it become law, as well as funding for a pilot program to reduce the use of Tobacco Products by children under 18 years of age:

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 Texas 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. Jurisdiction. Settling Defendants and the State of Texas acknowledge that this Court has jurisdiction over the subject matter of this action and over each of the parties hereto, 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.

2. Applicability. This Settlement Agreement shall be binding upon all Settling Defendants and their successors and assigns in the manner expressly provided for herein and shall inure to their benefit and to that of their respective directors, officers, employees, attorneys, representatives, insurers, suppliers, distributors and agents, and to that of any of their present or former parents, subsidiaries, affiliates, divisions or other organizational units of any kind; and the predecessors, successors and assigns of any of the foregoing. This Settlement Agreement shall be binding on and inure to the benefit of the State of Texas, its administrators, representatives, employees, officers, agents, Private Counsel, counsel and legal representatives; all agencies, departments, commissions and divisions of the State; all subdivisions, public entities, public corporations, instrumentalities and educational institutions over which the State has control; and the predecessors, successors and assigns of any of the foregoing. 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.

3. Voluntary Agreement of Parties. The State of Texas and Settling Defendants acknowledge and agree that this Settlement Agreement is voluntarily entered into by all parties hereto as the result of arms length negotiations during



which all such parties were represented by counsel. Settling Defendants understand and acknowledge that certain provisions of this Settlement Agreement impose specific requirements on them that could give rise to challenges under various federal and State constitutional provisions if the State of Texas unilaterally imposed such requirements. None of the parties hereto will seek to challenge this Settlement Agreement based on any such constitutional challenge to the provisions contained herein.

4. Definitions. For the purposes of this Settlement Agreement, the following terms shall have the meanings set forth below:

(a) "*State*" or "*State of Texas*" means the State of Texas, all of its officers acting in their official capacities and any department, subdivision or agency of the State, regardless of whether a named plaintiff;

(b) "*Settling Defendants*" means those Defendants in this action that are signatories hereto;

(c) "*Market Share*" means, for each year, a Settling Defendant's respective share of sales of cigarettes by unit for consumption in the United States;

(d) "*Tobacco Products*" means cigarettes and smokeless tobacco as those terms are defined in the Food and Drug Administration Rule;

(e) "*Billboards*" includes billboards, as well as all signs and placards in arenas and stadia, whether open-air or enclosed; "*Billboards*"

does not include: (1) any advertisements placed on or outside the premises of retail establishments licensed to sell Tobacco Products or any retail point-of-sale; and (2) billboards or advertisements in connection with the sponsorship by Settling Defendants of any transient entertainment, sporting or similar event, such as NASCAR, that appears in the State of Texas as part of a national or multi-state tour;

(f) "*Private Counsel*" means Walter Umphrey, John M. O'Quinn, P.C., John Eddie Williams, Jr., Reaud, Morgan & Quinn, and The Nix Law Firm, each of whom is defined and identified as "counsel" in the Outside Counsel Agreement executed by Attorney General Dan Morales on March 22, 1996, and Ness, Motley, Loadholt, Richardson & Poole;

(g) "*Transit Advertisements*" means advertising on private or public vehicles and all advertisements placed at, on or within any bus stop, taxi stand, transit 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; and

(h) "*Final Approval*" means the date on which all of the following shall have occurred:

- (1) The Settlement Agreement is approved by the Court;
- (2) Entry is made of an order of dismissal of claims or a

final judgment as provided herein; and

(3) The time for appeal or to seek permission to appeal from the Court's approval as described in (1) hereof and entry of final judgment or order of dismissal as described in (2) hereof has expired or, in the event of an appeal, the appeal has been dismissed or the approval described in (1) hereof and the judgment or order described in (2) hereof have been affirmed in all material respects by the court of last resort to which such appeal has been taken and such dismissal or affirmance has become no longer subject to further appeal or review.

5. Settlement Receipts; Use of Funds. The payments to be made by Settling Defendants under this Settlement Agreement during the year 1998 constitute reimbursement for public health expenditures of the State of Texas, including without limitation expenditures made by the State's Employees' Health Insurance Program and Charity Care programs. All other payments made by Settling Defendants pursuant to this Settlement Agreement are in satisfaction of all of the State of Texas's claims for damages incurred by the State in the year of payment or earlier years, including those for reimbursement of Medicaid expenditures and 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. Accordingly, subject to the

orders of this Court and the operation of applicable law, the parties hereto anticipate that funds due to the State of Texas under this Settlement Agreement, other than funds dedicated for legal expense reimbursement, will be allocated as follows, or for such other purposes as the State of Texas may determine:

- \$151 million dollars to the general revenue fund of the State of Texas, to be used for the exclusive purpose of providing funding, in conjunction with the federal government, for the Children's Health Insurance Program, pursuant to Title XXI of the Social Security Act.
- \$200 million dollars to the general revenue fund of the State of Texas to be used for the exclusive purpose of supporting smoking cessation programs, enforcement of juvenile smoking laws, counter-marketing promotional efforts directed toward youth, general anti-tobacco educational programs and other similar initiatives.
- \$200 million to the University of Texas Health Science Center at San Antonio for the exclusive purpose of establishing, maintaining and operating the Texas Children's Cancer Institute.
- \$428 million to the Texas Foundation for Children and Public Health to be used in accordance with Texas law for providing grants to organizations and programs which promote and protect the interest of Texas children and the public health, including but not limited to the following:
  - (1) Tobacco counter-marketing promotional efforts directed toward youth;
  - (2) General anti-tobacco education;
  - (3) Cigarette smoking and smokeless tobacco use cessation programs;
  - (4) Children's health screening;
  - (5) Childhood immunization;
  - (6) Childhood nutrition;
  - (7) Children's hospice;
  - (8) Pre-natal care;
  - (9) Health education programs;
  - (10) Rural health care initiatives;
  - (11) Mammography screening programs;
  - (12) Physical/sexual child abuse;

- (13) Adult domestic violence;
- (14) Substance abuse/mental health; and
- (15) Physical/mental disabilities.

- \$100 million to the M.D. Anderson Cancer Center in Houston for an endowment for research and for reimbursement of indigent health-care costs.
- \$50 million to the Texas Tech Health Sciences Center for border health initiatives, including the establishment and operation of the Institute of Border Health.
- \$50 million to the University of Texas Southwestern Medical Center at Dallas for research, endowments and other programs that benefit the public health.

All remaining amounts, including any amounts due to be paid by Settling Defendants after December 31, 1998, are to be allocated to the general revenue fund of the State of Texas to be used for such purposes as the State of Texas may determine.

6. Elimination of Billboards and Transit Advertisements. Settling Defendants agree to discontinue all Billboards and Transit Advertisements of Tobacco Products in the State of Texas. Settling Defendants agree to exercise their best efforts in cooperation with the State of Texas to identify all Billboards that are located within 1000 feet of any public or private school or playground in the State of Texas. Settling Defendants will remove such Tobacco Products advertisements (leaving the space unused or used for advertising unrelated to Tobacco Products) or, at the option of the State of Texas, will allow the State of Texas, at its expense, to substitute for the remaining term of the contract

alternative advertising intended to discourage the use of Tobacco Products by children under the age of 18. Settling Defendants agree to provide the State of Texas with preliminary lists of the locations of all Billboards and stationary Transit Advertisements within 30 days from the date of execution of this Settlement Agreement, such lists to be finalized within an additional 15 days, and to remove all Billboards and Transit Advertisements for Tobacco Products within the State of Texas at the earlier of the expiration of applicable contracts or 4 months from the date the final lists are supplied to the State of Texas. Settling Defendants also agree to cooperate to secure the expedited removal of up to 50 Billboards or stationary Transit Advertisements designated by the State of Texas, within 30 days after their designation.

Each Settling Defendant shall provide the Court and the Attorney General, or his designee, with the name of a contact person to whom the State of Texas may direct inquiries during the time such Billboards and Transit Advertisements are being eliminated, from whom the State of Texas 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 or Transit Advertisements that have not been eliminated in a timely manner.

7. Support of Legislation and Rules. Following Final Approval of this Settlement Agreement, the Settling Defendants will not challenge existing or proposed legislative or administrative initiatives insofar as they effectuate the

following:

(a) The prohibition of the sale of cigarettes in vending machines, except in adult-only locations and facilities;

(b) The strengthening of civil penalties for sales of Tobacco Products to children under the age of 18 years, including the suspension or revocation of retail licenses; and

(c) The strengthening of civil penalties for possession of Tobacco Products by children under the age of 18 years.

8. Initial Payments. Each Settling Defendant severally shall cause to be paid into the registry of the Court in accordance with paragraph 11 of this Settlement Agreement, the respective amounts listed for such Settling Defendant in Schedule A hereto, such amounts representing its share of the following payments: \$204 million to be paid on or before February 1, 1998; \$73 million to be paid on or before July 1, 1998; \$146 million to be paid on or before October 1, 1998; and \$302 million to be paid on or before November 1, 1998; the aggregate amount of such payments (\$725 million) being the State of Texas's good faith estimate of the portion Texas would receive of the \$10 billion payment provided for in Paragraph A on page 34 of the June 20, 1997 Proposed Resolution.

9. Pilot Program Payments. In support of the State of Texas's demonstrated commitment to the meaningful and immediate reduction of the use of Tobacco Products by children under the age of 18 years, Settling Defendants

agree to support a pilot program, the elements of which shall be aimed specifically at the reduction of the use of Tobacco Products by children under the age of 18 years. Accordingly, each Settling Defendant severally shall cause to be paid into the registry of the Court in accordance with paragraph 11 of this Settlement Agreement, the respective amounts listed for such Settling Defendant in Schedule B hereto, such amounts representing its share of the following payments: \$74 million to be paid on or before February 1, 1998; \$27 million to be paid on or before July 1, 1998; \$54 million to be paid on or before October 1, 1998; and \$109 million to be paid on or before November 30, 1998.

The pilot program shall commence within a reasonable period after Final Approval of this Settlement Agreement, and shall last for a period of no less than 24 months. The amounts paid by Settling Defendants pursuant to this paragraph 9 in support of the pilot program shall be used for general enforcement, media, educational and other programs directed to the underage users or potential underage users of Tobacco Products, but shall not be directed against any particular tobacco company or companies or any particular brand of Tobacco Products.

10. Annual Payments. Each of the Settling Defendants agrees that, on the dates specified in this paragraph 10 with regard to 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 into the registry of the Court in



accordance with paragraph 11 of this Settlement Agreement, pro rata in proportion to its respective Market Share, its share of 7.25% of the following amounts (in billions):

<u>Year</u>	1998	1999	2000	2001	2002	2003	thereafter
	1	2	3	4	5	6	
<u>Amount</u>	\$4B	\$4.5B	\$5B	\$6.5B	\$6.5B	\$8B	\$8B

The above amounts represent the amounts contemplated under the Proposed Resolution to be paid to the several States, without regard to the possibility of any claims for reimbursement or credit by any other person or entity including any federal government agency. The payments made by Settling Defendants pursuant to this paragraph 10 shall be adjusted upward by the greater of 3% or the Consumer Price Index applied each year on the previous year, beginning with the first annual payment. Such payments will also be decreased or increased, as the case may be, in accordance with decreases or increases in volume of domestic tobacco product volume sales as provided in Paragraph B.5 on pages 34-35 of the Proposed Resolution.

Settling Defendants shall make their first annual payment pursuant to this paragraph 10, without adjustment, and without regard to any first annual payment date provided for under any legislation implementing the Proposed Resolution (or a substantially equivalent federal program), as follows. Each Settling Defendant severally shall cause to be paid into the registry of the Court, in accordance with

paragraph 11 of this Settlement Agreement, its respective share of the following payments: \$89 million to be paid on or before November 1, 1998; and \$201 million to be paid on or before December 31, 1998. The payments to be made by Settling Defendants in 1998 in the manner described above shall be credited against any first annual payment due before February 28, 1999 under legislation implementing the Proposed Resolution (or a substantially equivalent federal program).

11. Payment of Settlement Proceeds. Any payment made pursuant to this Settlement Agreement shall be made to the registry of the Court; provided, that any such payments due to be made before Final Approval shall be paid into a special escrow account (the "Escrow Account"), to be held in escrow pending Final Approval pursuant to the terms of a mutually acceptable escrow agreement (the "Escrow Agreement"), and shall be disbursed only as provided by the terms of the Escrow Agreement. Upon Final Approval and pursuant to the terms of the Escrow Agreement, the amounts held in escrow pursuant to this paragraph 11 and the terms of the Escrow Agreement shall be transferred into the registry of the Court. Any funds held in the registry of the Court shall be disbursed only in accordance with the orders of the Court.

12. Adjustments in Event of Federal Resolution. In the event that legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted into law, the settlement provided herein shall remain

in place, but the terms of such legislation shall supersede the Settling Defendants' obligations under this Settlement Agreement, except such provisions as relate to the pilot program and except to the extent that the parties hereto have otherwise expressly agreed. The Settling Defendants agree that they will advocate the passage of the federal legislation contemplated by the Proposed Resolution, including the funding to the States contemplated therein. In order to provide Settling Defendants with a full credit for all payments made hereunder pursuant to paragraphs 8 and 10 of this Settlement Agreement in the event of such legislation, and to the extent that the payments made pursuant to paragraphs 8 and 10 of this Settlement Agreement differ from the amounts to be received by the State of Texas pursuant to such legislation, the State of Texas and the Settling Defendants shall take whatever steps are necessary to ensure that the principal amount of payments received by the State of Texas will be the same as the amounts it would receive pursuant to such legislation.

13. State of Texas's Dismissal of Claims. Upon approval of this Settlement Agreement by the Court, the State of Texas shall dismiss, with prejudice as to Settling Defendants (including their parents and affiliates), and without prejudice as to Defendant Hill & Knowlton, all claims in this action.

14. State of Texas's Waiver and Release. Upon Final Approval, the State of Texas shall release and forever discharge all Defendants and their present and former parents, subsidiaries, divisions, affiliates, 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 (except as to Settling Defendants' obligations under paragraph 17 of this Settlement Agreement), known or unknown, suspected or unsuspected, accrued or unaccrued, whether legal, equitable or statutory ("Claims") that the State of Texas (including any of its past, present or future agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions, divisions, subdivisions (political and otherwise), public entities, corporations, instrumentalities and educational institutions, 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:

(1) for the past, as to any Claims that were or could have been made in this action or any comparable federal or state action; and

(2) for the future, only as to 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").

The State of Texas 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 this paragraph 14 based, in whole or in part, upon any of the Released Claims, and the State of Texas agrees that this covenant and agreement shall be a complete defense to any such civil action or proceeding; provided, however, that Defendant Hill & Knowlton shall be entitled to the foregoing release and covenant not to sue only upon its assent, whenever given, to comply with the non-economic provisions of this Settlement Agreement, including waiver of claims, if any.

15. Settling Defendants' Waiver, Dismissal and Release of Claims. Upon Final Approval of this Settlement Agreement by the Court, Settling Defendants shall waive any and all claims against the State of Texas and any of its officers, employees, agents, Private Counsel, counsel, witnesses (fact or expert), whistleblowers or contractors, relating to or in connection with this litigation and shall dismiss, with prejudice, any pending claims or actions against such persons or entities, including but not limited to *Philip Morris, Inc. v. Morales*, Cause No. 95-14807 (120th Judicial Dist., Tex.).

In addition, upon Final Approval Settling Defendants shall release and

forever discharge the State of Texas and any of its employees, Private Counsel, counsel, witnesses (fact or expert), whistle-blowers or contractors, divisions, officers, employees, agents, officials acting in their official capacities, legal representatives, agencies, departments, commissions, divisions, subdivisions (political and otherwise), public entities, corporations, instrumentalities and educational institutions and insurers 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 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 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.

16. Most-Favored Nation. Settling Defendants agree that if they enter into any future pre-verdict settlement agreement of other litigation brought by a

non-federal governmental plaintiff on terms more favorable to such 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 will be revised so that the State of Texas will obtain treatment at least as relatively favorable as any such non-federal governmental entity. In addition, Settling Defendants agree that, in the event of any future settlement or final judgment with respect to the claims for non-economic injunctive relief pending in the lawsuit entitled *State of Florida v. American Tobacco Co.*, Civ. Action No. 95-1466 AH (15th Judicial Cir., Palm Beach County, Fla.), the terms of this Settlement Agreement will be revised so that the State of Texas will receive benefits comparable to the terms of any such settlement or final judgment (after due consideration of relevant differences in population or other appropriate factors).

17. Costs, Expenses and Fees. (a) *Reimbursement of Costs and Expenses.* Settling Defendants will reimburse the Office of the Attorney General and other appropriate State agencies and Private Counsel for reasonable costs and expenses incurred in connection with this litigation, provided that such costs and expenses are of the same nature as costs and expenses for which Settling Defendants would reimburse their own counsel or agents. Within 30 days after the date of this Settlement Agreement, each Settling Defendant shall severally cause to be paid to the Attorney General the respective amount listed for such

Settling Defendant in Schedule C hereto. The sum of such payments shall equal \$5 million; such amount being the Attorney General's best estimate of such costs and expenses (with costs for public employees to be fixed at prevailing market rates). In addition, within 30 days after the date of this Settlement Agreement, Settling Defendants shall, pursuant to the terms of Exhibit 1 hereto, pay to Walter Umphrey as representative of Private Counsel an amount equivalent to Private Counsel's best estimate of their reasonable costs and expenses consistent with the criteria set forth above. The Attorney General (for his office and for other appropriate State entities) and Private Counsel shall provide Settling Defendants with an appropriately documented statement of their costs and expenses. Settling Defendants shall promptly pay the amount of such costs and expenses in excess of the amounts already paid, or shall receive a refund if the total of such costs and expenses is less than amounts already paid. Any dispute as to the nature or amount of reimbursable costs and expenses shall be decided with finality by the persons selected to award fees, as provided below.

*(b) Payment of Fees.* Pursuant to the terms of Exhibit 1, Settling Defendants will pay reasonable attorneys' fees to Private Counsel and any other counsel retained by the State of Texas for their representation of the State of Texas in connection with this action. The State of Texas has retained Private Counsel to represent it in connection with this Action, and has advised Settling Defendants that it has entered into an agreement dated March 22, 1996 regarding



the payment of attorneys' fees to Private Counsel.

*(c) Exclusive Obligation of Settling Defendants as to Fees.* The provisions for payment of fees set forth in this Settlement Agreement and Exhibit 1 hereto constitute the entire obligation of Settling Defendants with respect to attorneys' fees in connection with this action and the exclusive means by which Private Counsel or other counsel representing the State of Texas in connection with this action may seek payment of fees by the Settling Defendants. Settling Defendants shall have no other obligation to pay fees or otherwise compensate Private Counsel or any other counsel or representative of the State of Texas.

*(d) Additional Compensation for State in Event of National Legislation.* If legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted, Settling Defendants and the State of Texas contemplate that the State of Texas and any other similar state which has made an exceptional contribution to secure the resolution of these matters may apply to the national panel of independent arbitrators described in section 2(g) of Exhibit 1 for reasonable compensation for its efforts in securing enactment of such legislation. Any amount awarded to the State of Texas by such panel shall be paid in conjunction with awards to other governmental entities and shall be paid in proportion to the respective unpaid amounts of such awards, subject to a separate annual cap of \$100 million on the total of all such payments to be made by Settling Defendants.

18. 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 the State's outside counsel that have represented the State of Texas in connection with this action are, by and through their authorized representatives, signatories to this Settlement Agreement.

19. Court Approval. If the Court refuses to approve this Settlement Agreement or any material provision hereof, or if such approval is modified in any material respect or set aside on appeal, or if the Court does not enter an order of dismissal of claims or final judgment as provided for in paragraph 13 of this Settlement Agreement, or if the Court enters the order of dismissal of claims or final judgment and appellate review is sought, and on such review such order of dismissal or final judgment is not affirmed in its entirety as to all material aspects of such order or final judgment, then this Settlement Agreement shall be canceled and terminated and it and all orders issued pursuant hereto shall become null and void and of no effect.

20. 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.

21. No Determination or Admission. This Settlement Agreement having

being executed prior to the taking of any testimony, no final determination of violation of any provision of law has been made in this action. 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 14 and 15 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.

22. 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. In addition to the foregoing, notwithstanding the conclusion of the settlement provided for herein, any restrictions imposed by any protective order in this action governing treatment of discovery materials during the pendency of this action shall remain in effect, and existing confidentiality designations shall remain undisturbed until the earlier of the enactment of legislation implementing the Proposed Resolution (or a

substantially equivalent federal program) or December 31, 1999. Thereafter, any party to the action may make any motion with respect to such discovery materials; provided, however, that nothing in this paragraph 22 shall preclude undersigned counsel from seeking disclosure of such materials in other actions or Settling Defendants from agreeing otherwise in any other action.

23. Amendment; Waiver. This Settlement Agreement may be amended only by a written instrument executed by the Attorney General, Private Counsel 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.

24. 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.

State of Texas:

Dan Morales  
Attorney General  
P.O. Box 12548  
Capitol Station  
Austin, TX 78711  
Fax: 512.463.2063

with copies to:

Walter Umphrey  
490 Park Street  
P.O. Box 4905  
Beaumont, TX 77704  
Fax: 409.838.8888

John M. O'Quinn  
440 Louisiana Street, Suite 2300  
Houston, TX 77002  
Fax: 713.222.6903

John Eddie Williams, Jr.  
8441 Gulf Freeway, Suite 600  
Houston, TX 77017  
Fax: 713.943.6226

Wayne A. Reaud  
Reaud, Morgan & Quinn, Inc.  
801 Laurel  
Beaumont, TX 77701  
Fax: 409.833.8236

Harold W. Nix  
Cary Patterson  
The Nix Law Firm  
205 Linda Drive  
P.O. Box 679  
Daingerfield, TX 75638  
Fax: 903.645.5389

Grant Kaiser

Kaiser & Morrison, P.C.  
440 Louisiana, Suite 1440  
Houston, TX  
Fax: 713.223.0440

Marc D. Murr  
Law Offices of Marc D. Murr, P.C.  
1001 Texas Avenue, Suite 1250  
Houston, TX 77002-3131  
Fax: 713.229.8003

Joseph F. Rice  
Ness, Motley, Loadholt, Richardson & Poole  
151 Meeting Street, Suite 600  
Charleston, SC 29402  
Fax: 803.720.9290

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

For United States Tobacco Company:

Richard H. Verheij  
UST, Inc.  
100 West Putnam Avenue  
Greenwich, CT 06830  
Fax: 203.863.7233

25. 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.

26. Governing Law. This Settlement Agreement shall be governed by the laws of the State of Texas.

27. 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.

28. Severability. In the event that any non-material provision of this Settlement Agreement is found to be invalid, the remainder of this Settlement Agreement shall be fully enforceable. The proposed allocations of amounts received by the State of Texas set forth in paragraph 5 of this Settlement Agreement shall not be considered material for purposes of this paragraph 28 or any other provision of this Settlement Agreement.

29. Intended Beneficiaries. This action was brought by the State of Texas, through its Attorney General, to recover certain monies and to promote the



health and welfare of the people of Texas. No portion of this Settlement Agreement shall provide any rights to, or be enforceable by, any person or entity that is not a party hereto, or a person covered by the releases provided in paragraphs 14 and 15 of this Settlement Agreement, and no portion of this Settlement Agreement shall bind any non-party or determine, limit or prejudice the rights of any such person or entity.

30. 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 16th day of January, 1998.

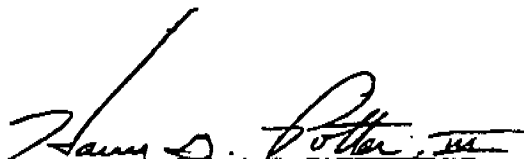
STATE OF TEXAS, acting by and through  
Dan Morales, its duly elected and authorized  
Attorney General

By: \_\_\_\_\_

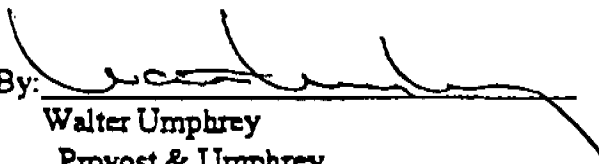
*Dan Morales*  
Dan Morales,  
Attorney General

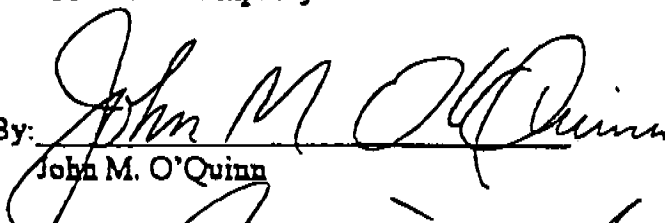
By: \_\_\_\_\_

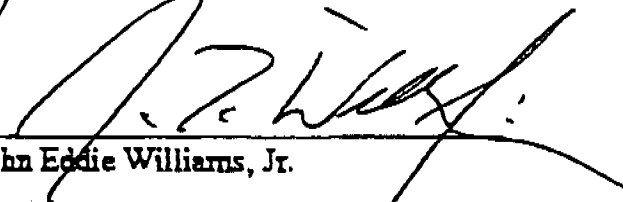
*Jorge Vega*  
Jorge Vega,  
First Assistant Attorney General

By:   
 Harry G. Potter, III  
 Special Assistant Attorney General

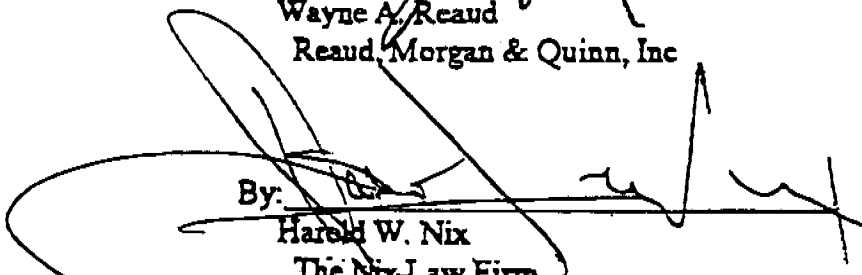
COUNSEL TO THE STATE OF TEXAS

By:   
 Walter Umphrey  
 Provost & Umphrey


By:   
 John M. O'Quinn

By:   
 John Eddie Williams, Jr.

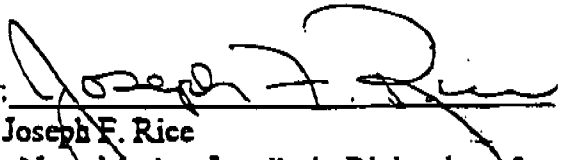
By:   
 Wayne A. Reaud  
 Reaud, Morgan & Quinn, Inc

By:   
 Harold W. Nix  
 The Nix Law Firm

By:   
 Cary Patterson  
 The Nix Law Firm

By:   
Marc. D. Murr  
Law Offices of Marc D. Murr, P.C.

By:   
Grant Kaiser  
Kaiser & Morrison

By:   
Joseph F. Rice  
Ness, Motley, Loadholt, Richardson &  
Poole

PHILIP MORRIS INCORPORATED

By: \_\_\_\_\_  
Meyer G. Koplrow  
Counsel

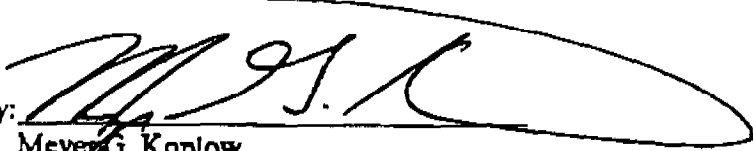
By: \_\_\_\_\_  
Martin J. Barrington  
General Counsel

By: \_\_\_\_\_  
Marc D. Murr  
Law Offices of Marc D. Murr, P.C.

By: \_\_\_\_\_  
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Kaiser & Morrison

By: \_\_\_\_\_  
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Ness, Motley, Loadholt, Richardson &  
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By: \_\_\_\_\_  
Grant Kaiser  
Kaiser & Morrison

By: \_\_\_\_\_  
Joseph F. Rice  
Ness, Motley, Loadholt, Richardson &  
Poole

PHILIP MORRIS INCORPORATED

By: \_\_\_\_\_  
Meyer G. Koplrow  
Counsel

By: Martin J. Barrington  
Martin J. Barrington  
General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By: Arthur F. Golden  
Arthur F. Golden  
Counsel

By: \_\_\_\_\_  
Charles A. Blixt  
General Counsel

BROWN & WILLIAMSON TOBACCO  
CORPORATION

By: \_\_\_\_\_  
Stephen R. Patton  
Counsel

By: \_\_\_\_\_  
Michael J. McGraw  
Senior Vice President

LORILLARD TOBACCO COMPANY

By: \_\_\_\_\_  
Arthur J. Stevens  
Senior Vice President & General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By: \_\_\_\_\_  
Arthur F. Golden  
Counsel

By: \_\_\_\_\_  
Charles A. Blixt  
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Senior Vice President & General Counsel

R.J. REYNOLDS TOBACCO COMPANY

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Arthur F. Golden  
Counsel

By: Charles A. Blixt  
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Arthur F. Golden  
Counsel

By: \_\_\_\_\_  
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Counsel

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Michael J. McGraw  
Senior Vice President

**LORILLARD TOBACCO COMPANY**

By: \_\_\_\_\_  
Arthur J. Stevens  
Senior Vice President & General Counsel

R.J. REYNOLDS TOBACCO COMPANY

By: \_\_\_\_\_  
Arthur F. Golden  
Counsel

By: \_\_\_\_\_  
Charles A. Blixt  
General Counsel

BROWN & WILLIAMSON TOBACCO CORPORATION

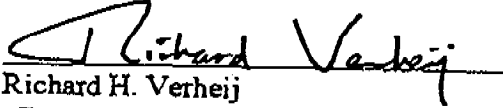
By: \_\_\_\_\_  
Stephen R. Patton  
Counsel

By: \_\_\_\_\_  
Michael J. McGraw  
Senior Vice President

LORILLARD TOBACCO COMPANY

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

UNITED STATES TOBACCO COMPANY

By:   
Richard H. Verheij  
Executive Vice President &  
General Counsel

SCHEDULE A

AMOUNTS PAYABLE BY SETTLING DEFENDANTS PURSUANT  
TO PARAGRAPH 8 OF THE SETTLEMENT AGREEMENT

<u>Date</u>	<u>2/1/98</u>	<u>7/1/98</u>	<u>10/1/98</u>	<u>11/1/98</u>
<b><u>Settling Defendants</u></b>				
Philip Morris Incorporated .....	\$ 138,720,000	\$ 49,640,000	\$ 99,280,000	\$ 205,360,000
R.J. Reynolds Tobacco Company .....	\$ 13,872,000	\$ 4,964,000	\$ 9,928,000	\$ 20,536,000
Brown & Williamson Tobacco Corporation	\$ 36,516,000	\$ 13,067,000	\$ 26,134,000	\$ 54,058,000
Lorillard Tobacco Company .....	\$ 14,892,000	\$ 5,329,000	\$ 10,658,000	\$ 22,046,000
United States Tobacco Company .....	\$ 0	\$ 0	\$ 0	\$ 0
<b>Total Amount .....</b>	<b>\$204,000,000</b>	<b>\$ 73,000,000</b>	<b>\$146,000,000</b>	<b>\$302,000,000</b>

SCHEDULE B

AMOUNTS PAYABLE BY SETTLING DEFENDANTS PURSUANT  
TO PARAGRAPH 9 OF THE SETTLEMENT AGREEMENT

<u>Date</u>	<u>2/1/98</u>	<u>7/1/98</u>	<u>10 /1/98</u>	<u>11/1/98</u>
<b><u>Settling Defendants</u></b>				
Philip Morris Incorporated . . . . .	\$ 36,452,400	\$ 13,300,200	\$ 26,600,400	\$ 53,693,400
R.J. Reynolds Tobacco Company . . . . .	\$ 18,122,600	\$ 6,612,300	\$ 13,224,600	\$ 26,694,100
Brown & Williamson Tobacco Corporation	\$ 11,988,000	\$ 4,374,000	\$ 8,748,000	\$ 17,658,000
Lorillard Tobacco Company . . . . .	\$ 6,489,800	\$ 2,367,900	\$ 4,735,800	\$ 9,559,300
United States Tobacco Company . . . . .	<u>\$ 947,200</u>	<u>\$ 345,600</u>	<u>\$ 691,200</u>	<u>\$ 1,395,200</u>
<b>Total Amount . . . . .</b>	<b>\$ 74,000,000</b>	<b>\$ 27,000,000</b>	<b>\$ 54,000,000</b>	<b>\$109,000,000</b>

SCHEDULE C

AMOUNTS PAYABLE BY SETTLING DEFENDANTS PURSUANT  
TO PARAGRAPH 17 OF THE SETTLEMENT AGREEMENT

<u>Settling Defendants</u>	<u>Amount</u>
Philip Morris Incorporated .....	\$ 2,463,000
R.J. Reynolds Tobacco Company .....	\$ 1,224,500
Brown & Williamson Tobacco Corporation .....	\$ 810,000
Lorillard Tobacco Company .....	\$ 438,500
United States Tobacco Company .....	<u>\$ 64,000</u>
<b>Total Amount .....</b>	<b>\$ 5,000,000</b>

## EXHIBIT 1 COSTS, EXPENSES AND FEES

### SECTION 1. *Reimbursement of Costs and Expenses.*

Pursuant to paragraph 17(a) of the Comprehensive Settlement Agreement and Release executed on January 16, 1998 in the case *State of Texas v. American Tobacco Co.*, No. 5-96CV-91 (E.D. Tex. filed Mar. 26, 1996) (the "Settlement Agreement"), to which this writing is attached as Exhibit 1, and the terms hereof, Settling Defendants shall reimburse Private Counsel for reasonable costs and expenses incurred in connection with this litigation, provided that such costs and expenses are of the same nature as costs and expenses for which Settling Defendants would reimburse their own counsel or agents. Within 30 days after the date of the Settlement Agreement, each Settling Defendant severally shall pay to Walter Umphrey the respective amount listed for such Settling Defendant in Rider A hereto. The sum of such payments shall equal \$40 million, such amount being Private Counsel's best estimate of such costs and expenses. Private Counsel shall provide Settling Defendants with an appropriately documented statement of their costs and expenses consistent with the criteria set forth above. Settling Defendants shall promptly pay the amount of such costs and expenses in excess of the amounts already paid, or shall receive a refund if the total of such costs and expenses is less than amounts already paid. Any dispute as to the nature or amount of reimbursable costs and expenses shall be decided with finality by the persons selected to award fees, as provided below.

### SECTION 2. *Payment of Fees.*

Pursuant to paragraph 17(b) of the Settlement Agreement and the terms hereof, Settling Defendants will pay reasonable attorneys' fees to Private Counsel, and any other counsel retained by the State of Texas, for their representation of the State of Texas in connection with this action. The amount of such fees will be set by a panel of three independent arbitrators (the "Panel") whose decisions shall be final and not appealable. The procedures governing Settling Defendants' obligations to pay such fees, including the procedures for awarding fees and the timing of payments on such awards, shall be as provided herein. Payment of such fees shall be subject to an annual aggregate national cap of \$500 million (beginning with payments for calendar year 1998) for all attorneys' fees and certain other professional fees to be paid by Settling Defendants in connection with tobacco and health cases settled by the Settling Defendants or legislatively resolved by operation of law through enactment of federal legislation implementing the terms of the Proposed Resolution (or a substantially equivalent

federal program). The Settling Defendants will pay the amount of unsatisfied fee awards up to \$500 million per year, but in no year shall Settling Defendants be required to pay more than \$500 million dollars with respect to such fees.

(a) *Exclusive Obligation of Settling Defendants as to Fees.* The provisions for payment of fees set forth herein constitute the entire obligation of Settling Defendants with respect to attorneys' fees in connection with this action and the exclusive means by which Private Counsel and any other counsel representing the State of Texas in connection with this action may seek payment of fees by the Settling Defendants in connection with this action. Settling Defendants shall have no other obligation to pay fees or otherwise compensate Private Counsel or any other counsel or representative of the State of Texas. The State of Texas has hired and employed Private Counsel to represent it in connection with this action, and has advised Settling Defendants that it has entered into a separate agreement dated March 22, 1996 regarding the payment of attorneys' fees to Private Counsel. The obligations and rights of the parties to that agreement are unaffected by the Settlement Agreement and this Exhibit thereto.

(b) *Composition of the Panel.*

(i) The members of the Panel shall be selected as follows. The first member shall be a person selected by the Settling Defendants. The second member shall be a person selected by agreement of Settling Defendants and a majority of the members of a committee which shall be composed of the following members: Joseph F. Rice, Richard F. Scruggs, Steven W. Berman, Walter Umphrey, two representatives of the Castano Plaintiffs' Legal Committee and, at the option of Settling Defendants, one additional representative to serve on behalf of counsel for any one or more States that, subsequent to the date hereof, enters into a settlement agreement with Settling Defendants (if such agreement provides for a similar method for determining fees for such State's private counsel).

(ii) The first and the second Panel members to be selected as described above shall both be permanent members of the Panel and, as such, shall participate in the determination of all awards of attorneys' fees in connection with tobacco and health cases settled by the Settling Defendants or resolved by operation of law through enactment of legislation incorporating the terms of the Proposed Resolution (or a substantially equivalent federal program). The third Panel member shall not be a permanent Panel member, but instead shall be a state-specific member selected to determine fees in connection with all fee applications relating to litigation within a single state. For purposes of determining the amount of fees to be awarded to Private Counsel (and other outside



counsel for the State of Texas) in connection with their representation of the State of Texas in this action, the state-specific member of the Panel shall be selected by Walter Umphrey on behalf of Private Counsel. As a state-specific member of the Panel, the person so selected shall not participate in any determination as to the amount of fees to be awarded on any applications other than those in connection with litigation within the State of Texas (unless also selected to participate in determinations on fee applications in connection with litigation in states other than the State of Texas by such persons as may be authorized to make such selections under the terms of other settlement agreements).

(c) *Commencement of Panel Proceedings.* The membership of the Panel shall have been established, and the Panel shall begin deliberations on any pending fee applications, either within 30 days after the date of enactment of legislation implementing the terms of the Proposed Resolution (or a substantially equivalent federal program) or by November 1, 1998, whichever is earlier. No fee application may be presented to the Panel until 30 days after the date of enactment of such legislation or November 1, 1998, whichever is earlier. Private Counsel shall apply for fees collectively. Any other counsel for the State of Texas (or any person or entity seeking an award from the Panel in their stead) shall submit any applications for fees within 10 days of the submissions by Private Counsel, or shall forfeit the right to any award of fees by the Panel. The Panel shall render a determination on the amount of fees to be awarded to Private Counsel, and to other counsel for the State of Texas on whose behalf applications have been timely submitted, no later than 30 days after the date on which all completed applications for fees on behalf of Private Counsel have been submitted.

(d) *Procedures Before the Panel.*

(i) All interested parties, including persons not parties hereto, may submit to the Panel any material that they wish. The members of the Panel will consider all information submitted to them in reaching a decision that fairly provides for full reasonable compensation for Private Counsel (and any other outside counsel for the State of Texas) for their representation of the State of Texas in connection with this action. Settling Defendants will not take any position adverse to the size of the fee award requested by Private Counsel, nor will they or their representatives express any opinion (even upon request) as to the appropriateness or inappropriateness of any proposed amount. The undersigned outside counsel for Settling Defendants Philip Morris Incorporated and R.J. Reynolds Tobacco Company will appear, if requested, to provide information as to the nature and efficacy of the work of Private Counsel

and to advise the Panel that they support an award of full reasonable compensation under the circumstances.

(ii) In considering the amount of fees to be awarded to Private Counsel in connection with their representation of the State of Texas in this action, the Panel shall award fees to Texas's counsel without consideration of any fees that already have been or yet may be awarded by the Panel.

(e) *Operation of the Annual Cap.*

(i) *General.* The annual \$500 million cap for each calendar year shall be allocated equally among each month of the year. A case shall be eligible to participate in the amount allocated for a given month if it was settled, or was legislatively resolved by operation of federal legislation implementing the Proposed Resolution (or a substantially equivalent federal program), in or before that month ("Eligible Case"). Except as provided in paragraph (iii), the available payment for each month shall be allocated among all unsatisfied fee awards rendered as of the applicable payment date with respect to eligible cases in proportion to their respective unsatisfied amounts.

(ii) *Payments with Respect to 1998.*

(a) Settling Defendants shall make an initial payment (the "Initial Fee Payment") on the earlier of December 15, 1998 or 15 days from the date the Panel awards fees for Private Counsel (and other outside counsel for the State of Texas). The Initial Fee Payment shall include payment of such counsels' allocable share for each month preceding the month in which such payment is made; except that the Initial Fee Payment shall not include payment of a share for any month for which an Eligible Case exists, but as to which case no award of fees has been made (either because the fee award is still under consideration or for any other reason).

(b) Settling Defendants shall make a second payment on January 15, 1999 of private counsel's (and other outside counsel for the State of Texas's) allocable share for each month of 1998 as to which no payment was made pursuant to subsection (a).

(iii) *Payments with Respect to 1999 and Subsequent Years.* Settling Defendants shall pay Private Counsel's (and other outside counsel

for the State of Texas's allocable share for each month in a calendar quarter within 10 business days after the end of such calendar quarter, subject to the following:

(a) In the event that federal legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted during or before the calendar year in which such calendar quarter occurs, all unsatisfied fee awards with respect to cases settled (or legislatively resolved pursuant to such legislation) before the end of the calendar year in question shall be entitled to share in the total amount to be paid for that year, in proportion to their respective unsatisfied amounts. To accomplish this end, with respect to the second through fourth quarterly payments in any year, any unsatisfied fee awards that have not received a proportional share (as described in the preceding sentence) of all prior quarterly payments in that year shall be the exclusive recipients of subsequent quarterly payments for the year until each such award has received the principal amount of its proportional share of all prior quarterly payments for that year.

(b) In the event that federal legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is not enacted during or before the calendar year in which such calendar quarter occurs, all unsatisfied fee awards with respect to cases settled before the end of the calendar year in question shall be entitled to share in the payments for each month of that year beginning with the month of settlement, in proportion to their respective unsatisfied amounts. To accomplish this end, with respect to the second through fourth quarterly payments in any year, any unsatisfied fee awards that have not received a proportional share (as described in the preceding sentence) of all prior payments for months of such year beginning with the month of settlement shall be the exclusive recipients of subsequent quarterly payments for the year until each such award has received the principal amount of its proportional share of all prior payments for months for which the respective awards were eligible.

(c) Adjustments pursuant to subsections (a) and (b) shall be made separately for each calendar year. No amounts paid in any calendar year shall be subject to refund, nor shall any payment made in any prior calendar year affect the allocation of payments to be made in any subsequent calendar year.

(iv) *Credits and Limitations.*

(a) All payments pursuant to this section are subject to a credit as provided in section (f)(ii) regarding fees advanced to Private Counsel.

(b) In no event shall Settling Defendants be required to make any quarterly payment greater than \$125 million unless necessary in the final quarter to satisfy unsatisfied fee awards up to the aggregate annual amount of \$500 million. Nor shall Settling Defendants be required to make payments in any calendar year totaling more than \$500 million minus any advances described in section (f) and any payments described in section (g), with respect to all attorney's fees and certain professional fees

(f) *Advance on Payment of Fees.*

(i) Settling Defendants collectively and the State of Texas each will advance \$50 million to Private Counsel toward payment of attorneys' fees to counsel retained by the State of Texas in this action, such amounts to be credited to the Settling Defendants and the State of Texas, in the amounts of their respective advances, against subsequent payments of attorney's fees. The obligation of Settling Defendants to advance such amount is expressly conditioned on the continuing agreement of the State of Texas to advance an equal amount in accordance with the terms of the Settlement Agreement and this Exhibit. Such advance will be made by Settling Defendants severally and not jointly in proportion to their respective market shares, as set forth in Rider B hereto, within 45 days after the date of the Settlement Agreement and shall be paid to Walter Umphrey on behalf of Private Counsel. The advance to be made by the State of Texas shall be made no later than ten days after Final Approval of the Settlement Agreement or July 10, 1998, whichever is later. If the full amount of the advance to be made by the State of Texas is not paid by such date, the Settling Defendants shall be entitled to a refund of the advance paid by Settling Defendants in an amount equal to the unpaid portion of the State's advance.

(ii) Any advance made by Settling Defendants pursuant to this paragraph shall be credited against any amounts payable by Settling Defendants to Private Counsel on any award of fees pursuant to the Settlement Agreement. Such credit shall apply to the earliest amounts payable to Private Counsel by Settling Defendants pursuant to any such award until the amount of the advance is repaid in full. Notwithstanding

any other provision of the Settlement Agreement or this Exhibit, any advances paid by Settling Defendants to Private Counsel (or paid to private counsel for any other State or governmental entity with which a settlement has been reached providing for a similar method for determining fees) shall count against and operate to reduce the \$500 million annual cap described above for the year in which the case is settled or, if the amount remaining for payment of fees under the annual cap for that year has already been paid, in the following year.

(iii) In the event that legislation implementing the Proposed Resolution (or a substantially equivalent federal program) has not been enacted by December 15, 1998, and, further, that the Settlement Agreement is canceled and terminated pursuant to paragraph 19 of the Settlement Agreement, Settling Defendants and the State of Texas shall be entitled to a full refund of any advances paid pursuant to this paragraph.

(g) *Contribution to National Legislation.* If legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted, a three-member national panel including the two permanent members of the Panel shall consider any application by Private Counsel for fees for any contributions made toward the enactment of such legislation, along with all applications by any other persons who claim to have made similar contributions. No person shall make more than one application for fees in connection with any such contributions toward enactment of the legislation. All payments of fees awarded for such contributions shall be subject to, and shall count against, the same \$500 million aggregate annual cap referenced in this section 2 and shall be paid in accordance with the provisions of subsection (e).

(h) *Application by State in Event of National Legislation.* If legislation implementing the Proposed Resolution (or a substantially equivalent federal program) is enacted, Settling Defendants and the State of Texas contemplate that the State of Texas and any other similar state which has made an exceptional contribution to secure the resolution of these matters may apply to the national panel of independent arbitrators described in subsection (g) for reasonable compensation for its efforts in securing enactment of such legislation. Any amount awarded to the State of Texas by such panel shall be paid in conjunction with awards to other governmental entities and shall be paid in proportion to the respective unpaid amounts of such awards, subject to a separate annual cap of \$100 million on the total of all such payments to be made by Settling Defendants.

AMOUNTS PAYABLE BY SETTLING DEFENDANTS PURSUANT  
TO SECTION 1 OF EXHIBIT 1 TO THE SETTLEMENT AGREEMENT

<u>Settling Defendants</u>	<u>Amount</u>
Philip Morris Incorporated .....	\$ 19,704,000
R.J. Reynolds Tobacco Company .....	\$ 9,796,000
Brown & Williamson Tobacco Corporation .....	\$ 6,480,000
Lorillard Tobacco Company .....	\$ 3,508,000
United States Tobacco Company .....	<u>\$ 512,000</u>
<b>Total Amount</b> .....	<b>\$ 40,000,000</b>

AMOUNTS PAYABLE BY SETTLING DEFENDANTS PURSUANT  
TO SECTION 2(f)(i) EXHIBIT 1 TO THE SETTLEMENT AGREEMENT

<u>Settling Defendants</u>	<u>Amount</u>
Philip Morris Incorporated .....	\$ 24,630,000
R.J. Reynolds Tobacco Company .....	\$ 12,245,000
Brown & Williamson Tobacco Corporation .....	\$ 8,100,000
Lorillard Tobacco Company .....	\$ 4,385,000
United States Tobacco Company .....	<u>\$ 640,000</u>
<b>Total Amount .....</b>	<b>\$ 50,000,000</b>