

SETTLEMENT AGREEMENT

1. The parties to this Agreement are the People of the State of California through the Attorney General ("California"), the State of Arizona ("Arizona") and R. J. Reynolds Tobacco Company ("Reynolds").

2. California, Arizona and Reynolds are parties to the Master Settlement Agreement ("MSA") which settled the litigation entitled People of the State of California v. Philip Morris Inc., Sacramento County Superior Court No. 97AS03031, Judicial Council Coordination Proceeding No. 4041 ("J.C.C.P. No. 4041"), and State of Arizona v. American Tobacco Co., Inc., Maricopa County Superior Court No. CV-96-14769, and other claims and matters pending at the time of the settlement. Pursuant to the MSA, the Superior Courts of California and Arizona entered Consent Decrees and Final Judgments ("Consent Decree") on December 9, 1998 and November 23, 1998, respectively, retaining continuing jurisdiction for the purposes of implementing and enforcing the MSA and the Consent Decree. Consent Decree Section VI.A.

3. California and Arizona, jointly and severally, have investigated Reynolds' Product Perception Tracking ("PPT") program, which involves mailing brand-identified free cigarettes to California and Arizona residents for the stated purpose of consumer testing or evaluation, in order to determine whether the PPT program violated the MSA's and/or the Consent Decree's restrictions on the distribution of free samples (MSA Section 111(g) (2), Consent Decree Section V.E.) or any statutes and regulations extant in either state. On February 17, 2000, California gave Reynolds formal thirty-day notice of its intent to initiate enforcement proceedings concerning said practices pursuant to Section VII(c) of the MSA.

4. On May 11, 2000, California filed an Application (the "Application") for Enforcement Order for Violation of the Consent Decree and Final Judgment in the San Diego County Superior Court before the Honorable Ronald S. Prager, presiding as the appointed Coordination Trial Judge in J.C.C.P. No. 4041 (the "California Superior Court"), seeking an order finding that Reynolds' program of mailing free cigarettes for purposes of consumer testing or evaluation violated the Consent Decree and requesting certain injunctive relief. On July 17, 2000, the California Superior Court denied the Application in its entirety. The California Superior Court confirmed its ruling after oral argument on July 28, 2000. California appealed this ruling by filing a Notice of Appeal on or about August 18, 2000.

5. On May 25, 2000, California filed a Complaint (the "Complaint") captioned People of the State of California v. R. J. Reynolds Tobacco Company, San Diego County Superior Court No. G1C749017, alleging that Reynolds violated the MSA and Consent Decree, and California Business and Professions Code Sections 17200 et seq. On July 6, 2000, Reynolds answered the Complaint, denying all allegations of wrongdoing and raising various affirmative defenses.

6. Arizona notified Reynolds on November 30, 1999 that it had received complaints from certain adult Arizona residents that they had received unsolicited cigarettes sent to them through the mail by Reynolds and asserting a potential violation of the MSA.

7. On June 1, 2000, Arizona invoked certain discovery rights available to it pursuant to Section VII(g) of the MSA. Arizona has not completed its investigation or expressed any formal conclusion that Reynolds' practices violate the MSA or any provision of Arizona laws. Nevertheless, in consideration of the duties and obligations accepted and undertaken by Reynolds pursuant to this Agreement, Arizona is willing to enter into this Settlement Agreement.

8. Reynolds disagrees with California's and Arizona's contentions. The parties have discussed and disputed issues in meetings and in correspondence, and have worked cooperatively to resolve these disputes informally as contemplated by Section VII(c)(6) of the MSA and Section VI.A of the Consent Decree. Arizona and California have determined that it is in the public interest of their respective States (and their residents) to enter into this Agreement rather than continue with additional discovery and/or litigation. Reynolds also has decided to resolve the disputes by entering into this Agreement rather than continue with additional discovery and/or litigation. California and Arizona have kept the NAAG Tobacco Enforcement Committee (the "Committee") informed of the discussions and correspondence between the parties. If a member of the Committee expresses to California or Arizona any objection to this Agreement's content or provisions prior to execution of this Agreement, California or Arizona will promptly so notify Reynolds.

9. The parties believe that this Agreement constitutes a good faith settlement of (i) said disputes and disagreements between the parties relating to the application of the MSA and the Consent Decree to Reynolds' distribution of free cigarettes through the mail pursuant to the PPT program; and (ii) any related public or private harm alleged to be suffered by the residents of either Arizona or California. This Agreement is for settlement purposes only and does not constitute an admission by Reynolds that either the MSA or the Consent Decree

has been violated or that the facts as alleged or asserted by California and Arizona or any other state are true.

10. Following execution of this Agreement by the parties, California and Arizona will promptly submit this Agreement to the NAAG Tobacco Enforcement Committee and will request that the Committee endorse the Agreement as a fair and reasonable resolution of the disputed issues and recommend the Agreement to the other Settling States (as defined in the MSA) as a fair and reasonable resolution of issues raised by Reynolds' practices referred to herein.

11. Promptly following execution of this Agreement by the Parties, California will submit this Agreement to the California Superior Court in action No. G1C749017 and J.C.C.P. No. 4041 for approval of its terms. California Superior Court approval of this Agreement is a material consideration for Reynolds entering into this Agreement, and any failure of the Court to approve the settlement will constitute grounds for termination by Reynolds of this Agreement.

12. Promptly following execution of this Agreement by the Parties, Arizona will file an Application (the "Arizona Application") for an enforcement order for violation of the Consent Decree and Final Judgment in the Maricopa County Superior Court No. CV-96-14769 (the "Arizona Superior Court"), seeking an order finding that Reynolds' PPT program violated the Consent Decree and requesting certain injunctive relief. The Arizona Application shall be substantially similar to California's Application in J.C.C.P. 4041. At the same time Arizona files the Arizona Application, it will submit this Agreement to the Arizona Superior Court in action No. CV-9614769 for approval of its terms. Arizona Superior Court approval, and the finality of such approval, of this Agreement is a material consideration for Reynolds entering into this Agreement, and any failure of the Arizona Superior Court to approve the settlement will constitute grounds for termination by Reynolds of this Agreement.

13. In the event either California or Arizona later settles a dispute with another entity which is a party to the MSA relating to the mailing of free cigarettes, which settlement contains one or more terms which are more favorable to said entity than a provision of this Agreement, Reynolds shall be entitled to the benefit of said more favorable terms and this Agreement shall be deemed revised so that Reynolds is treated as favorably with respect to said activity.

14. The parties agree to discuss in good faith any disputes or other issues that may arise with respect to this Agreement. In the event that either California or Arizona believe that Reynolds has acted or is acting contrary to any provision of this Agreement and the parties are unable to resolve said dispute

through discussion, California or Arizona can exercise their enforcement rights under the MSA and/or the Consent Decree. The California Superior Court and the Arizona Superior Court, respectively, shall retain exclusive judicial jurisdiction over all disputes which may arise with respect to this Agreement.

15. California will dismiss action No. G1C749017 and the appeal in No. D036261 with prejudice promptly after approval of this Agreement by the California Superior Court. The finality of the judgment of dismissal in No. G1C749017 and the dismissal of the appeal in No. D036261 are material consideration for Reynolds entering into this Agreement, and any failure of the finality of such judgment of dismissal and dismissal of the appeal will constitute grounds for termination by Reynolds of this Agreement.

16. Beginning with mailings of free cigarettes for purposes of consumer testing or evaluation, the addressees for which are chosen by Reynolds by creation of a file of the name and address of a qualified adult smoker to receive a mailing of free cigarettes in Reynolds' database (mail file creation date) after February 28, 2001, Reynolds will only mail to adults who have given specific, prior consent to participate in consumer testing or evaluation.

17. All certifications used as evidence of specific, prior consent for adult smokers to participate in the consumer testing or evaluation of free cigarettes used after February 28, 2001, whether produced by Reynolds or a third party for Reynolds, must meet the following requirements:

a. The certification of a person's willingness to receive free cigarettes through the mail for purposes of testing or evaluation must be provided distinctly from any other certification, either on a separate document or on the same document, or other reliable method (e.g., reliable voice signature or reliable electronic signature);

b. The certification must be printed in at least ten point type in an easily readable font; and

c. The certification language must state that the free cigarettes are being provided for purposes of consumer testing or evaluation. Acceptable language is as follows:

"I certify that I am a smoker 21 years or older and that I am willing to participate in a program of consumer testing or evaluation of free cigarettes that may be sent to me through the mail for this purpose. I understand that giving false

information to participate in this program may constitute a violation of law.”

In the event Reynolds decides to use alternative certification language, Reynolds shall inform California and Arizona of the proposed alternative language prior to implementation and afford California and Arizona the opportunity to discuss said language with Reynolds pursuant to paragraph 14.

18. Beginning on February 28, 2001, with respect to individuals on Reynolds’ mailing list to whom Reynolds intends to send free cigarettes through the mail in order to conduct consumer testing or evaluation pursuant to MSA Section 111(g) (2), Reynolds must provide these individuals the opportunity to affirmatively confirm or reconfirm their willingness to participate in such consumer testing or evaluation prior to their receiving such free cigarettes through the mail. Said opportunity to confirm or re-confirm shall take the form of a request that individuals interested in participating in consumer testing or evaluation expressly “opt-in” to Reynolds’ testing or evaluation program by completing a certification that complies with the requirements of paragraph 17. Reynolds shall not send free cigarettes through the mail to any individual until such individual has opted-in; provided, however, the provisions of this paragraph shall not apply to individuals who have been encountered in person at an Adult-Only Facility as defined in the MSA and who have provided proof of age (via government-issued identification) that has been recorded by digital camera or otherwise and provided a certification conforming to the requirements of paragraph 17.

19. Beginning with mailings of free cigarettes for purposes of consumer testing or evaluation the addressees for which are chosen (mail-file creation date) after February 28, 2001, and excluding cigarettes mailed pursuant to an unidentified product testing or evaluation program presently known as Reynolds’ Blind Smokers Acceptance Testing Program, Reynolds will mail free cigarettes for purposes of consumer testing or evaluation only to persons from whom it has received within 180 days preceding the date the mailing is transferred to the custody of the United States Postal Service or other third party delivery service (i) an “opt-in” as designated in paragraph 18 (if applicable) and receipt of a certification in compliance with paragraph 17 or (ii) a response to a consumer testing or evaluation instrument.

20. California and Arizona have not challenged the adequacy of Reynolds’ procedures for verifying the adult status of addressees of its mailings of free cigarettes for the purpose of testing or evaluation. Reynolds will continue to take appropriate steps to verify the adult status of intended recipients of free

cigarettes for testing or evaluation purposes, and will not mail free cigarettes to anyone it has not verified as an adult.

21. With respect to all mailings of free cigarettes for the purpose of consumer testing or evaluation released to the custody of the United States Postal Service or other third party delivery service after February 28, 2001, Reynolds will: (i) use mailers that fit in a regulation size mail receptacle as determined by the applicable Postal Regulation(s) including U.S. Postal Service Standard USPS-STD-4B ¶¶3.6 and 3.6.1 dated March 28, 1984; (ii) include no more than two packages of cigarettes (containing not more than 40 cigarettes in total) in each mailer; and (iii) mail no more than five mailers containing product to any one addressee during any twelve month period. In the event that Reynolds mails free cigarettes using a delivery service other than the United States Postal Service, it will provide written instructions to the delivery service that the cigarettes are to be personally delivered to either the addressee or to another adult. The provisions of this paragraph 21 do not apply to mailings of free cigarettes pursuant to a Reynolds' unidentified product testing or evaluation program and free Eclipse product. The free Eclipse product mailings shall be limited to one carton every six months.

22. Reynolds acknowledges that California and Arizona are concerned about the total number of free cigarettes that Reynolds has distributed through the mail under its PPT program. The total number of free cigarettes distributed during the first six months of 2000 in each of California and Arizona, respectively, through the mail under its PPT program will be set forth in a side letter (the "Side Letter") from Reynolds dated concurrently with this Agreement. Reynolds expects that the total number of free cigarettes distributed through the mail under its PPT program will decrease once the changes specified in this Agreement are made. No later than 60 days after December 31 and June 30 of each calendar year, Reynolds will provide California and Arizona semi-annual (covering respectively, January 1 through June 30 and July 1 through December 31) written statements of the number of free cigarettes distributed in each of their respective states through the mail under Reynolds' PPT program. If after the implementation of this Agreement, annual state distribution for either California or Arizona, respectively (as reflected on such semi-annual statements), of free cigarettes through the mail under Reynolds PPT program increases as compared with a number equal to two times the individual state numbers set forth in the Side Letter, then Reynolds, California and/or Arizona shall meet and discuss the reasons for such increase if requested by California or Arizona. In the event of an increase in one or both of California or Arizona, California and Arizona expressly reserve their respective enforcement rights under the Consent Decree, the MSA, and state law and otherwise. Such an increase shall not, in and of itself,

constitute prima facie or conclusive evidence of a breach of this Agreement or the MSA or of a violation of the Consent Decree or state law, but California and/or Arizona (as the case may be) may introduce any such increase as evidence in support of a claimed violation and argue its relevance and import.

23. With respect to Reynolds' obligations under this Agreement, California and Arizona will have the discovery rights contained in Section VII(g) of the MSA, and whatever discovery rights might be provided by state law.

24. Although Reynolds was the successful party in connection with the Application described in paragraph 4 herein, California and Arizona have demanded that Reynolds pay California's and Arizona's investigative costs, including legal fees, in this matter because California and Arizona believe such costs should be reimbursed in cases where alleged violations of law, agreements or orders are being resolved on behalf of the People of the State of California or Arizona. Reynolds does not share California's or Arizona's belief or concede the applicability of either any California or Arizona policy or any provision of the MSA to the settlement of a matter such as this. This settlement does not constitute an admission that either the MSA, the Consent Decree, or any provision of law has been violated and, therefore, Reynolds has refused California's and Arizona's demand. Nevertheless, the parties agree that it would not be in the public's interest or in either of their interests either to litigate this matter or to allow it to remain unresolved. Therefore, without intending to or, in fact, establishing any precedent, Reynolds is willing to and will pay after the finality of the dismissals described in paragraph 15 herein and the finality of the approval of the Arizona Application described in paragraph 12 herein, and California and Arizona together are willing to and will accept between them the total sum of \$175,000 payable as follows: \$87,500 within 20 days of the finality of the dismissals pursuant to paragraph 15; \$87,500 within 10 days of July 1, 2001 in lieu of California's and Arizona's investigative costs, including legal fees. These amounts shall be paid by check and sent via overnight delivery service as instructed by California and Arizona.

25. California and Arizona, now and forever release and discharge Reynolds and its past and present affiliates, directors, parents, predecessors, subsidiaries, partnerships, funds, employees, officers, directors, shareholders, members, partners, attorneys, representatives, agents, subcontractors (including without limitation Kevin Berg & Associates a/k/a KBA Marketing), trusts, trustees, heirs, family, successors, assigns and insurers, of and from any and all claims (including without limitation, claims for attorneys' fees, costs, damages or restitution), debts, liabilities, demands, obligations, costs, fees, expenses, charges, grievances, damages, actions and causes of action whatsoever, known, unknown,

discovered, undiscovered, suspected or unsuspected, which California and Arizona owns, holds or has owned or held, based upon the allegations of the Complaint or Application or Arizona Application.

26. California expressly waives the provisions of Section 1542 of the California Civil Code, and understands that California Civil Code Section 1542 provides:

“A general release does not extend to claims which the creditor does not know or suspect to exist in his favor at the time of executing the release, which if known by him must have materially affected his settlement with the debtor.”

27. This Agreement shall be governed by and construed in accordance with the laws of the States of California and Arizona, respectively, without reference to conflict of laws rules.

28. The Parties understand and acknowledge that this Agreement constitutes a compromise and settlement of disputed claims. No action taken by the Parties hereto, or any of them, either previously or in connection with this Agreement, shall be deemed or construed to be (a) an admission of truth of any claims heretofore made; or (b) an acknowledgment by any party of any fault or liability whatsoever to any other party or to any third party.

29. This Agreement constitutes the entire agreement between the Parties pertaining to its subject matter and supersedes any and all prior and/or contemporaneous oral or written negotiations, agreements, representations, and undertakings. The Parties, and each of them, understand that this Agreement is made without reliance upon any inducement, statement, promise, or representation other than those contained within this Agreement. In particular, the Parties have not entered into this Agreement in reliance on any representations, statements, or promises with respect to the tax consequences of the Agreement. This Agreement may not be altered, amended, modified or otherwise changed in any respect or particular whatsoever, except by a writing duly executed by the Parties to this Agreement or their authorized representatives. The Parties acknowledge and agree that the Agreement shall not become final and binding until approved by the California and Arizona Superior Courts and orders issued dismissing the Complaint and the appeal pursuant to paragraph 15 of this Agreement.

30. This Agreement may be executed in telecopied counterparts, each of which will constitute an original but all of which taken together shall constitute one and the same document.

DATED: 11/29, 2000.

R. J. REYNOLDS TOBACCO
COMPANY

By: [Signature]

Name: Guy M. Blynn

Title: Vice-President, Deputy General Counsel &
Secretary

DATED: 12/11, 2000.

THE PEOPLE OF THE STATE OF
CALIFORNIA

By: [Signature]

Name: Dennis Eckhart

Title: Sr. Asst. Attorney General

DATED: 12/7, 2000.

THE STATE OF ARIZONA

By: [Signature]

Name: DENNIS BURKE

Title: Chief Deputy

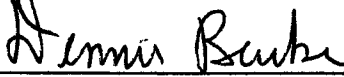
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