COUNTY OF LOS ANGELES
TREASURER AND TAX COLLECTOR

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 437
LOS ANGELES, CA 90012
TELEPHONE: (213) 974-2101 FAX: (213) 626-1812

MARK J. SALADINO
TREASURER AND TAX COLLECTOR

January 4, 2006

The Honorable Board of Supervisors
County of Los Angeles
383 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, California 90012

Dear Supervisors:

ISSUANCE AND SALE OF
CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
TOBACCO SETTLEMENT ASSET-BACKED BONDS
(LOS ANGELES COUNTY SECURITIZATION CORPORATION)
SERIES 2006A
(FIRST DISTRICT) (3 VOTES)

IT IS RECOMMENDED THAT YOUR BOARD:

1. Adopt a Resolution approving membership in the California County Tobacco Securitization Agency, the formation of a non-profit corporation, the execution of a sale agreement, and the subsequent issuance of tax-exempt bonds by the California County Tobacco Securitization Agency to finance and refinance certain construction costs related to the LAC+USC Medical Center Replacement Facility.

2. Make a finding pursuant to Government Code Section 6586.5 that the financing provides a significant public benefit.

PURPOSE/JUSTIFICATION OF RECOMMENDED ACTION

Adoption of the recommendations will authorize membership in the California County Tobacco Securitization Agency, the creation of the non-profit Los Angeles County Securitization Corporation and the issuance of the California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A (the Tobacco Bonds) to finance and refinance certain construction costs related to the LAC+USC Medical Center Replacement Facility

(the Project). The Project is necessary in order to preserve access to high-quality medical care in the County and provide the Department of Health Services (DHS) with a fully-modernized and comprehensive health center. When completed, the Project will consist of four distinct components, including a 600-bed Inpatient Tower, Diagnostic/Treatment Facility, specialty Outpatient Clinic Building, and Central Plant.

Implementation of Strategic Plan Goals

This action supports the County's Strategic Plan goals of Fiscal Responsibility and Service Excellence by providing cost-effective financing for the development of essential public infrastructure.

FISCAL IMPACT/FINANCING

Financing for the Project to date has been provided by general fund contributions from the DHS budget, the County's commercial paper program, and State and Federal emergency funding related to the 1994 Northridge earthquake. The issuance of the Tobacco Bonds will provide long-term tax-exempt financing for the Project. In the near-term, this will enable the County to retire approximately $240 million of outstanding commercial paper, thereby eliminating more than $5 million in annual interest expense currently being charged to DHS. In the long-term, as the Project nears completion in 2007, the alternative to the Tobacco Bonds would be to recommend that long-term lease revenue bonds be issued to retire or "take-out" the commercial paper issued to pay the construction costs of the Project. The issuance of Tobacco Bonds will eliminate the need to issue lease revenue bonds, thereby saving DHS approximately $25 million in annual debt service costs for the next 30 years.

The Tobacco Bonds will be structured such that annual debt service payments will not start until June 2011, and all future principal and interest will be paid from a fixed percentage (currently estimated at 25.9%) of the County's future tobacco settlement payments to be received from the State. It has been determined that allocating approximately 26% of the future tobacco settlement revenues (TSRs) to finance the Project will neither impede nor disrupt those DHS programs that rely on TSRs for funding. Furthermore, by protecting against the risk of a substantial decline in future TSRs, the issuance of Tobacco Bonds will enhance the near-term public benefits associated with those future revenues.

FACTS AND PROVISIONS/LEGAL REQUIREMENTS

On November 23, 1998, the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Territory of the Northern Marianas reached agreement with the then four largest U.S. tobacco manufacturers in resolution of cigarette smoking-related litigation. The resulting Master Settlement Agreement (the MSA) required the tobacco companies to make annual payments to the states in exchange for continuing release of future smoking-related claims. As the largest county in the State of California, the County of Los Angeles is entitled to receive approximately 12.5% of the State's annual revenues from the MSA. This amount totaled approximately $102 million in 2005 and is forecasted to reach nearly $200 million by 2045.

In order to mitigate against the risk of a substantial decline in TSRs and assure a source of funds for future projects, various counties in the State have formed a joint exercise of powers authority to issue tobacco securitization bonds. The Counties of Stanislaus, Merced, Kern, Sonoma, Marin, Fresno, Placer and Alameda have joined together to form The California County Tobacco Securitization Agency, and each county has previously issued tobacco bonds secured by some or all of their respective TSRs. To facilitate the issuance of its own series of tobacco securitization bonds, the County now seeks membership in the Agency.

The Tobacco Bonds will be structured pursuant to an asset sale of approximately 26% of the County's interest in future TSRs. This will require that the County form a non-profit public benefit corporation to purchase the TSRs from the County and then, with that asset as collateral, borrow the bond proceeds from the Agency following the sale of the Tobacco Bonds. Because the Bonds will be issued through a joint exercise of powers authority, the Treasurer and Tax Collector (the Treasurer) is required by Government Code Section 6586.5 to publish a notice and hold a public hearing on the financing of the project prior to the meeting of your Board. Following the hearing, your Board, as the governing body of the local agency with jurisdiction over the area in which the Project is located, must approve the financing and make a finding of significant public benefit for the project.

The Tobacco Bonds will be issued at a true interest cost not to exceed eight percent (8%) per annum. The maximum initial principal amount of the Tobacco Bonds will not exceed $400 million, and gross proceeds to the County will be used to finance ongoing costs of the Project, retire outstanding commercial paper, pay costs of issuance and, if

required, fund a debt service reserve fund. The final maturity of the Bonds will be determined at pricing, but in no event will exceed June 1, 2055. The Treasurer and Tax Collector anticipates issuing a combination of capital appreciation bonds (CABs) and convertible CABs, which will serve to defer debt service payments until 2011 and provide the County with an accelerated pre-payment option at the lowest possible interest cost. Prior to 2011, the County will only be responsible for administrative costs associated with the issuance of the Tobacco Bonds. The ratings on the Bonds are anticipated to be at the investment-grade level, with the possible exception of the longest bond maturities.

Pursuant to the County's policy for the issuance of bonds, the Treasurer is recommending a negotiated sale due to the technical complexities involved in issuing tobacco securitization bonds and to secure the lowest possible borrowing costs at the time of pricing the bonds. Following a modified bid request from our approved pool of senior underwriters, the Treasurer has selected Citigroup Global Markets Inc. as senior manager and Bear Stearns and UBS Financial Services as co-senior managers. Public Resources Advisory Group has been selected from the Board-approved pool of financial advisors to provide financial advisory services for this transaction. Sidley, Austin, Brown & Wood LLP will serve as transaction counsel and Hawkins Delafield & Wood will provide services as disclosure counsel.

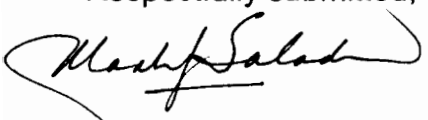
IMPACT ON CURRENT SERVICES (PROJECTS)

The proposed Tobacco Bonds will facilitate the long-term financing of ongoing construction costs at the LAC+USC Medical Center Replacement Facility.

CONCLUSION

Upon adoption, please return two (2) original executed copies of this letter and the resolution to the Treasurer and Tax Collector's Office.

Respectfully submitted,



MARK J. SALADINO
Treasurer and Tax Collector

MJS:GB:DB
Z:Board Letter/ ____ 2006A

Attachments

c: Chief Administrative Officer
County Counsel
Auditor-Controller

A RESOLUTION OF THE BOARD OF SUPERVISORS OF THE COUNTY OF LOS ANGELES APPROVING MEMBERSHIP IN THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY, THE FORMATION OF THE LOS ANGELES COUNTY SECURITIZATION CORPORATION, THE EXECUTION OF A SALE AGREEMENT, AND OTHER RELATED MATTERS.

WHEREAS, the County of Los Angeles, California (the "County") is a political subdivision duly organized and existing under the Constitution and laws of the State of California; and

WHEREAS, on November 23, 1998, the attorneys general of 46 states (including the State of California (the "State")), the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Territory of the Northern Marianas (collectively, the "Settling States"), and the then four largest United States tobacco manufacturers (the "Original Participating Manufacturers" or "OPM") entered into a master settlement agreement (the "MSA") in resolution of cigarette smoking-related litigation between the Settling States and the OPM; and

WHEREAS, the MSA released the OPM from past and present smoking-related claims and provides for a continuing release of future smoking-related claims in exchange for, among other things, certain payments to be made to the Settling States; and

WHEREAS, on August 5, 1998, the counsel representing the State, various cities and counties in the State and certain other parties entered into a Memorandum of Understanding (the "MOU") pursuant to which the County is entitled to receive a portion of the payments to be made to the State pursuant to the MSA; and

WHEREAS, the State, certain California cities and all California counties have entered into an Agreement Regarding Interpretation of Memorandum of Understanding (the "ARIMOU") setting forth their understanding of the interpretation to be given to the terms in the MOU and establishing a procedure for the expeditious resolution of future disputes as to the proper interpretation of such terms or of the ARIMOU; and

WHEREAS, the Superior Court of the County of San Diego approved the ARIMOU by order entered on January 18, 2000; and

WHEREAS, the Superior Court of the County of San Diego approved the Order Approving the Amendment to ARIMOU by order entered on July 30, 2001; and

WHEREAS, the ARIMOU required the State to enter into an escrow agreement to provide for the disbursement of the moneys contemplated by the ARIMOU; and

WHEREAS, the State and Citibank, N.A., as escrow agent, entered into the contemplated escrow agreement, dated as of April 12, 2000 (the "2000 California Escrow Agreement"); and

WHEREAS, the State and Citibank, N.A., as escrow agent, entered into an amendment to escrow agreement, dated as of July 19, 2001 (the "Amendment to 2000 California Escrow Agreement", and together with the 2000 California Escrow Agreement, the "California Escrow Agreement"); and

WHEREAS, the payments under the MSA (and hence under the MOU, the ARIMOU and the California Escrow Agreement) are subject to numerous adjustments pursuant to the terms of the MSA, including, without limitation, the Volume Adjustment, the Inflation Adjustment and the Nonparticipating Manufacturers Adjustment (each as defined in the MSA) and are further subject to delay or reduction in the event of the bankruptcy of a Participating Manufacturer (as defined in the MSA); and

WHEREAS, the County desires effectively to insure itself and otherwise protect against the risk of substantial decline in the payments it is entitled to receive pursuant to the MSA and MOU ("Tobacco Revenues") and thereby assure a source of funds from which to meet the social needs of its population, including, in particular, the financing and refinancing of certain construction costs related to the LAC+USC Medical Center Replacement Facility; and

WHEREAS, the County has the power to insure its real and personal property by obtaining insurance from the commercial marketplace or through self-insurance; and

WHEREAS, after investigation, the County has determined the it cannot obtain insurance in the commercial market against a substantial decline in Tobacco Revenues on a cost-effective basis; and

WHEREAS, the County desires to self-insure against the risk of a substantial loss of a portion of Tobacco Revenues through the sale of its right to receive a portion of the Tobacco Revenues and the related transactions authorized in this resolution; and

WHEREAS, pursuant to Chapter 5 of Division 7 of Title 1 of the Government Code of the State (Commencing with Section 6500), as amended and supplemented from time to time (the "Law"), local agencies may, pursuant to a joint exercise of powers agreement, form a joint exercise of powers authority, which authority may exercise powers common to the constituent local agencies, and may exercise additional powers granted to it pursuant to the Law; and

WHEREAS, the County desires to become a member of The California County Tobacco Securitization Agency (the "Agency"), created pursuant to a joint exercise of powers agreement, dated as of November 15, 2000, as amended, by and among the Counties of Stanislaus, Merced, Kern, Sonoma, Marin, Fresno, Placer and Alameda (the "Agency Agreement") to exercise powers common to these counties and under the Law for the purpose of assisting these counties to insure and otherwise protect against the risk of a substantial decline in Tobacco Revenues and thus to assure a source of funds from which these counties can meet the social needs of their respective populations; and

WHEREAS, in furtherance of its objective to insure and otherwise protect against the risk of a substantial decline in Tobacco Revenues and to assure a source of funding for county programs, the County desires to form a non-profit public benefit corporation to be named the "Los Angeles County Securitization Corporation" (the "NPC"), and to sell to the NPC, pursuant to the terms of a sale agreement, by and between the County and the NPC (the "Sale Agreement"), all right, title and interest of the County in and to that portion of Tobacco Revenues identified in the Sale Agreement (the "Sold Tobacco Assets"); and

WHEREAS, the Law authorizes and empowers a joint exercise of powers authority to issue bonds for financing public capital improvements, working capital, liability or other insurance needs, and for any other purpose for which the joint exercise of powers agency could have executed and delivered certificates of participation in lease or installment sale agreements; and

WHEREAS, the Agency will issue a series of bonds pursuant to the Law (the "Tobacco Bonds" or the "Bonds"), the proceeds of which bonds will be loaned to the NPC pursuant to a secured loan agreement, by and between the NPC and the Agency (the "Loan Agreement") and the proceeds of such loan, net of costs of issuance of the Tobacco Bonds, estimated operating expenses for a year and the funding of necessary reserves, will be paid to the County by the NPC as part of the purchase price for the Sold Tobacco Assets, the remaining portion of the purchase price being evidenced by an ownership interest in a trust formed to own any excess of NPC revenue; and

WHEREAS, the Tobacco Bonds will be limited obligations of the Agency secured solely by loan repayments under the Loan Agreement (which in turn will be secured solely by the Sold Tobacco Assets), together with certain funds to be held under the indenture pursuant to which the Tobacco Bonds will be issued (the "Indenture"); and

WHEREAS, the County will apply the net proceeds from the sale of the Sold Tobacco Assets to finance and refinance certain construction costs related to the LAC+USC Medical Center Replacement Facility; and

WHEREAS, after public hearing, the County has determined that "significant public benefits" will accrue to the County, including but not limited to demonstrable savings in interest and other bond issuance and carrying costs as a result of the use of the Agency to issue the Bonds; and

WHEREAS, the County has determined that the Sale Agreement, the issuance of the Tobacco Bonds and the transactions related thereto, as herein approved, will reduce the amount and duration of risk associated with the County's de facto investment in the tobacco companies resulting from the MSA and the receipt of Tobacco Revenues thereunder; and

WHEREAS, all acts, conditions and things required by the Constitution and laws of the State of California to exist, to have happened and to have been performed precedent to and in connection with the consummation of the transactions authorized

hereby do exist, have happened and have been performed in regular and due time, form and manner as required by law, and the County is duly authorized and empowered, pursuant to each and every requirement of law, to consummate such transactions for the purpose, in the manner and upon the terms herein provided.

NOW, THEREFORE, BE IT RESOLVED as follows:

SECTION 1. Declaration of Board. The Board of Supervisors hereby specifically finds and declares that the actions authorized hereby constitute and are public affairs of the County and that the statements, findings and determinations of the County set forth in the preambles above and of the documents approved herein are true and correct.

SECTION 2. Approval of Amendment to Agency Agreement. The form of the Amendment to Agency Agreement, presented to this meeting and on file with the Executive Officer-Clerk of the Board of Supervisors is hereby approved. The Treasurer and Tax Collector of the County and his or her respective designees ("Authorized Officer"), is hereby authorized and directed, for and in the name and on behalf of the County, to execute, acknowledge and deliver the Amendment to Agency Agreement in substantially said form, with such changes therein as such executing officer may require or approve, such approval to be conclusively evidenced by the execution and delivery thereof. The Treasurer and Tax Collector and the Auditor-Controller are hereby designated to serve as the initial Agency Commissioners for the County.

SECTION 3. Formation of the NPC; Related Authorizations. The Articles of Incorporation and Bylaws of the NPC presented to this meeting and on file with the Executive Officer-Clerk of the Board of Supervisors are hereby approved, subject to such changes as the Authorized Officer may require or approve to carry out the purposes of this resolution (including such changes as may be required by any rating agency rating the Bonds), and the Authorized Officer is authorized to take such further actions which, upon the advice of County Counsel or Transaction Counsel, are necessary or appropriate (i) to create the NPC, including the appointment of one or more independent directors as required by Article VII of the Articles of Incorporation, (ii) to permit the NPC to carry out its purposes, including purchasing the Sold Tobacco Assets with the proceeds of a loan obtained from the Agency and transferring its "residual" ownership interest in the Sold Tobacco Assets (after payment of all obligations under the Loan Agreement) to a Delaware business trust formed by the NPC, and assigning its ownership interest in the business trust to the County in partial payment of the purchase price for the Sold Tobacco Assets. All prior actions taken by, or on behalf of, the County towards the establishment of the NPC are hereby ratified and approved.

SECTION 4. Sale Agreement; Parameters of Sale and Bond Issuance. The form of Sale Agreement presented to this meeting and on file with the Executive Officer-Clerk of the Board of Supervisors is hereby approved. The Authorized Officer is hereby authorized and directed, for and in the name and on behalf of the County, to execute, acknowledge and deliver the Sale Agreement in substantially said form, with such changes therein as such executing officer may require or approve (including such

changes as may be required by the rating agencies rating the Bonds), such approval to be conclusively evidenced by the execution and delivery thereof; provided that (i) the initial principal amount of the Bonds does not exceed $400 million; (ii) the net interest cost on all of the Bonds shall not be more than 8%; (iii) the final maturity of the Bonds shall not be later than June 1, 2055; and (iv)(a) the Bond issue shall be structured substantially as provided in the form of Indenture presented to this meeting and on file with the Executive Officer-Clerk of the Board of Supervisors, (b) the loan to the NPC shall be made substantially as provided in the form of Loan Agreement presented to this meeting and on file with the Executive Officer-Clerk of the Board and (c) the sale of the Bonds to the underwriter will be made upon substantially the terms provided in the form of Contract of Purchase, by and between the Agency and Citigroup Global Markets Inc., as senior managing underwriter, presented to this meeting and on file with the Executive Officer-Clerk of the Board. The execution and delivery of the Loan Agreement, the Indenture, the Contract of Purchase, the Offering Circular and related documents by the Authorized Officer shall evidence conclusively the satisfaction of the conditions set forth in clause (iv) above.

SECTION 5. Further Actions. The Authorized Officer is hereby authorized and directed to do any and all things and to execute and deliver any and all documents which he or she may deem necessary or advisable in order to consummate, carry out, give effect to and comply with the terms and intent of this resolution and the consummation of the transactions hereby including, but not limited to, (a) the preparation and delivery of irrevocable instructions to the State and to the escrow agent under the California Escrow Agreement in order to assure that all payments of the Sold Tobacco Assets are made directly to the Indenture Trustee for the benefit of the holders of the Bonds, (b) naming the NPC (including its directors, with the independent director being deemed a volunteer of the County, and officers) and the Agency (including the Agency, its Commissioners and officers) as additional insured on any and all current and future insurance coverage obtained by the County; (c) the execution of any certifications which are consistent, upon the advice of County Counsel and Transaction Counsel, with the requirements of the Sale Agreement, the Loan Agreement, the Indenture, the Indenture Supplements and any bond purchase contract filed with the Board in connection with the sale of the Bonds and (d) the refinancing of that portion of the County's outstanding commercial paper issued for construction costs related to the LAC+USC Medical Center Replacement Facility. Any actions heretofore taken in furtherance of any of the transactions authorized herein are hereby ratified, confirmed and approved.

SECTION 6. Effective Date. This resolution shall take effect immediately upon its passage.

The foregoing resolution was, on the ____ day of _____, 2006, adopted by the Board of Supervisors of the County of Los Angeles and ex-officio the governing body of all other special assessment and taxing districts, agencies and authorities for which said Board so acts.

VIOLET VARONA-LUKENS,
Executive Officer-Clerk of the Board of
Supervisors of the County of Los Angeles

By: _____
Deputy

APPROVED AS TO FORM:

RAYMOND G. FORTNER, JR.,
County Counsel

By: _____
Principal Deputy County Counsel

THIRD AMENDMENT TO JOINT EXERCISE OF POWERS AGREEMENT

OF

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

BY AND AMONG

THE COUNTY OF STANISLAUS, THE COUNTY OF MERCED,

THE COUNTY OF SONOMA, THE COUNTY OF KERN, THE COUNTY OF MARIN, THE COUNTY OF PLACER, THE COUNTY OF FRESNO, THE COUNTY OF ALAMEDA AND THE COUNTY OF LOS ANGELES

DATED AS OF _____, 2005

THIS THIRD AMENDMENT TO JOINT EXERCISE OF POWERS AGREEMENT, dated as of _____, 2005 (the "Third Amendment"), is made and entered into by and among the COUNTY OF STANISLAUS, a body corporate and politic and a political subdivision in the State of California (the "State"), the COUNTY OF MERCED, a body corporate and politic and a political subdivision of the State, the COUNTY OF SONOMA, a body corporate and politic and a political subdivision of the State, the COUNTY OF KERN, a body corporate and politic and a political subdivision of the State, the COUNTY OF MARIN, a body corporate and politic and a political subdivision of the State, the COUNTY OF PLACER, a body corporate and politic and a political subdivision of the State, the COUNTY OF FRESNO, a body corporate and politic and a political subdivision of the State, the COUNTY OF ALAMEDA, a body corporate and politic and a political subdivision of the State and the COUNTY OF LOS ANGELES, a body corporate and politic and a political subdivision of the State (each of the County of Stanislaus, the County of Merced, the County of Sonoma, the County of Kern, the County of Marin, the County of Placer, the County of Fresno, the County of Alameda, and the County of Los Angeles together with any other county executing this Agreement, except those counties that have withdrawn in accordance with Section 11 hereof, being herein referred to as a "Member")

W I T N E S S E T H:

WHEREAS, the County of Stanislaus, the County of Merced, the County of Sonoma, and the County of Kern have heretofore entered into an agreement entitled "Joint Exercise of Powers Agreement," dated November 15, 2000, (the "Original Agreement"), creating The California County Tobacco Securitization Agency (the "Agency");

WHEREAS, the County of Marin, the County of Placer, and the County of Fresno have heretofore entered into an agreement entitled "First Amendment to Joint Exercise of Powers Agreement," dated May 1, 2002, as amended (the "First Amendment");

WHEREAS, the County of Alameda has heretofore entered into an agreement entitled, Second Amendment to Joint Exercise of Powers Agreement, dated August 15, 2002, as amended (the "Second Amendment"). The Original Agreement, collectively with the First Amendment, the Second Amendment and the Third Amendment are hereinafter referred to as the "Agreement");

WHEREAS, the County of Los Angeles desires to become a member of the Agency, and has filed with the Agency Secretary an executed counterpart of this Third Amendment, together with a certified copy of the resolution of its Board of Supervisors approving this Third Amendment and the execution and delivery hereof;

WHEREAS, the Board of Supervisors of each of Stanislaus, Merced, Sonoma, Kern, Marin, Placer, Fresno and Alameda have approved the admission of the County of Los Angeles to the Agency;

NOW, THEREFORE, the Agreement is amended as follows:

SECTION 1. Admission of Additional Members.

The County of Los Angeles is admitted as a Member to the Agency, and by execution of this Third Amendment, such County agrees to be bound by the terms of the Agreement as if it were an original party thereto.

SECTION 2. Filing of Notice of Amendment to Agreement.

Within 30 days after the effective date hereof, the Secretary shall cause a notice of this Third Amendment to be prepared and filed with the office of the Secretary of State in the manner set forth in Section 6503.5 of the California Government Code.

SECTION 3. Effectiveness; Counterparts.

This Third Amendment shall become effective upon execution hereof. This Third Amendment may be executed in counterpart as provided in Section 17 of the Agreement.

IN WITNESS WHEREOF, the parties hereto have caused this Third Amendment to the Agreement to be executed and attested by their duly authorized proper officers, and their official seals to be hereto affixed, as of the day and year first above written.

COUNTY OF STANISLAUS, CALIFORNIA

By _____
Chief Executive Officer

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF MERCED, CALIFORNIA

By _____
County Executive Officer

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF SONOMA, CALIFORNIA

By _____
County Administrator

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF KERN, CALIFORNIA

By _____
County Administrative Officer

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF MARIN, CALIFORNIA

By _____
President, Board of Supervisors

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF PLACER, CALIFORNIA

By _____
Chairman, Board of Supervisors

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF FRESNO, CALIFORNIA

By _____
County Administrative Officer

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF ALAMEDA, CALIFORNIA

By _____
County Administrator

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

COUNTY OF LOS ANGELES, CALIFORNIA

By _____
Chairman, Board of Supervisors

[SEAL] Attest:

_____
Clerk of the Board of Supervisors

Approved as to form:

_____
County Counsel

DIRECTION AND DESIGNATION BY AUTHORIZED OFFICER
OF THE COUNTY OF LOS ANGELES REGARDING THE
LOS ANGELES COUNTY SECURITIZATION CORPORATION

I, Mark J. Saladino, hereby certify that I am the duly authorized Treasurer and Tax Collector (the "Authorized Officer") of the County of Los Angeles (the "County"), and as such I am authorized to execute this Direction and Designation on behalf of the County.

Pursuant to Section 3 of the Resolution of the Board of Supervisors of the County of Los Angeles Approving Membership in the California County Tobacco Securitization Agency, the Formation of the Los Angeles County Securitization Corporation, the Execution of a Sale Agreement and Other Related Matters adopted by the Board of Supervisors of the County on [January 17, 2006], I hereby (i) direct that the Articles of Incorporation in the form attached hereto as Exhibit A be filed with the California Secretary of State, (ii) approve the Bylaws in the form attached hereto as Exhibit B to regulate the activities of the Los Angeles County Securitization Corporation (the "Corporation"), subject to affirmation by the Board of Directors of the Corporation at their first meeting, and (iii) designate the following named individuals as the Directors of the Corporation:

Mark J. Saladino, County Director
J. Tyler McCauley, County Director
[_____], Independent Director

Dated: [_____], 2006

COUNTY OF LOS ANGELES

By: _____
Mark J. Saladino
Treasurer and Tax Collector
Authorized Officer

ARTICLES OF INCORPORATION
OF
LOS ANGELES COUNTY SECURITIZATION CORPORATION

ARTICLE I.

The name of the corporation shall be Los Angeles County Securitization Corporation (hereinafter referred to as the "Corporation").

ARTICLE II.

This Corporation is a nonprofit public benefit corporation and is not organized for the private gain of any person. It is organized under the Nonprofit Public Benefit Corporation Law (commencing at Section 5110 of the California Corporations Code) for charitable and public purposes.

The purpose for which the Corporation is to be formed and operated, exclusively for charitable purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, is to lessen the burdens of government by engaging solely in the following activities:

(a) To acquire from the County of Los Angeles (the "County") all or any part of the rights of the County under and pursuant to the Memorandum of Understanding (the "MOU") entered into on August 5, 1998, among the State of California (the "State"), various cities and counties in the State and certain other parties, as augmented by the Agreement Regarding Interpretation of Memorandum of Understanding, as amended (the "ARIMOU"), entered into on April 12, 2000, by the State, various cities in the State, and all counties in the State, and as implemented by the escrow agreement, dated as of April 12, 2000, between the State and Citibank, N.A., as escrow agent, including without limitation, the rights of the County to receive all or any part of the moneys due to it thereunder (collectively, the "Tobacco Assets");

(b) To purchase, acquire, own, hold, sell, assign, pledge, manage and otherwise deal with the Tobacco Assets, any collateral securing the Tobacco Assets and any proceeds or further rights associated with the Tobacco Assets;

(c) To borrow money (each a "borrowing"), secured or collateralized by the Tobacco Assets (or any part thereof), the proceeds of which borrowing are used to purchase Tobacco Assets, to fund reserves for the borrowing and to pay costs incidental to such borrowing;

(d) To engage the services of one or more consultants, attorneys, financial advisors and other persons whose services shall be necessary or desirable in connection with the acquisition of the Tobacco Assets and the borrowing referred to above;

(e) To act as depositor, settlor or transferor of a trust (the "Trust") and to deposit, transfer or convey to such Trust a residual certificate issued by the Corporation, subordinate to all borrowings of the Corporation, and to transfer, sell, and assign to the County the Corporation's beneficial ownership of the Trust; and

(f) In general, to perform any and all acts and things and exercise any and all powers that may now or hereafter be lawful for the Corporation to do or exercise under and pursuant to the laws of the State for the purpose of accomplishing any of the foregoing purposes of the Corporation.

The acquisition referred to in subparagraph (a) above and the payment of moneys to the County in consideration therefor will achieve the lawful public purpose of meeting the County's social programs and insurance and risk management needs and otherwise lessen the burdens of government, the carrying out of such purposes and the exercise of the powers conferred on the Corporation, being the performance of an essential governmental function, it being understood that the Corporation is necessary to the continued meeting of the County's social programs and insurance and risk management needs.

ARTICLE III.

This Corporation is organized under the direction of a group of public-spirited citizens for the purposes described in Article II. This Corporation shall never engage in any business or activity other than that necessary or convenient for or incidental to the carrying out of the purpose set forth in Article II hereof. Notwithstanding any other provision of these Articles of Incorporation, the Bylaws and any provision of law, so long as any borrowing remains unpaid, the Corporation shall not do any of the following:

(a) engage in any business or activity other than as set forth in Article II hereof;

(b) without the affirmative vote of all of the members of the Board of Directors of the Corporation at which a Full Quorum is present, (i) dissolve or liquidate, in whole or in part, or institute proceedings to be adjudicated bankrupt or insolvent; (ii) consent to the institution of bankruptcy or insolvency proceedings against it; (iii) file or join in any filing of a petition with respect to the Corporation or its assets seeking or consenting to reorganization or relief under any applicable federal or state law relating to bankruptcy or insolvency; (iv) consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator or other similar official of the Corporation or a substantial part of its property; (v) make a general assignment for the benefit of creditors; (vi) admit in writing its inability to pay its debts generally as they become due; or, (vii) take any corporate action in furtherance of the actions set forth in clauses (i) through (vi) of this paragraph;

(c) without the affirmative vote of all of the members of the Board of Directors of the Corporation at which a Full Quorum is present, (i) merge or consolidate with any other corporation, company or entity or, except to the extent contemplated by

Article II hereof, sell all or substantially all of its assets or acquire all or substantially all of the assets or capital stock or other ownership interest of any other corporation, company or entity or (ii) authorize any amendment to these Articles of Incorporation or the Bylaws of the Corporation; or

(d) incur or assume any indebtedness for borrowed money other than as set forth in Article II(c) hereof or except as expressly permitted in any legal document pursuant to which any borrowing authorized under Article II(c) is undertaken.

When voting on whether the Corporation will take any action described in paragraph (b) or (c) above, each Director shall owe a fiduciary duty to the Corporation and also to the creditors of the Corporation, as authorized or required by applicable law.

To the extent permitted by law, each Independent Director shall consider the interests of the Corporation's creditors when voting on any matter described in paragraph (b) or (c) above.

For the purpose of this Article, a Full Quorum means all three Directors (including the Independent Director, as defined in Article VII below).

ARTICLE IV.

The property of the Corporation is irrevocably dedicated to charitable purposes. No part of the income or earnings of the Corporation shall inure to the benefit or profit of, nor shall any distribution of its property or assets be made to, any director or officer of the Corporation, or private person, corporate or individual, or to any other private interest, except that the Corporation may repay loans made to it and may repay contributions (other than dues) made to it to the extent that any such contribution may not be allowable as a deduction in computing taxable income under the Internal Revenue Code of 1986, as amended.

The Corporation shall not attempt to influence legislation by propaganda or otherwise, or to participate in or intervene, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office.

The Corporation shall not engage in any activities not permitted to be carried on by an organization exempt from federal income taxation pursuant to Section 501(c)(3) of the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

ARTICLE V.

In the event of the dissolution of the Corporation or the winding up of its affairs, the Board of Directors shall, after paying or making provision for the payment of all of the liabilities of the Corporation, and after compliance with Chapters 15, 16 and 17 of the California Nonprofit Public Benefit Corporation Law, distribute all of the remaining assets and property of the Corporation to the County.

ARTICLE VI.

The principal office of the Corporation shall be located in the County and such office shall be functionally separate from the County (although such office may be in a facility leased from the County on arms'-length terms). As used below, "Person" means any individual or entity. The Corporation at all times shall:

(a) maintain separate accounting records and other corporate records from those of the County and any other Person;

(b) not divert the Corporation's funds to any other person or for other than the use of the Corporation and not commingle any of the Corporation's assets with those of the County or any other Person;

(c) pay any employee, consultant or actual agent of the Corporation, or any other operating expense incurred by the Corporation, from the assets of the Corporation and not from the assets of the County;

(d) maintain its own deposit account or accounts, separate from those of the County and any other Person, with commercial banking institutions;

(e) to the extent that the Corporation contracts or does business with vendors or service providers where the goods and services provided are partially for the benefit of any other Person, the costs incurred in so doing shall be fairly allocated to or among the Corporation and such Persons for whose benefit the goods and services are provided, and the Corporation and each such Person shall bear its fair share of such costs;

(f) conduct its business in its own name and conduct all material transactions between the Corporation and the County or any joint powers agency of which the County is a member only on an arm's-length basis;

(g) observe all necessary, appropriate and customary corporate formalities, including, but not limited to, holding all regular and special members' and directors' meetings appropriate to authorize all corporate action, keeping separate and accurate minutes of such meetings, passing all resolutions or consents necessary to authorize actions taken or to be taken, and maintaining accurate and separate books, records and accounts, including, but not limited to, inter-company transaction accounts. Regular members' and directors' meetings shall be held at least annually;

(h) ensure that decisions with respect to its business and daily operations shall be independently made by the Corporation (although the officer making any particular decision also may be an employee, officer or director of the County);

(i) act solely in its own corporate name and through its own authorized officers and agents, and use its own stationery, invoices and checks, and to correct any known misunderstanding regarding its separate identity;

(j) ensure that the County does not supply funds to, or guarantee debts of, the Corporation;

(k) other than organizational expenses and as expressly provided herein, pay all expenses, indebtedness and other obligations incurred by it;

(l) not enter into any guaranty, or otherwise become liable, with respect to any obligation of the County or any other Person;

(m) cause any financial reports required of the Corporation to be prepared in accordance with generally accepted accounting principles and be audited annually and be issued separately from, although they may be consolidated with, any reports prepared for the County; and

(n) ensure that at all times it is adequately capitalized to engage in the transactions contemplated herein.

ARTICLE VII.

The Corporation shall be managed by a Board of Directors consisting of three Directors. The Treasurer and Tax Collector and the Auditor-Controller of the County, each serving in his or her *ex officio* capacity, shall be Directors of the Corporation (each a "County Director"). The third Director of the Corporation shall be designated by at least one County Director and shall be the Independent Director, who is not, and has not been for a period of five years prior to his or her appointment as Independent Director (i) a creditor (other than being a creditor of the County by virtue of being a taxpayer or resident of the County), a customer, supplier, manager, contractor or advisor of the County; (ii) an official, member, stockholder, director, officer, employee, agent or affiliate of the County (other than the Corporation); (iii) an official, member, stockholder, director, other employee, agent or affiliate of the County or any Person described in clause (i), or a member of the County Board of Supervisors; (iv) a person related to any person referred to in clause (i) or (ii); or (iv) a trustee, conservator or receiver for the County. In the event of the death, incapacity, resignation or removal of the Independent Director, the remainder of the Directors shall promptly appoint a replacement Independent Director. The Board of Directors shall not vote on any matter requiring the vote of the Independent Director under these Articles of Incorporation unless and until an Independent Director is serving on the Board and participating in such vote. The term "Director" as used herein shall include such persons so designated. The Independent Director shall serve for a period of two years following his or her designation as Independent Director. Thereafter, the Independent Director shall be designated biennially by at least one County Director; provided, however, if at least one County Director does not expressly designate a new Independent Director within such period, the incumbent Independent Director shall be deemed re-designated as Independent Director for the next succeeding biennial period as provided in the Bylaws.

The Directors of the Corporation shall have no liability for dues or assessments. There shall be no members of the Corporation.

The Corporation shall indemnify, each Director and each officer (or employee of the Corporation), to the full extent to which indemnification is permitted under the California Nonprofit Public Benefit Corporation Law (as provided under section 5238) and authorized by the Bylaws and by the Board of Directors. Such indemnification shall be (i) subordinate to the obligations of the Corporation under the documentation related to any Securitization (defined below) of Tobacco Assets involving Rated Obligations (defined below) and (ii) payable only from amounts permitted to be distributed to the Corporation pursuant to the terms of such documentation or other amounts not required to be paid to the issuer of the Rated Obligations or holders of the Rated Obligations. "Securitization" means a sale, lease, secured loan, or other financial transaction involving the Tobacco Assets structured with the intent that such assets be isolated from the risk of bankruptcy of the County. "Rated Obligation" means an obligation of the Corporation, any joint powers agency of which the Corporation is a member, or any other issuer in connection with a Securitization for which any nationally recognized statistical rating agency has issued a rating (including, with respect to any obligations for which there is a bond insurance policy issued, any shadow rating issued for such bonds that assumes the absence of the related bond insurance policy).

For so long as any Rated Obligation remains outstanding, no amendment to Article II, Article III, Article VI or Article VII of those Articles of Incorporation shall be effective unless the Corporation shall have obtained written evidence from each nationally recognized rating agency then rating the Rated Obligations that such amendment will not, in and of itself, result in a downgrade or withdrawal of the ratings then in effect with respect to such Rated Obligations.

The name and address in this State of the Corporation's initial agent for service of process is:

Executive Officer-Clerk of the Board of Supervisors
County of Los Angeles
500 West Temple Street, Room 383
Los Angeles, California 90012

IN WITNESS WHEREOF, for the purposes of forming the corporation under the laws of the State of California, the undersigned has executed these Articles of Incorporation this [__] day of [_____], 2006.

_____
Cammy DuPont
Incorporator

BYLAWS

OF THE

LOS ANGELES COUNTY SECURITIZATION CORPORATION

ARTICLE I.

Name, Organization, Purpose and Principal Office

Section 1.01. Name. The name of this corporation is the Los Angeles County Securitization Corporation (hereinafter referred to as the "Corporation").

Section 1.02. Organization, Purpose and Use of Funds. The Corporation is a nonprofit public benefit corporation organized under the Nonprofit Public Benefit Corporation Law of the State of California, at Title 1, Division 2, Parts 1 and 2 of the California Corporations Code. The purpose and activities of the Corporation shall be limited to the purpose and activities described in its Articles of Incorporation. No gains, profits or dividends shall be distributed to any of the Directors or officers of the Corporation; and no part of the net earnings, funds or assets of the Corporation shall inure to the benefit of any Director or any other person, firm or corporation excepting only the County of Los Angeles (the "County").

Section 1.03. Principal Office. The principal office of the Corporation is hereby fixed and located at the offices of the County. The Board of Directors is hereby granted full power and authority to change said principal office from one location to another. Any such change shall be noted by the Secretary opposite this section, but shall not be considered an amendment to these Bylaws.

ARTICLE II.

No Members

Section 2.01. No Members. Pursuant to Section 5310 of the Nonprofit Public Benefit Corporation Law, the bylaws of a nonprofit corporation may provide that the corporation shall have no members. The Corporation shall have no members.

ARTICLE III.

Directors

Section 3.01. Powers. Subject to limitations of the Articles of Incorporation or the Bylaws, and of the California Nonprofit Public Benefit Corporation Law, and subject to the duties of Directors as prescribed by the Bylaws, all powers of the Corporation shall be exercised by or under the authority of, and the business and affairs of the Corporation shall be controlled by, the Board of Directors. No Director shall be

responsible for any error in judgment or for anything that he or she may do or refrain from doing in good faith.

Section 3.02. Number and Election; Alternate Directors. The Corporation shall be managed by a Board of Directors consisting of three Directors. The Treasurer and Tax Collector and the Auditor-Controller of the County, each serving in his or her *ex officio* capacity shall be a Director (each a "County Director"). One Director shall be designated by at least one County Director and shall be the Independent Director, who is not, and has not been for a period of five years prior to his or her appointment as Independent Director (i) a creditor (other than being a creditor of the County, by virtue of being a taxpayer or resident of the County), a customer, supplier, manager, contractor or advisor of the County; (ii) an official, member, stockholder, director, officer, employee, agent or affiliate of the County (other than the Corporation), or any Person described in clause (i), or a member of the County Board of Supervisors; (iii) a person related to any person referred to in clause (i) or (ii); or (iv) a trustee, conservator or receiver for the County. In the event of the death, incapacity, resignation or removal of the Independent Director, at least one County Director promptly shall appoint a replacement Independent Director A County Director may, by written instrument filed with the Corporation, designate one or more alternates to perform in his or her absence. The term "County Director" as used herein shall include such persons so designated.

Section 3.03. Term of Office. Each County Director shall serve so long as such Director continues to serve in his or her official capacity or, if earlier, until the appointment of such Director's successor. The Independent Director shall serve for a period of two years following his or her designation as Independent Director. Thereafter, the Independent Director shall be designated biennially by the at least one County Director; provided, however, if at least one County Director does not expressly designate a new Independent Director within such period, the incumbent Independent Director shall be deemed re-designated as Independent Director for the next succeeding biennial period.

Section 3.04. Vacancies. Subject to the provisions of Section 5226 of the California Nonprofit Public Benefit Corporation Law, any Director may resign effective upon giving written notice to the President, the Secretary or the Board of Directors, unless the notice specifies a later time for the effectiveness of such resignation. If the resignation is effective at a future time, a successor may be selected before such time, to take office when the resignation becomes effective.

A vacancy or vacancies in the Board of Directors shall be deemed to exist in case of the death, resignation, or removal of any Director, or if the authorized number of Directors is increased.

Vacancies in the Board of Directors shall be filled in the same manner as the Director whose office is vacant was selected. Each Director so selected shall hold office until the expiration of the term of the replaced Director and until a successor has been selected by the County or a County Director and has accepted the office.

Section 3.05. Organization and Annual Meetings. The Board of Directors shall hold an annual meeting for the purpose of organization, selection of officers, and the transaction of other business. Annual meetings of the Board of Directors shall be held without call or notice in January of each year at the County of Los Angeles, 437 Kenneth Hahn Hall of Administration, 500 West Temple Street, Los Angeles, California 90012.

Section 3.06. Regular Meetings. The Board of Directors by resolution may provide for the holding of regular meetings and may fix the time and place of holding such meetings. Notice of regular meetings need not be given.

Section 3.07. Special Meetings; Notice Waiver. A special meeting of the Board of Directors shall be held whenever called by the President or by a majority of the Directors. Written notice of each such meeting shall be delivered personally or by telegram to each Director at least 48 hours before the time of such meeting or shall be sent to each Director by mail, charges prepaid, at least four days before the time of such meeting as specified in the notice. The call and notice shall be posted at least 24 hours prior to the special meeting in a location that is freely accessible to members of the public. The call and notice shall signify the time and place of the special meeting and the business to be transacted. No other business shall be considered at such meeting by the Board of Directors. Notice of adjournment of a meeting need not be given to absent Directors if the time and place are fixed at the meeting adjourned. The transactions of any meeting of the Board of Directors, however called and noticed and wherever held, shall be as valid as though had at a meeting held after regular call and notice, if a quorum is present; provided, however, that before the meeting, each of the Directors not present signs a written waiver of notice and files said written waiver of notice with the Secretary; and provided further, that notice be given to each local newspaper of general circulation, radio or television station requesting notice in writing pursuant to California Government Code Section 54956. All waivers shall be filed with the corporate records and be made a part of the minutes of the meeting.

Section 3.08. Adjourned Meetings; Notice of Adjournment. The Board of Directors may adjourn any regular, adjourned regular, special or adjourned special meeting to a time and place specified in the order of adjournment. Less than a quorum may so adjourn from time to time. A copy of the order or notice of adjournment shall be conspicuously posted on or near the door of the place where the regular, adjourned regular, special or adjourned special meeting was held within 24 hours after the time of the adjournment. When a regular or adjourned regular meeting is adjourned as provided in this section, the resulting adjourned regular meeting is a regular meeting for all purposes.

Section 3.09. Full Quorum. All of the authorized number of Directors shall be necessary to constitute a Full Quorum for the transaction of business. Every act or decision done or made by all of the Directors present at a meeting duly held at which a Full Quorum is present shall be regarded as an act of the Board of Directors.

Section 3.10. Fees and Compensation. Directors, other than the Independent Director, shall receive no compensation or expenses for their services as Directors.

Section 3.11. Ralph M. Brown Act. Notwithstanding any of the provisions of these Bylaws to the contrary, all meetings of Directors shall be subject to the Ralph M. Brown Act, (Chapter 9 of Part 1 of Division 2 of Title 5 of the Government Code of the State of California (Sections 54950 to 54962) or any successor legislation hereinafter enacted (the "Brown Act")).

Section 3.12. Conduct of Meetings. The President or, in the President's absence, the Vice President, or a Chairman chosen by a majority of the Directors present, shall preside.

Section 3.13. Participation in Meetings by Conference Telephone. Directors may participate in a meeting through use of conference telephone, electronic video screen communication, or other communication equipment, so long as all members participating in such meeting can hear one another.

ARTICLE IV.

Officers

Section 4.01. Officers. The officers of the Corporation shall be a President, a Secretary and Treasurer. The Corporation may also have, at the discretion of the Board of Directors, one or more Vice Presidents, one or more Assistant Secretaries, and such other officers as may be appointed by the Board of Directors. One person may hold two or more offices, except that the offices of President and Secretary or Treasurer may not be combined.

Section 4.02. Designation and Election. The President of the Corporation shall be the Treasurer and Tax Collector of the County; the Treasurer of the Corporation shall be the Auditor-Controller of the County; and, the Secretary of the Corporation shall be the Executive Officer-Clerk of the Board of Supervisors of the County. All officers and each shall hold office until the officer shall resign, be removed, or otherwise become disqualified to serve, or the officer's successor shall be elected or appointed and qualified.

Section 4.03. Removal and Resignation. Any officer may resign, or may be removed, with or without cause, by the Board of Directors at any time; provided that if an *ex officio* officer of the County is removed, these Bylaws may be amended simultaneously therewith to assure an orderly succession. Vacancies caused by death, resignation or removal of any officer may be filled by appointment by the Board of Directors, or by the President until such appointment by the Board of Directors.

Section 4.04. President. The President shall be the executive officer of the Corporation and, subject to the control of the Board of Directors, shall have general supervision, direction and control of the affairs of the Corporation. The President shall preside at all meetings of members and meetings of the Board of Directors.

Section 4.05. Vice President. In the absence or disability of the President, the Vice President shall perform all the duties of the President, and when so acting shall have all the powers of, and be subject to all the restrictions upon, the President. The Vice President shall have such other powers and perform such other duties as from time to time may be prescribed for the Vice President by the Board of Directors or by the Bylaws.

Section 4.06. Secretary. The Secretary shall keep at the principal office of the Corporation a book of minutes of all meetings of Directors, with the time and place of holding, how called or authorized, the notice thereof given, and the names of those present at such meetings.

Section 4.07. Treasurer. The Treasurer shall be the chief financial officer and shall keep and maintain adequate and correct books of account showing the receipts and disbursements of the Corporation, and an account of its cash and other assets, if any. Such books of account shall at all reasonable times be open to inspection by any Director.

The Treasurer shall deposit all moneys of the Corporation with such depositories as are designated by the Board of Directors, and shall disburse the funds of the Corporation as may be ordered by the Board of Directors, and shall render to the President or the Board of Directors, upon request, statements of the financial condition of the Corporation.

Section 4.08. Subordinate Officers. Subordinate officers shall perform such duties as shall be prescribed from time to time by the Board of Directors or the President.

ARTICLE V.

Financial Records

Section 5.01. Audited Financial Statements; Annual Report. The Corporation shall cause to be prepared audited annual financial statements in accordance with generally accepted accounting principles. The annual report referred to in Section 6321 of the Nonprofit Public Benefit Corporation Law of the State of California is expressly dispensed with.

Section 5.02. Fiscal Year. The fiscal year of the Corporation shall begin July 1 and end June 30 of each year, except for the first fiscal year which shall run from the date of incorporation to June 30, 2006.

ARTICLE VI.

Amendments and Inspection of Bylaws

Section 6.01. Power of Directors. New Bylaws may be adopted or these Bylaws may be amended or repealed by the vote of the Board of Directors, provided,

however, that any provision of Article III, this Section 6.01, Section 7.01 or Section 7.03 of these Bylaws may be amended only with the approval of all of the directors then in office (which shall include the approval of the director who is an Independent Director). No amendment to these Bylaws shall be effective until approved by the Board of Directors.

Section 6.02. Inspection of Bylaws. The Corporation shall keep in its principal office the original or a copy of these Bylaws, as amended or otherwise altered to date, certified by the Secretary, which shall be open to inspection by the members and the Directors at all reasonable times during office hours.

ARTICLE VII.

Indemnification

Section 7.01. Right of Indemnity. To the fullest extent permitted by law, the Corporation shall indemnify its directors, officers, employees, and other persons described in Section 5238(a) of the California Corporations Code, including persons formerly occupying any such position, against all expenses, judgments, fines, costs, settlements and other amounts actually and reasonably incurred by them in connection with any "proceeding," as that term is used in that Section, and including an action by or in the right of the Corporation, by reason of the fact that the person is or was a person described in that Section. "Expenses," as used in this bylaw, shall have the same meaning as in Section 5238(a) of the California Corporations Code. Such indemnification shall be (i) subordinate to the obligations of the Corporation under the documentation related to any Securitization of Tobacco Assets involving Rated Obligations and (ii)] payable only from amounts permitted to be distributed to the Corporation pursuant to the terms of such documentation [or other amounts not required to be paid to the issuer of the Rated Obligations or holders of the Rated Obligations. "Securitization" means a sale, lease, secured loan, or other financial transaction involving the Tobacco Assets structured with the intent that such assets be isolated from the risk of bankruptcy of the County. "Rated Obligation" means an obligation of the Corporation, any joint powers agency of which the Corporation is a member, or any other issuer in connection with a Securitization for which any nationally recognized statistical rating agency has issued a rating (including, with respect to any obligations for which there is a bond insurance policy issued, any shadow rating issued for such bonds that assumes the absence of the related bond insurance policy).

Section 7.02. Approval of Indemnity. On written request to the Board of Directors by any person seeking indemnification under Section 5238(b) or Section 5238(c) of the California Corporations Code, the Board of Directors shall promptly determine under Section 5238(e) of the California Corporations Code whether the applicable standard of conduct set forth in Section 5238(b) or Section 5238(c) has been met and, if so, the Board of Directors shall authorize indemnification. If the Board of Directors cannot authorize indemnification because the number of Directors who are parties to the proceeding with respect to which indemnification is sought prevents the formation of a quorum of Directors who are not parties to that proceeding, the court in

which such proceeding is or was pending upon application made by the Corporation or the agent or the attorney or other person rendering services in connection with the defense, whether or not such application by the agent, attorney, or other person is opposed by the Corporation, shall determine under Section 5238(e) of the California Corporations Code whether the applicable standard of conduct set forth in Section 5238(b) or Section 5238(c) has been met and, if so, the court shall authorize indemnification.

Section 7.03. Advancement of Expenses. To the fullest extent permitted by law and by the Corporation's Articles of Incorporation, and except as otherwise determined by the Board of Directors in a specific instance, expenses incurred by a person seeking indemnification under Sections 7.01 and 7.02 hereof in defending any proceeding covered by those sections shall be advanced by the Corporation before final disposition of the proceeding, on receipt by the Corporation of an undertaking by or on behalf of that person that the advance will be repaid unless it is ultimately determined that the person is entitled to be indemnified by the Corporation for those expenses. Such indemnification shall be (i) subordinate to the obligations of the Corporation under the documentation related to any Securitization of Tobacco Assets involving Rated Obligations and (ii) payable only from amounts permitted to be distributed to the Corporation pursuant to the terms of such documentation or other amounts not required to be paid to the issuer of the Rated Obligations or holders of the Rated Obligations.

Section 7.04. Insurance. The Corporation shall have the right to purchase and maintain insurance to the full extent permitted by law on behalf of its officers, directors, employees, and other agents, against any liability asserted or incurred by any officer, director, employee, or agent in such capacity or arising out of the officer's, director's, employee's, or agent's status as such.

ARTICLE VIII.

Miscellaneous

Section 8.01. Execution of Documents. The Board of Directors may authorize any officer or officers as agent or agents to enter into any contract or execute any instrument in the name of and on behalf of the Corporation, and such authority may be general or confined to specific instances; and unless so authorized by the Board of Directors, no officer, agent or other person shall have any power or authority to bind the Corporation by any contract or engagement or to pledge its credit or to render it liable for any purpose or to any amount.

Section 8.02. Construction and Definitions. Unless the context otherwise requires, the general provisions, rules of construction and definitions contained in the Nonprofit Public Benefit Corporation Law of the State of California shall govern the construction of these Bylaws. If any section, subsection, sentence, clause or phrase of these Bylaws, or the application thereof, is contrary to the Nonprofit Public Benefit Corporation Law of the State of California, the provisions of that law shall prevail. Without limiting the generality of the foregoing, the masculine gender includes the

feminine and neuter, the singular number includes the plural and the plural number includes the singular, and the term “person” includes a corporation as well as a natural person.

ARTICLE IX.

Certificate of Secretary

I, the undersigned, certify that I am presently the appointed and acting Secretary of Los Angeles County Securitization Corporation, a California nonprofit corporation, and the above bylaws, consisting of eight (8) pages, are the Bylaws of this Corporation as adopted at a meeting of the Board of Directors held on [_____], 2006.

DATED: [_____], 2006.

_____
Secretary

COUNTY OF LOS ANGELES,
as Seller

and the

LOS ANGELES COUNTY SECURITIZATION CORPORATION,
as Purchaser

SALE AGREEMENT

Dated as of [Date]

SALE AGREEMENT

THIS SALE AGREEMENT, dated as of [Date] (this "Agreement"), is entered into by and between:

(1) COUNTY OF LOS ANGELES, a political subdivision of the State of California (the "Seller"); and the

(2) LOS ANGELES COUNTY SECURITIZATION CORPORATION, a California nonprofit public benefit corporation (the "Purchaser").

RECITALS

A. The Seller is the owner of the County Tobacco Assets.

B. The payments under the County Tobacco Assets are subject to numerous adjustments pursuant to the terms of the MSA, including the Volume Adjustment, the Inflation Adjustment and the NPM Adjustment (each as defined in the MSA) and are further subject to delay or reduction in the event of the bankruptcy of a PM.

C. The Seller desires to reduce the amount and the duration of its payment risks associated with the County Tobacco Assets and its credit risks associated with the PMs, thereby enhancing the relationship between its risk and return with respect to the payments it is entitled to receive pursuant to the County Tobacco Assets.

D. The Seller desires effectively to insure itself against the risk of a substantial decline in the payments it is entitled to receive pursuant to the MSA and to provide a source of funds from which to meet the social needs of its population.

E. The Purchaser was formed to assist the Seller in financing the meeting of the Seller's social program and self-insurance needs and in furtherance thereof desires to purchase, in a single installment, the Sold County Tobacco Assets.

F. The Seller is willing to sell, and the Purchaser is willing to purchase, the Sold County Tobacco Assets upon the terms specified in this Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the above Recitals and the mutual covenants herein contained, the parties hereto hereby agree as follows:

1. Definitions.

(a) Whenever used in this Agreement, the following words and phrases, unless the context otherwise requires, shall have the following meaning:

"County Tobacco Assets" shall mean, collectively and severally, all right, title and interest of the Seller in, to and under the MOU, the ARIMOU, the MSA and the Consent Decree including the rights of the Seller to be paid the money due to it under the MOU, the ARIMOU, the MSA and the Consent Decree from and after [Date].

"Ownership Interest" shall have the meaning set forth in the Trust Agreement.

"Residual Trust" shall mean the trust established by the Purchaser pursuant to the Trust Agreement and which, as a result of its ownership of the Residual Certificate (as defined in the Trust Agreement), is entitled to receive the revenues of the Purchaser that are in excess of the Purchaser's expenses, debt service and contractual obligations pursuant to the Loan Agreement.

"Sold County Tobacco Assets" shall have the meaning set forth in Section 2 hereof.

"Trust Agreement" means the Declaration and Agreement of Trust relating to the Residual Trust by and between the Trustee and the Purchaser, dated as of [Date], as such agreement may be amended and restated pursuant to the provisions thereof.

"Trust Officer" means, in the case of the Trustee, any officer in the Corporate Trust Administration Department of the Trustee with direct responsibility for the administration of the Trust Agreement on behalf of the Trustee.

"Trustee" means [Delaware Trustee], its successors in interest and any successor trustee under the Trust Agreement.

"Unsold County Tobacco Assets" shall mean the County Tobacco Assets other than the Sold County Tobacco Assets.

(b) For all purposes of this Agreement, except as otherwise expressly provided herein or unless the context otherwise requires, capitalized terms not otherwise defined herein shall have the meanings ascribed to such terms in that certain indenture, dated as of [Date], between The California County Tobacco Securitization Agency and [Indenture Trustee] (the "Indenture"), as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

(c) The words "hereof," "herein," "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement; Section and Exhibit references contained in this Agreement are references to Sections and Exhibits in or to this Agreement unless otherwise specified; and the term "including" shall mean "including without limitation."

(d) Any agreement, instrument or statute defined or referred to herein or in any instrument or certificate delivered in connection herewith means such agreement, instrument or statute as from time to time may be amended, modified or

supplemented and includes (in the case of agreements or instruments) references to all attachments thereto and instruments incorporated therein; and any references to a Person are also to its permitted successors and assigns.

2. Conveyance of Sold County Tobacco Assets and Payment of Purchase Price. In consideration of the payment and delivery by the Purchaser to the Seller of $[_____] in cash and the delivery by the Purchaser to the Seller of the Ownership Interest (collectively, the "Purchase Price") on [Closing Date] (the "Closing Date"), the Seller does hereby (a) transfer, grant, bargain, sell, assign, convey, set over and deliver to the Purchaser, absolutely and not as collateral security, without recourse except as expressly provided herein, and the Purchaser does hereby purchase, accept and receive the [25.9] percent of the County Tobacco Assets (the "Sold County Tobacco Assets"), and (b) assign to the Purchaser, to the extent permitted by law (as to which no representation is made), all present or future rights, if any, of the Seller to enforce or cause the enforcement of payment of the Sold County Tobacco Assets pursuant to the MOU and the ARIMOU.

The right of the Purchaser to receive the Sold County Tobacco Assets is equal to and on a parity with, and is not inferior or superior to, the right of the Seller to receive the Unsold County Tobacco Assets. Neither the Purchaser nor the Indenture Trustee shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Sold County Tobacco Assets from the Unsold County Tobacco Assets and, likewise, shall not have any right to make a claim to mitigate all or any part of an asserted deficiency in the Unsold County Tobacco Assets from the Sold County Tobacco Assets. Nothing herein shall be deemed to prevent the Seller from hereafter selling all or a portion of the Unsold County Tobacco Assets to the Purchaser or any other person for assignment to a trustee under a separate indenture. In such case, the right of the trustee under the separate indenture to receive the Unsold County Tobacco Assets so sold shall be equal to and on a parity with, and shall not be inferior or superior to, the right of the Indenture Trustee to receive the Sold County Tobacco Assets pledged to it and the right of the Seller to receive any Unsold County Tobacco Assets not so sold.

3. Representations and Warranties of the Purchaser. The Purchaser represents and warrants to the Seller that, effective as of the Closing Date, (a) it is duly organized, validly existing and in good standing in the jurisdiction of its organization, (b) it has full power and authority to enter into this Agreement and to perform its obligations hereunder, (c) neither the execution and delivery by it of this Agreement, nor the performance by it of its obligations hereunder, shall conflict with or result in a breach or default under any of its organizational documents, or any law, rule, regulation, judgment, order or decree to which it is subject or any agreement or instrument to which it is a party, and (d) this Agreement, and its execution, delivery and performance hereof have been duly authorized by it, and this Agreement has been duly executed and delivered by it and constitutes its legal, valid and binding obligation enforceable against it in accordance with the terms hereof, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

4. Representations and Warranties of the Seller. The Seller hereby represents and warrants to the Purchaser, as of the Closing Date, as follows:

(a) The Seller is validly existing as a political subdivision under the laws of the State, with full power and authority to execute and deliver this Agreement and to carry out its terms.

(b) The Seller has full power, authority and legal right to sell and assign the Sold County Tobacco Assets to the Purchaser and has duly authorized such sale and assignment to the Purchaser by all necessary action; and the execution, delivery and performance by the Seller of this Agreement has been duly authorized by the Seller by all necessary action.

(c) This Agreement has been duly executed and delivered by the Seller and, assuming the due authorization, execution and delivery of this Agreement by the Purchaser, constitutes a legal, valid and binding obligation of the Seller enforceable against the Seller in accordance with its terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

(d) No consent, approval, authorization, order, registration or qualification of or with any court or governmental agency or body is required for the consummation by the Seller of the transactions contemplated by this Agreement, except for those which have been obtained and are in full force and effect.

(e) The consummation by the Seller of the transactions contemplated by this Agreement and the fulfillment of the terms hereof do not in any material way conflict with, result in any material breach by the Seller of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a default by the Seller under any indenture, agreement or other instrument to which the Seller is a party or by which it is bound; nor violate any law, order, rule or regulation applicable to the Seller of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Seller.

(f) To the best of its knowledge, there are no material proceedings or investigations pending against the Seller before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Seller: (i) asserting the invalidity of this Agreement, or the Loan Agreement, the Indenture or the Bonds, (ii) seeking to prevent the consummation of any of the transactions contemplated by this Agreement, or the Loan Agreement, the Indenture or the Bonds or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of this Agreement, or the Loan Agreement, the Indenture or the Bonds. There are no initiatives pending that would affect the Seller's sale of the Sold County Tobacco Assets or the use of the Purchase Price.

(g) Immediately prior to the sale of the Sold County Tobacco Assets to the Purchaser, the Seller was the sole owner of the Sold County Tobacco Assets, and had such right, title and interest as provided in the MOU and the ARIMOU. From and after the conveyance of the Sold County Tobacco Assets by the Seller to Purchaser on the Closing Date, the Seller shall have no interest in the Sold County Tobacco Assets (other than as the holder of the Ownership Interest).

(h) Except to the extent that the State has the right to reallocate moneys paid under the MOU and the ARIMOU, as provided in the MOU and the ARIMOU, immediately prior to the sale of the Sold County Tobacco Assets to the Purchaser, the Seller held title to the Sold County Tobacco Assets free and clear and without liens, pledges, charges, security interests or any other impediments of any nature concerning the Sold County Tobacco Assets. Except as set forth in this Agreement, the Seller has not sold, transferred, assigned, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Sold County Tobacco Assets, nor has the Seller created, or to its knowledge permitted the creation of, any lien thereon.

(i) The Seller acts solely through its authorized officers or agents.

(j) The Seller maintains records and books of account separate from both the Purchaser and the Issuer.

(k) The financial statements and books and records of the Seller prepared after the Closing Date shall reflect the separate existence of the Purchaser and the Issuer.

(l) The Seller maintains its respective assets separately from the assets of both the Purchaser and the Issuer (including through the maintenance of separate bank accounts); and the Seller's funds and assets, and records relating thereto, have not been and are not commingled with those of the Purchaser or the Issuer.

(m) The Seller's principal place of business and chief executive office is located at 500 West Temple Street, Los Angeles, California 90012.

(n) The Seller shall treat the sale of the Sold County Tobacco Assets as a sale for tax reporting and accounting purposes, and title to the Sold County Tobacco Assets shall not be a part of the debtor's estate in the event of the filing of a bankruptcy petition by or against the Seller under any bankruptcy law.

(o) The Seller has received reasonably equivalent value for the Sold County Tobacco Assets.

(p) The Seller does not act as an agent of the Purchaser or the Issuer in any capacity, but instead presents itself to the public as an entity separate from the Purchaser and the Issuer.

(q) The Seller has not guaranteed and shall not guarantee the obligations of the Purchaser or the Issuer, nor shall it hold itself out or permit itself to be held out as having agreed to pay or as being liable for the debts of the Purchaser or the Issuer; and the Seller has not received nor shall the Seller accept, any credit or financing from any Person who is relying upon the availability of the assets of the Issuer or the Purchaser to satisfy the claims of such creditor.

(r) All transactions between or among the Seller, on the one hand, and the Issuer or the Purchaser on the other hand (including transactions governed by contracts for services and facilities, such as payroll, purchasing, accounting, legal and personnel services and office space) shall be on terms and conditions (including terms relating to amounts to be paid thereunder) which are believed by each such party thereto to be both fair and reasonable and comparable to those available on an arms-length basis from Persons who are not affiliates.

5. Covenants of the Seller.

(a) The Seller shall not take any action or omit to take any action that shall adversely affect the ability of the Purchaser, and any assignee of the Purchaser, to receive payments made under the MOU, the ARIMOU, the MSA and the Consent Decree; provided, however, that nothing in this Agreement shall be deemed to prohibit the Seller from undertaking any activities (including educational programs, regulatory actions, or any other activities) intended to reduce or eliminate smoking or the consumption or use of tobacco or tobacco related products.

(b) The Seller shall not take any action or omit to take any action and shall use its reasonable efforts not to permit any action to be taken by others that would release any Person from any of such Person's covenants or obligations under the MSA, the MOU or the ARIMOU, or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MSA, the MOU or the ARIMOU, nor, without the prior written consent of the Purchaser or its assignee, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the MSA, the MOU or the ARIMOU, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Bondholders.

(c) Upon request of the Purchaser or its assignee, the Seller shall execute and deliver such further instruments and do such further acts as may be reasonably necessary or proper to carry out more effectively the purposes and intent of this Agreement. The Seller shall take all actions necessary to preserve, maintain and protect the title of the Purchaser to the Sold County Tobacco Assets.

(d) The Seller shall at all times do and perform all acts and things permitted by law and this Agreement which are necessary or desirable in order to assure that interest paid on the Bonds (or any of them) will be excluded from gross income for federal income tax purposes and shall take no action that would result in such interest not

being excluded from gross income for federal income tax purposes. Without limiting the generality of the foregoing, the Seller agrees that it will comply with the provisions of the Seller Tax Certificate which are incorporated herein.

(e) The Seller shall execute the Seller Tax Certificate containing all necessary and appropriate covenants, agreements, representations, statements of intention and reasonable expectations and certifications of fact for bond counsel to render its opinion that interest on the Bonds is excluded from gross income for federal income tax purposes pursuant to Section 103 of the Tax Code, including but not limited to matters relating to the use and investment of the proceeds of Bonds and any other moneys of the Seller, and the use of any and all property financed or refinanced with the proceeds of the Bonds received by the Seller as part of the Purchase Price or otherwise.

(f) The Purchaser hereby requests, and the Seller hereby agrees, that on or before the Closing Date, the Seller shall send (or cause to be sent) an irrevocable instruction to the Attorney General of the State pursuant to Sections 4.B.(2)(i)(aa) and 4.B.(2)(i)(bb) of the ARIMOU, to cause the California Escrow Agent to disburse all of the payments receivable on account of the Sold County Tobacco Assets from the California Escrow to the Indenture Trustee, together with notice of the sale of the Sold County Tobacco Assets to the Purchaser and the assignment and grant of a security interest in such assets to the Issuer, and by the Issuer to the Indenture Trustee, and an acknowledgement that such instructions shall only be further modified with the countersignature of a designated representative of the Indenture Trustee until the Indenture Trustee gives notice to the Attorney General of the State that there are no longer any Bonds Outstanding under the Indenture, after which any further modification must be countersigned by a representative of the Purchaser. The Seller hereby relinquishes and waives any control over the Sold County Tobacco Assets, any authority to collect the Sold County Tobacco Assets, and any power to revoke or amend the instructions to the Attorney General contemplated by this paragraph. The Seller shall not rescind, amend or modify the instruction described in the first sentence of this paragraph. In the event that the Seller receives any proceeds of any Sold County Tobacco Assets, the Seller shall hold the same in trust for the benefit of the Purchaser, the Issuer and the Indenture Trustee as their interests may appear and shall promptly remit the same to the Indenture Trustee as assignee of the Purchaser.

(g) The Seller acknowledges that certain of the proceeds received by the Seller as part of the Purchase Price hereunder or otherwise continue to be proceeds of the Bonds in the hands of the Seller and agrees to invest such amounts solely in Eligible Investments to the extent that such proceeds are subject to the investment limitation requirements of the Seller Tax Certificate.

(h) The Seller hereby covenants and agrees that it will not at any time institute against the Purchaser, or join in instituting against the Purchaser, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

(i) The Seller shall object in any relevant bankruptcy case to the consolidation of the assets of the Purchaser or the Issuer with those of the Seller.

(j) The Seller shall assist the Purchaser in complying with Section 6.01(o) of the Loan Agreement.

6. Notices of Breach.

(a) Upon discovery by the Seller or the Purchaser that the Seller has breached any of its covenants or that any of its representations or warranties are materially false or misleading, in a manner that materially and adversely affects the value of the Sold County Tobacco Assets, the discovering party shall give prompt written notice thereof to the other party, the Indenture Trustee, the Trustee and the Rating Agencies.

(b) The Seller shall not be liable to the Purchaser, the Issuer, the Indenture Trustee, the Trustee or the Bondholders for any loss, cost or expense resulting solely from the failure of the Indenture Trustee to promptly notify the Seller upon the discovery by a Responsible Officer of the Indenture Trustee of a breach of any covenant or any materially false or misleading representation or warranty contained herein as required hereby.

7. Liability of Seller; Indemnification. The Seller shall be liable in accordance herewith only to the extent of the obligations specifically undertaken by the Seller under this Agreement, as follows: the Seller shall indemnify, defend and hold harmless the Purchaser, the Issuer, the Trustee and the Indenture Trustee and their respective officers, directors, employees and agents from and against any and all costs, expenses, losses, claims, damages and liabilities to the extent that such cost, expense, loss, claim, damage or liability arose out of, or was imposed upon any such Person by the Seller's breach of any of its covenants contained herein or any materially false or misleading representation or warranty of the Seller contained herein. The Seller shall indemnify, defend and hold harmless the Purchaser, the Issuer, the Trustee and the Indenture Trustee and their respective officers, directors, employees and agents from and against any and all costs, expenses, losses, claims, damages and liabilities arising out of or incurred in connection with the Seller's obligations under the Seller Tax Certificate, including any rebate or other obligation to the United States Department of the Treasury, resulting from actions by or omissions of the Seller, including from the investment of the proceeds of the Bonds by the Seller and the use of any and all property financed or refinanced with the proceeds of such Bonds received by the Seller as part of the Purchase Price.

8. Limitation on Liability.

(a) The Seller and any officer or employee or agent of the Seller may rely in good faith on the advice of counsel, or on any document of any kind prima facie properly executed and submitted by any Person respecting any matters arising hereunder.

(b) No officer or employee of the Seller shall have any liability for the representations, warranties, covenants, agreements or other obligations of the Seller hereunder or in any of the certificates, notices or agreements delivered pursuant hereto, as to all of which recourse shall be had solely to the assets of the Seller.

9. Seller's Acknowledgment. The Seller hereby agrees and acknowledges that the Purchaser intends to assign and grant a security interest in its rights hereunder and its rights to the Sold County Tobacco Assets to the Issuer pursuant to the terms of the Loan Agreement, and that the Issuer intends to assign and grant a security interest in the same to the Indenture Trustee pursuant to the Indenture. The Seller further agrees and acknowledges that the Issuer, the Trustee, the Indenture Trustee and the Bondholders have relied and shall continue to rely upon each of the foregoing representations and warranties, and further agrees that such Persons are entitled so to rely thereon. Each of the above representations and warranties shall survive any assignment and grant of a security interest in this Agreement or the Sold County Tobacco Assets to the Issuer and by the Issuer to the Indenture Trustee, and shall continue in full force and effect, notwithstanding any subsequent termination of this Agreement and the other Basic Documents. The above representations and warranties shall inure to the benefit of Issuer and the Indenture Trustee.

10. Purchaser's Acknowledgment. The Purchaser hereby agrees and acknowledges that the Seller is irrevocably transferring, granting, bargaining, selling, assigning, conveying, and delivering to the Purchaser the Sold County Tobacco Assets without recourse, and, except as expressly set forth above, without representation or warranty of any kind or description.

11. Intent to Effect Irrevocable, Absolute Sale and Not a Transfer as Collateral or Security. The Seller and the Purchaser hereby confirm their intent and agree that the Seller is irrevocably transferring, granting, bargaining, selling, assigning, conveying, and delivering to the Purchaser the Sold County Tobacco Assets absolutely and not as collateral security.

12. Receipt. By their respective signatures below, the Seller hereby acknowledges receipt of the Purchase Price, and the Purchaser hereby acknowledges receipt of the Sold County Tobacco Assets.

13. Notices. All demands, notices and communications upon or to the Seller, the Purchaser, the Indenture Trustee or the Trustee under this Agreement shall be in writing, personally delivered or mailed by certified mail, return receipt requested, and shall be deemed to have been duly given upon receipt:

(a) in the case of the Seller, to:

County of Los Angeles
Treasurer and Tax Collector,
500 West Temple Street
Los Angeles, CA 90012
Attention: Office of Public Finance,
Room 432

(b)	in the case of the Purchaser, to:	Los Angeles County Securitization Corporation [Corporation Address]
(c)	in the case of the Indenture Trustee, to:	[Indenture Trustee] [Indenture Trustee Address] Attention: Corporate Trust Department
(d)	in the case of the Trustee, to:	[Delaware Trustee] [Delaware Trustee Address] Attention: Corporate Trust Administration Department
(e)	in the case of the Rating Agencies, to:	[_____] [_____]

or, as to each of the foregoing, at such other address as shall be designated by written notice in conformance with this Section to the other parties.

14. Amendments. This Agreement may be amended by the Seller and the Purchaser, with the consent of the Indenture Trustee and the Trustee: (a) to cure any ambiguity; (b) to correct or supplement any provisions in this Agreement; (c) to correct or amplify the description of the Sold County Tobacco Assets; (d) to add additional covenants for the benefit of the Purchaser; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in this Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Indenture Trustee, adversely affect in any material respect payment of principal of or interest on the Bonds.

Promptly after the execution of any such amendment, the Purchaser shall furnish written notification of the substance of such amendment to the Rating Agencies.

15. Successors and Assigns. This Agreement shall be binding upon and inure to the benefit of the Seller, the Purchaser and their respective successors and permitted assigns. The Seller acknowledges that the Purchaser will grant a security interest in its rights under this Agreement to the Lender pursuant to the Loan Agreement and consents to such grant of a security interest. The Seller may not assign or transfer any of its rights or obligations under this Agreement without the prior written consent of the Purchaser. Except as specified herein, the Purchaser may not assign or transfer any of its rights or obligations under this Agreement without the prior written consent of the Seller.

16. Third Party Rights. Each of the Issuer, the Indenture Trustee, the Bondholders and the Trustee is an express and intended third party beneficiary under this Agreement. Nothing expressed in or to be implied from this Agreement is intended to give, or shall be construed to give, any Person, other than the parties hereto, the Issuer, the Indenture Trustee, the Bondholders and the Trustee, and their permitted successors and assigns hereunder, any benefit or legal or equitable right, remedy or claim under or by virtue of this Agreement or under or by virtue of any provision herein.

17. Partial Invalidity. If at any time any provision of this Agreement is or becomes illegal, invalid or unenforceable in any respect under the law of any jurisdiction, neither the legality, validity or enforceability of the remaining provisions of this Agreement nor the legality, validity or enforceability of such provision under the law of any other jurisdiction shall in any way be affected or impaired thereby.

18. Counterparts. This Agreement may be executed in any number of identical counterparts, any set of which signed by all the parties hereto shall be deemed to constitute a complete, executed original for all purposes.

19. Entire Agreement. This Agreement sets forth the entire understanding and agreement of the parties with respect to the subject matter hereof and supersedes any and all oral or written agreements or understandings between the parties as to the subject matter hereof.

20. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State.

IN WITNESS WHEREOF, the Seller and the Purchaser have caused this Sale Agreement to be duly executed as of [Date].

COUNTY OF LOS ANGELES

By:_____
Authorized Officer

LOS ANGELES COUNTY
SECURITIZATION CORPORATION

By:_____
Authorized Officer

LOS ANGELES COUNTY SECURITIZATION CORPORATION,
as Borrower

and the

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY,
as Lender

SECURED LOAN AGREEMENT

Dated as of [Date]

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SECURED LOAN AGREEMENT

THIS SECURED LOAN AGREEMENT, dated as of [Date] (this "Loan Agreement"), is entered into by and between the:

(1) LOS ANGELES COUNTY SECURITIZATION CORPORATION, a California nonprofit public benefit corporation (the "Borrower"); and the

(2) THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY, a public entity of the State of California (the "Lender").

RECITALS

A. The Borrower is the owner of the Sold County Tobacco Assets (as defined below).

B. The Borrower has requested the Lender to provide a loan to the Borrower secured by the Corporation Tobacco Assets (as defined below).

C. The Lender is willing to provide such loan upon the terms specified in this Loan Agreement.

AGREEMENT

NOW, THEREFORE, in consideration of the above Recitals and the mutual covenants herein contained, the parties hereto hereby agree as follows:

SECTION I. INTERPRETATION.

1.01. Definitions.

(a) For all purposes of this Loan Agreement, except as otherwise expressly provided herein or unless the context otherwise requires, capitalized terms not otherwise defined herein shall have the meanings ascribed to such terms in that certain indenture, dated as of [Date], between the Lender and [Indenture Trustee] (the "Indenture"), as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

(b) The words "hereof," "herein," "hereunder" and words of similar import when used in this Loan Agreement shall refer to this Loan Agreement as a whole and not to any particular provision of this Loan Agreement; Paragraph, Section and Exhibit references contained in this Loan Agreement are references to Paragraphs, Sections and Exhibits in or to this Loan Agreement unless otherwise specified; and the term "including" shall mean "including without limitation."

(c) Any agreement, instrument or statute defined or referred to herein or in any instrument or certificate delivered in connection herewith means such agreement, instrument or statute as from time to time may be amended, modified or supplemented and includes (in the

case of agreements or instruments) references to all attachments thereto and instruments incorporated therein; and any references to a Person are also to its permitted successors and assigns.

SECTION II. ISSUANCE OF SERIES 2006 BONDS; LOANS TO BORROWER; RELATED OBLIGATIONS.

2.01. Issuance of Series 2006 Bonds; Deposit of Proceeds. Pursuant to the Indenture, the Lender has authorized the issuance of the Series 2006 Bonds in the initial principal amount of [_____] Dollars ($[_____]). The Lender hereby loans and advances to the Borrower, and the Borrower hereby borrows and accepts from the Lender a loan of the proceeds of the Series 2006 Bonds which are to be applied under the terms and conditions of this Loan Agreement to provide funds to assist the Borrower in financing the acquisition of the Sold County Tobacco Assets (the "Loan"). For purposes of this Loan Agreement, the amount of any proceeds of the Series 2006 Bonds deposited in the Debt Service Reserve Account, the Operating Account or the Costs of Issuance Account and the amount of any underwriters' discount and any discount to investors on the Series 2006 Bonds shall also be deemed to have been loaned to the Corporation. The Borrower hereby approves the Indenture and the assignment under the Indenture to the Indenture Trustee of the right, title and interest of the Lender in this Loan Agreement.

2.02. Amounts Payable.

(a) In consideration of the Loan to the Borrower, the Borrower agrees that, as long as any of the Bonds remain Outstanding under the Indenture, it shall pay or cause to be paid to the Indenture Trustee for deposit in the Collection Account established under the Indenture all payments receivable with respect to the Sold County Tobacco Assets when and as such are received. Each payment by, or caused to be made by, the Borrower to the Indenture Trustee hereunder (the "Loan Payments") shall be in lawful money of the United States of America and paid to the Indenture Trustee at its Corporate Trust Office and held, invested, disbursed and applied as provided in the Indenture. Except as otherwise expressly provided herein, all amounts payable hereunder by the Borrower to the Lender shall be paid to the Indenture Trustee as assignee of the Lender.

(b) The Borrower will also pay (from the Tobacco Settlement Revenues deposited by the Indenture Trustee in the Operating Account under the Indenture) all fees and expenses of the Indenture Trustee and the Lender in connection with the Loan and the Bonds, including, without limitation, legal fees and expenses incurred in connection with any redemption of the Bonds or in connection with the interpretation, enforcement or amendment of any documents relating to the Loan, the Corporation Tobacco Assets or the Bonds, as and when such amounts become due and payable; provided, that in each case, to the extent amounts in the Operating Account under the Indenture are insufficient to make any such payments, the Borrower shall not be required to make such payments until such time as amounts are available for such purpose in the Operating Account under the Indenture.

(c) In order to ensure payment of the amounts set forth in subsections (a) and (b) of this Section, the Borrower shall cause the Seller to give to the Attorney General of the State the instructions described in Section 4.01(c) hereof.

(d) In the event the Borrower fails to make any of the payments required in this Section, the item or installment not so paid shall continue as an obligation of the Borrower until the amount not so paid shall have been fully paid.

(e) The Borrower also covenants and agrees (from the Tobacco Settlement Revenues deposited by the Indenture Trustee in the Operating Account under the Indenture) to indemnify and save the Indenture Trustee and its officers, directors, agents and employees, harmless against any losses, expenses (including legal fees and expenses) and liabilities which it may incur arising out of or in the exercise and performance of its powers and duties hereunder and under the Indenture, including the costs and expenses of defending against any claim of liability, but excluding any and all losses, expenses and liabilities which are due to the negligence, bad faith or willful misconduct of the Indenture Trustee. The obligations of the Borrower under this paragraph shall survive the resignation or removal of the Indenture Trustee under the Indenture and payment of the principal of and interest on the Bonds.

2.03. Obligations Unconditional; Limited Recourse. The obligations of the Borrower to make the payments required in Section 2.02 and other Sections hereof and to perform and observe the other agreements contained herein shall be absolute and unconditional and shall not be subject to any defense or any right of setoff, counterclaim or recoupment arising out of any breach by the Lender or the Indenture Trustee of any obligation to the Borrower whether hereunder or otherwise, or out of any indebtedness or liability at any time owing to the Borrower by the Lender or the Indenture Trustee, and until such time as the principal of, redemption premiums, if any, and interest on the Bonds shall have been fully paid or provision for the payment thereof shall have been made in accordance with the Indenture, the Borrower (a) will not suspend or discontinue any payments provided for in Section 2.02 hereof, (b) will perform and observe all other agreements contained in this Loan Agreement, and (c) will not terminate this Loan Agreement for any cause, including, without limiting the generality of the foregoing, the occurrence of any acts or circumstances that may constitute failure of consideration, commercial frustration of purpose, any change in the tax or other laws of the United States of America or of the State or any political subdivision of either or any failure of the Lender or the Indenture Trustee to perform and observe any agreement, whether express or implied, or any duty, liability or obligation arising out of or connected with this Loan Agreement. Nothing contained in this Section shall be construed to release the Lender from the performance of any of the agreements on its part herein contained, and in the event the Lender or the Indenture Trustee fails to perform any such agreement on its part, the Borrower may institute such action against the Lender or the Indenture Trustee as the Borrower may deem necessary to compel performance so long as such action does not abrogate the obligations of the Borrower contained in the first sentence of this Section.

Notwithstanding the foregoing or any other provision or obligation to the contrary contained in this Loan Agreement or any other Basic Document, the liability of the Borrower under this Loan Agreement and the other Basic Documents to any Person, including, but not limited to, the Indenture Trustee or the Lender and their successors and assigns, is limited to the Borrower's interest in the Corporation Tobacco Assets, and the amounts held in the funds and accounts created under the Indenture, and such Persons shall look exclusively thereto, or to such other security as may from time to time be given for the payment of obligations arising out of

this Loan Agreement or any other agreement securing the obligations of the Borrower under this Loan Agreement.

SECTION III. SECURITY.

3.01. Grant of Security Interest. As security for the Loan and any obligations related thereto, the Borrower hereby pledges and assigns to the Lender and grants to the Lender a first priority perfected security interest in all right, title and interest of the Borrower, whether now owned or hereafter acquired, in, to and under the following property (collectively and severally, the "Corporation Tobacco Assets"):

(a) the Sold County Tobacco Assets purchased from the Seller;

(b) to the extent permitted by law (as to which no representation is made), corresponding present or future rights, if any, of the Borrower to enforce or cause the enforcement of payment of such purchased Sold County Tobacco Assets pursuant to the MOU and the ARIMOU;

(c) the corresponding rights of the Borrower under the Sale Agreement; and

(d) all proceeds of any and all of the foregoing.

SECTION IV. CONDITIONS PRECEDENT.

4.01. Conditions Precedent to Borrowing. The obligation of the Lender to make the Loan on the Closing Date is subject to the conditions that:

(a) The representations and warranties of the Borrower set forth in Section 5.01 are true and correct in all material respects;

(b) All agreements relating to the transactions contemplated hereby are in form and substance satisfactory to the Lender and the Borrower; and

(c) The Borrower shall have given or caused to be given instructions to the Attorney General of the State pursuant to Sections 4.B.(2)(i)(aa) and 4.B.(2)(i)(bb) of the ARIMOU to cause the California Escrow Agent to disburse all of the payments receivable on account of the Sold County Tobacco Assets from the California Escrow to the Indenture Trustee, together with an acknowledgement that such instructions shall only be further modified with the countersignature of a designated representative of the Indenture Trustee until the Indenture Trustee gives notice to the Attorney General of the State that there are no longer any Bonds Outstanding under the Indenture, after which any further modification must be countersigned by a representative of the Borrower.

4.02. Waiver and Satisfaction of Conditions Precedent. The Lender, by making the Loan hereunder, either waives or acknowledges satisfaction of the conditions precedent set forth in Section 4.01.

SECTION V. REPRESENTATIONS AND WARRANTIES.

5.01. Representations and Warranties of the Borrower. In order to induce the Lender to enter into this Loan Agreement, the Borrower hereby represents and warrants to the Lender as follows:

(a) The Borrower is validly existing as a nonprofit public benefit corporation under the laws of the State, with full power and authority to execute and deliver this Loan Agreement and the Sale Agreement and to carry out their terms.

(b) The Borrower has full power, authority and legal right to grant a security interest in the Corporation Tobacco Assets to the Lender and has duly authorized such grant of a security interest to the Lender by all necessary action; and the execution, delivery and performance by the Borrower of this Loan Agreement and the Sale Agreement have been duly authorized by the Borrower by all necessary action.

(c) This Loan Agreement and the Sale Agreement have been duly executed and delivered by the Borrower and, assuming the due authorization, execution and delivery of each such agreement by the other parties thereto, constitute legal, valid and binding obligations of the Borrower enforceable against the Borrower in accordance with their terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

(d) No consent, approval, authorization, order, registration or qualification of or with any court or governmental agency or body is required for the consummation by the Borrower of the transactions contemplated by this Loan Agreement and the Sale Agreement, except for those which have been obtained and are in full force and effect.

(e) The consummation by the Borrower of the transactions contemplated by this Loan Agreement and the Sale Agreement and the fulfillment by the Borrower of the terms thereof do not in any material way conflict with, result in any breach by the Borrower of any of the material terms and provisions of, nor constitute (with or without notice or lapse of time) a default by the Borrower under any indenture, agreement or other instrument to which the Borrower is a party or by which it is bound; nor violate any law, order, rule or regulation applicable to the Borrower of any court or of any federal or state regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Borrower.

(f) To the best of its knowledge, there are no proceedings or investigations pending against the Borrower, before any court, regulatory body, administrative agency or other governmental instrumentality having jurisdiction over the Borrower: (i) asserting the invalidity of this Loan Agreement or the Sale Agreement, or the Indenture or the Series 2006 Bonds, (ii) seeking to prevent the consummation of any of the transactions contemplated by this Loan Agreement or the Sale Agreement, or the Indenture or the Series 2006 Bonds, or (iii) seeking any determination or ruling that would materially and adversely affect the validity or enforceability of this Loan Agreement or the Sale Agreement, or the Indenture or the Series 2006 Bonds.

(g) Based on the representations and warranties of the Seller set forth in the Sale Agreement, except to the extent that the State has the right to reallocate moneys paid under the MOU and the ARIMOU, as provided in the MOU and the ARIMOU, the Borrower owns and has good marketable title to the Corporation Tobacco Assets free and clear and without liens thereon, other than the lien of this Loan Agreement and the lien of the Indenture. The Borrower has not sold, transferred, assigned, pledged, granted a security interest in, set over or otherwise conveyed any right, title or interest of any kind whatsoever in all or any portion of the Corporation Tobacco Assets, nor has the Borrower created or permitted the creation of, any Lien thereon, other than the lien of this Loan Agreement and the lien of the Indenture.

(h) This Loan Agreement creates a valid and continuing security interest (as defined in the applicable Uniform Commercial Code ("UCC")) in the Corporation Tobacco Assets in favor of the Lender, which security interest is prior to all other liens, and is enforceable as such as against creditors of and purchasers from the Borrower.

(i) The Corporation Tobacco Assets constitute "accounts" or "general intangibles" within the meaning of the applicable UCC.

(j) The Borrower has caused or will have caused, within ten days, the filing of all appropriate financing statements in the proper filing office in the appropriate jurisdictions under applicable law in order to perfect the security interest in the Corporation Tobacco Assets granted to the Lender hereunder.

(k) Other than the security interest granted to the Lender pursuant to this Loan Agreement, the Borrower has not pledged, assigned, sold, granted a security interest in, or otherwise conveyed any of the Corporation Tobacco Assets. The Borrower has not authorized the filing of and is not aware of any financing statements against the Borrower that include a description of collateral covering the Corporation Tobacco Assets other than any financing statement relating to the security interest granted to the Lender hereunder or that has been terminated. The Borrower is not aware of any judgment or tax lien filings against the Borrower.

(l) The Borrower has received all consents and approvals required by the terms of the Corporation Tobacco Assets to the grant of security interest in the Corporation Tobacco Assets hereunder to the Lender.

5.02. Representations and Warranties of the Lender. In order to induce the Borrower to enter into this Loan Agreement, the Lender hereby represents and warrants to the Borrower as follows:

(a) The Lender is a joint powers authority duly organized and validly existing under the laws of the State. Pursuant to a resolution duly adopted by the Commission of the Lender, the Lender has authorized the execution and delivery by the Lender of this Loan Agreement and the other Basic Documents to which it is a party, and the performance by the Lender of all of its obligations hereunder and under the other Basic Documents to which it is a party.

(b) The Lender has complied with all of the provisions of the laws of the State relating to the Basic Documents, and has full power and authority to consummate all transactions

contemplated by the Bonds, the Basic Documents and any and all other agreements relating thereto, and to perform all of its obligations hereunder and thereunder.

(c) The Lender has not pledged and covenants that it will not pledge the amounts derived from this Loan Agreement and the Corporation Tobacco Assets other than to secure the Bonds.

(d) The Lender will duly file Internal Revenue Form 8038-G with respect to the Bonds, which shall contain the information required to be filed pursuant to Section 149 of the Code.

SECTION VI. COVENANTS.

6.01. Covenants. Until the termination of this Loan Agreement and the satisfaction in full by the Borrower of all obligations hereunder, the Borrower shall comply, and shall cause compliance, with the following affirmative covenants:

(a) Preservation of Rights. The Borrower shall take all actions as may be required by law to fully preserve, maintain, defend, protect and confirm the interests of the Lender and the interests of the Indenture Trustee in the Corporation Tobacco Assets. The Borrower shall not take any action that shall adversely affect the Lender's or the Indenture Trustee's ability to receive payments made under the MOU, the ARIMOU, the MSA and the Consent Decree.

(b) No Impairment. The Borrower shall not limit or alter the rights of the Lender to fulfill the terms of its agreements with the Holders of the Bonds, or in any way impair the rights and remedies of such Holders or the security for the Bonds and shall enforce all of its rights under the Sale Agreement, until the Bonds, together with the interest thereon and all costs and expenses in connection with any action or proceeding by or on behalf of such Holders, are fully paid and discharged.

(c) No Amendments to Collateral Documents. The Borrower shall not amend the Sale Agreement, except as provided therein. The Borrower shall not take any action and shall use its best efforts not to permit any action to be taken by others that would release any Person from any of such Person's covenants or obligations under the MOU or the ARIMOU or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, the MOU or the ARIMOU, nor, without the prior written consent of the Lender and the Indenture Trustee, amend, modify, terminate, waive or surrender, or agree to any amendment, modification, termination, waiver or surrender of, the terms of the MOU or the ARIMOU, or waive timely performance or observance under such documents, in each case if the effect thereof would be materially adverse to the Bondholders.

(d) Further Acts. Upon request of the Lender or the Indenture Trustee, the Borrower shall execute and deliver all such further agreements, instruments, financing statements or other assurances as may be reasonably necessary to carry out the intention or to facilitate the performance of this Loan Agreement, including, without limitation, to perfect and continue the security interests herein intended to be created.

(e) Tax Covenant. The Borrower shall at all times do and perform all acts and things permitted by law which are necessary or desirable in order to assure that interest paid on the Bonds (or any of them) will be excluded from gross income for federal income tax purposes and shall take no action that would result in such interest not being excluded from gross income for federal income tax purposes.

(f) Books and Records. The Borrower shall at all times keep proper books of record and account in which full, true and correct entries shall be made of its transactions in accordance with generally accepted accounting principles.

(g) Change of Name, Type, or Jurisdiction of Incorporation. The Borrower shall not change its name or its type or jurisdiction of organization without the consent of the Indenture Trustee.

(h) Inspections. The Borrower shall permit any Person designated by the Lender, upon reasonable notice and during normal business hours, to visit and inspect any of the properties and offices of the Borrower, to examine the books and records of the Borrower and make copies thereof and to discuss the affairs, finances and business of the Borrower with, and to be advised as to the same by, their officers, auditors and accountants, all at such times and intervals as the Lender may reasonably request.

(i) Use of Proceeds. The Borrower shall use the proceeds of the Loan only for the purposes set forth in Section 2.01.

(j) Status as Special Purpose Entity. The Borrower shall: (1) conduct its own business in its own name and not in the name of any other Person; (2) compensate all employees, consultants and agents directly, from the Borrower's bank accounts, for services provided to the Borrower by such employees, consultants and agents and, to the extent any employee, consultant or agent of Borrower is also an employee, consultant or agent of any other Person, allocate the compensation of such employee, consultant or agent between the Borrower and such Person on a basis that reflects the services rendered to the Borrower and such Person; (3) have a separate telephone number, which will be answered only in its name and separate stationery, invoices and checks in its own name; (4) conduct all transactions with any other Person strictly on an arm's-length basis, allocate all overhead expenses (including, without limitation, telephone and other utility charges) for items shared between the Borrower and such Person on the basis of actual use to the extent practicable and, to the extent such allocation is not practicable, on a basis reasonably related to actual use; (5) at all times have a Board of Directors consisting of at least three members (including one Independent Director, as defined in the Borrower's articles of incorporation); (6) observe all corporate formalities as a distinct entity, and ensure that all corporate actions relating to (i) the dissolution or liquidation of the Borrower or (ii) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Borrower, are duly authorized by unanimous vote of its Board of Directors; (7) maintain the Borrower's books and records separate from those of any other Person and maintain its assets readily identifiable as its own assets rather than assets of the County; (8) prepare its financial statements separately from those of any other Person and not prepare any financial statements that are consolidated with those of such Person; (9) only maintain bank accounts or other depository accounts to which the Borrower alone is the account

party, and from which only the Borrower has the power to make withdrawals; (10) pay all of the Borrower's operating expenses from the Borrower's own assets or as pursuant to Section 402 of the Indenture (except for expenses incurred prior to the Closing Date); (11) operate its business and activities such that: it does not engage in any business or activity of any kind, or enter into any transaction or indenture, mortgage, instrument, agreement, contract, lease or other undertaking, other than the transactions contemplated and authorized by the Basic Documents; and does not create, incur, guarantee, assume or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (i) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (ii) the incurrence of obligations under the Basic Documents, and (iii) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Basic Documents; (12) maintain its corporate organization in conformity with this Loan Agreement, such that it does not amend, restate, supplement or otherwise modify its articles of incorporation or bylaws in any respect that would impair its ability to comply with the terms or provisions of any of the Basic Documents, including, without limitation, this Section; and (13) maintain its corporate separateness such that it does not merge or consolidate with or into, or convey, transfer, lease or otherwise dispose of (whether in one transaction or in a series of transactions, and except as otherwise contemplated herein) all or substantially all of its assets (whether now owned or hereafter acquired) to, or acquire all or substantially all of the assets of, any Person.

(k) Filings. The Borrower, at the Borrower's expense, shall promptly procure, execute and deliver to the Lender all documents, instruments and agreements and perform all acts which are necessary or desirable, or which the Lender may reasonably request, to establish, maintain, continue, preserve, protect and perfect the grant of security interest in the Corporation Tobacco Assets, the lien granted to the Lender herein and the first priority of such lien or to enable the Lender to exercise and enforce its rights and remedies hereunder with respect to the grant of a security interest in the Corporation Tobacco Assets. Without limiting the generality of the preceding sentence, the Borrower shall (i) procure, execute and deliver to the Lender all endorsements, assignments, financing statements and other instruments of transfer requested by the Lender, (ii) deliver to the Lender promptly upon receipt all originals of Corporation Tobacco Assets consisting of instruments, documents, chattel paper, letters of credit and certificated securities and (iii) take or cause to be taken such actions as may be necessary to perfect the lien of Lender in any Corporation Tobacco Assets consisting of investment property (including taking the actions and, in those jurisdictions where appropriate, causing such liens to be recorded or registered in the books of any securities intermediary, requested by the Lender).

(l) No Modification of Escrow Instruction. So long as any Bonds of any Series are Outstanding under the Indenture, the Borrower shall not rescind, amend, or modify the instruction described in Section 4.01(c) hereof without the consent of the Indenture Trustee.

(m) Nonpetition Covenant By Borrower. The Borrower hereby covenants and agrees that it will not at any time institute against the Lender, or join in instituting against the Lender, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

(n) Bankruptcy. The Borrower shall object in any relevant bankruptcy case to the consolidation of the assets of the Borrower or the Lender with those of the Seller.

(o) Continuing Disclosure. The Borrower shall assist the Lender in complying with Section 505(a)(1) of the Indenture.

6.02. Nonpetition Covenant By Lender. The Lender hereby covenants and agrees that it will not at any time institute against the Borrower, or join in instituting against the Borrower, any bankruptcy, reorganization, arrangement, insolvency, liquidation, or similar proceeding under any United States federal or state bankruptcy or similar law.

SECTION VII. DEFAULT.

7.01. Events of Default. The occurrence or existence of any one or more of the following shall constitute an "Event of Default" hereunder:

(a) Failure to Pay or Cause to be Paid Tobacco Settlement Revenues Relating to Sold County Tobacco Assets to Trustee. The Borrower shall fail to pay, or cause to be paid, to the Indenture Trustee for deposit in the Collection Account established under the Indenture the portion of the Tobacco Settlement Revenues relating to the Sold County Tobacco Assets as required pursuant to Section 2.02; or

(b) Other Defaults. The Borrower shall fail to observe or perform any other covenant, obligation, condition or agreement contained in this Loan Agreement and such failure shall continue for thirty (30) days from the date of written notice from the Lender or the Indenture Trustee of such failure; or

(c) Representations and Warranties. Any representation, warranty, certificate, information or other statement (financial or otherwise) made or furnished by or on behalf of the Borrower to the Lender in or in connection with this Loan Agreement shall be false, incorrect, incomplete or misleading in any material respect when made or furnished; or

(d) Insolvency, Voluntary Proceedings. The Borrower shall (i) apply for or consent to the appointment of a receiver, trustee, liquidator or custodian of itself or of all or a substantial part of its property, (ii) be unable, or admit in writing its inability, to pay its debts generally as they mature, (iii) make a general assignment for the benefit of its or any of its creditors, (iv) be dissolved or liquidated in full or in part, (v) become insolvent (as such term may be defined or interpreted under any applicable statute), (vi) commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or consent to any such relief or to the appointment of or taking possession of its property by any official in an involuntary case or other proceeding commenced against it, or (vii) take any action for the purpose of effecting any of the foregoing; or

(e) Involuntary Proceedings. Proceedings for the appointment of a receiver, trustee, liquidator or custodian of the Borrower or of all or a substantial part of the property thereof, or an involuntary case or other proceedings seeking liquidation, reorganization or other relief with respect to the Borrower or the debts thereof under any bankruptcy, insolvency or other similar law now or hereafter in effect shall be commenced and an order for relief entered or such proceeding shall not be dismissed or discharged within sixty (60) days of commencement; or

(f) Agreement. This Loan Agreement or any material term hereof shall cease to be, or be asserted by the Borrower not to be, a legal, valid and binding obligation of the Borrower enforceable in accordance with its terms; or

(g) Revocation of Instructions to Attorney General. The instructions to the Attorney General of the State regarding disbursing the Corporation Tobacco Assets to the Indenture Trustee as provided in Section 4.01(c) shall be revoked or cease to be complied with.

7.02. Remedies. At any time after the occurrence and during the continuance of any Event of Default, the Lender may, by written notice to the Borrower exercise any right, power or remedy available to it by law, either by suit in equity or by action at law, or both.

No remedy herein conferred upon or reserved to the Lender is intended to be exclusive of any other available remedies, but each and every such remedy shall be cumulative and shall be in addition to every other remedy given under this Loan Agreement or now or hereafter existing at law or in equity. No delay or omission to exercise any right or power accruing upon any Default shall impair any such right or power or shall be construed to be a waiver thereof, but any such right or power may be exercised from time to time and as often as may be deemed expedient. In order to entitle the Lender to exercise any remedy reserved to it in this Section, it shall not be necessary to give any notice, other than such notice as may be required in this Section. Such rights and remedies as are given the Lender hereunder shall also extend to the Indenture Trustee, and the Indenture Trustee and the Bondholders, subject to the provisions of the Indenture, shall be entitled to the benefit of all covenants and agreements herein contained.

SECTION VIII. MISCELLANEOUS.

8.01. Notices. All demands, notices and communications upon or to the Borrower, the Lender, the Indenture Trustee or the Rating Agencies under this Loan Agreement shall be in writing, personally delivered or mailed by certified mail, return receipt requested, and shall be deemed to have been duly given upon receipt:

(a)	in the case of the Borrower, to:	Los Angeles County Securitization Corporation [Corporation Address]
(a)	in the case of the Lender, to:	The California County Tobacco Securitization Agency 1221 Oak Street, Suite 536 Oakland, CA 94612 Attention: President
(b)	in the case of the Indenture Trustee, to:	[Indenture Trustee] [Indenture Trustee Address] Attention: Corporate Trust Department
(d)	in the case of the Rating Agencies, to:	[_____] [_____]

or, as to each of the foregoing, at such other address as shall be designated by written notice in conformance with this Section to the other parties.

8.02. Amendments. This Loan Agreement may be amended by the Borrower and the Lender, with the consent of the Indenture Trustee: (a) to cure any ambiguity; (b) to correct or supplement any provisions in this Loan Agreement; (c) to correct or amplify the description of the Corporation Tobacco Assets; (d) to add additional covenants for the benefit of the Lender; or (e) for the purpose of adding any provisions to or changing in any manner or eliminating any of the provisions in this Loan Agreement that shall not, as evidenced by a Rating Confirmation delivered to the Indenture Trustee, adversely affect in any material respect payment of the Bonds.

Promptly after the execution of any such amendment, the Borrower shall furnish written notification of the substance of such amendment to the Rating Agencies.

8.03. Successors and Assigns. This Loan Agreement shall be binding upon and inure to the benefit of the Borrower, the Lender and their respective successors and permitted assigns. The Borrower acknowledges that the Lender will assign its rights under this Loan Agreement to the Indenture Trustee pursuant to the Indenture and consents to such assignment. The Borrower may not assign or transfer any of its rights or obligations under this Loan Agreement without the prior written consent of the Lender and the Indenture Trustee.

8.04. Third Party Rights. The Indenture Trustee is an express and intended third party beneficiary under this Loan Agreement. Nothing expressed in or to be implied from this Loan Agreement is intended to give, or shall be construed to give, any Person, other than the parties hereto and the Indenture Trustee and their permitted successors and assigns hereunder, any benefit or legal or equitable right, remedy or claim under or by virtue of this Loan Agreement or under or by virtue of any provision herein.

8.05. Partial Invalidity. If at any time any provision of this Loan Agreement is or becomes illegal, invalid or unenforceable in any respect under the law of any jurisdiction, neither the legality, validity or enforceability of the remaining provisions of this Loan Agreement nor the legality, validity or enforceability of such provision under the law of any other jurisdiction shall in any way be affected or impaired thereby.

8.06. Counterparts. This Loan Agreement may be executed in any number of identical counterparts, any set of which signed by all the parties hereto shall be deemed to constitute a complete, executed original for all purposes.

8.07. Entire Agreement. This Loan Agreement sets forth the entire understanding and agreement of the parties with respect to the subject matter hereof and supersedes any and all oral or written agreements or understandings between the parties as to the subject matter hereof.

8.08. Governing Law. This Loan Agreement shall be governed by and construed in accordance with the laws of the State.

IN WITNESS WHEREOF, the Borrower and the Lender have caused this Loan Agreement to be executed as of [Date].

LOS ANGELES COUNTY
SECURITIZATION CORPORATION

By:_____
Authorized Officer

THE CALIFORNIA COUNTY TOBACCO
SECURITIZATION AGENCY

By:_____
Authorized Officer

DECLARATION AND AGREEMENT OF TRUST

relating to

LOS ANGELES COUNTY SECURITIZATION CORPORATION RESIDUAL TRUST

by and between

[DELAWARE TRUSTEE],
as Trustee

and

LOS ANGELES COUNTY SECURITIZATION CORPORATION
or any successor as Owner of the Ownership Interest
from time to time hereunder

Dated as of [DATE]

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Exhibit A Residual Certificate..... A-1

DECLARATION AND AGREEMENT OF TRUST relating to Los Angeles County Securitization Corporation Residual Trust, dated as of [Date] by and between [Delaware Trustee], as Trustee, and Los Angeles County Securitization Corporation (the "Corporation"), or its successor as Owner of the Ownership Interest from time to time hereunder.

WHEREAS, the Corporation has acquired from Los Angeles County (the "County") the Sold County Tobacco Assets pursuant to the Sale Agreement; and

WHEREAS, in order to finance its payment to the County of the cash portion of the purchase price for the Sold County Tobacco Assets (as defined in the Sale Agreement), the Corporation has entered into a Secured Loan Agreement with The California County Tobacco Securitization Agency (the "Agency");

WHEREAS, in order to fund its loan to the Corporation pursuant to said Secured Loan Agreement, the Agency shall issue pursuant to an Indenture between [Indenture Trustee], as Indenture Trustee, and the Agency, certain Tobacco Bonds; and

WHEREAS, as the non-cash portion of the purchase price paid to the County by the Corporation, the Corporation shall deliver to or upon the order of the County the Ownership Interest.

NOW, THEREFORE, in consideration of the premises and the mutual agreements herein contained, the parties hereto hereby agree as follows:

ARTICLE I

DEFINITIONS

SECTION 1.01. Capitalized Terms. For all purposes of this Agreement, the following terms shall have the meanings set forth below:

"Agency" shall mean The California County Tobacco Securitization Agency, or any successor thereto.

"Agreement" shall mean this Declaration and Agreement of Trust, as the same may be amended and supplemented from time to time.

"Authorized Financial Officer of the Owner" shall mean, if and so long as the County is the Owner, its Auditor-Controller and Treasurer-Tax Collector, and their respective designees.

"Certificate of Trust" shall mean the Certificate of Trust of the Trust to be filed with the Secretary of State pursuant to Section 3810(a) of the Statutory Trust Statute.

"Code" shall mean the Internal Revenue Code of 1986, as amended, and Treasury Regulations promulgated thereunder.

"Corporate Trust Office" shall mean, with respect to the Trustee, the principal corporate trust office of the Trustee located [_____], Delaware [_____], or at such other address as the

Trustee may designate by notice to the Owner, or the principal corporate trust office of any successor Trustee (the address of which such successor owner trustee will notify the Owner, as the same may be amended from time to time).

"Corporation" shall mean Los Angeles County Securitization Corporation, or any successor thereto.

"County" shall mean the County of Los Angeles, California.

"Distribution Account" shall have the meaning assigned to such term in Section 5.01.

"Eligible Deposit Account" shall mean either (a) a segregated trust account held in the corporate trust department of the Trustee or the Indenture Trustee or (b) a segregated trust account with the corporate trust department of a depository institution organized under the laws of the United States of America or any one of the states thereof or Puerto Rico or the District of Columbia (or any domestic branch of a foreign bank), having corporate trust powers and a [Rating Agency] rating of at least [___] of its senior long-term unsecured debt obligations and acting as trustee for funds deposited in such account.

"Exchange Act" shall mean the Securities Exchange Act of 1934, as amended.

"Expenses" shall have the meaning assigned to such term in Section 8.01.

"Indenture" shall mean the Indenture, dated as of [Date], between the Indenture Trustee and the Agency, as the same may be amended or supplemented from time to time.

"Indenture Trustee" shall mean [Indenture Trustee], as trustee pursuant to the Indenture.

"Loan Agreement" shall mean the Secured Loan Agreement dated as of [Date], between the Corporation and the Agency, as the same may be amended or supplemented from time to time.

"Opinion of Counsel" shall mean one or more written opinions of counsel who may, except as otherwise expressly provided in this Agreement, be employees of or counsel to the Trust and who shall be satisfactory to the Trustee, and which opinion or opinions shall be addressed to the Trust and the Trustee and in form and substance satisfactory to the Trustee.

"Owner" shall mean the owner of the Ownership Interest in the Trust, initially the Corporation and then, by operation of the Sale Agreement, the County.

"Ownership Interest" shall mean the undivided beneficial interest in the Trust created by this Agreement.

"Person" shall mean any individual, corporation, estate, partnership, joint venture, association, joint stock company, trust (including any beneficiary thereof), unincorporated organization or government or any agency or political subdivision thereof.

"Residual Certificate" shall mean an instrument substantially in the form of Exhibit A hereto.

"Sale Agreement" shall mean the Sale Agreement dated as of [Date], between the Corporation and the County, as the same may be amended or supplemented from time to time.

"Secretary of State" shall mean the Secretary of State of the State of Delaware.

"Series 2006 Borrowing" shall mean the borrowing of Tobacco Bond proceeds under the Loan Agreement.

"Statutory Trust Statute" shall mean Chapter 38 of Title 12 of the Delaware Code, 12 Del. Code, § 3801 et seq., as the same may be amended from time to time.

"Tobacco Bondholder" shall mean the holders or registered owners of the Tobacco Bonds.

"Tobacco Bonds" shall mean the Agency's $[_____] Tobacco Settlement Asset-Backed Bonds, (Los Angeles County Securitization Corporation) Series 2006A, dated [_____], including any Bonds issued in exchange or replacement therefor.

"Transaction Documents" shall mean this Agreement, the Indenture, the Loan Agreement, the Sale Agreement and the Contract of Purchase.

"Treasury Regulations" shall mean regulations, including proposed or temporary regulations, promulgated under the Code. References herein to specific provisions of proposed or temporary regulations shall include analogous provisions of final Treasury Regulations or other successor Treasury Regulations.

"Trust" shall mean the trust established by this Agreement.

"Trust Company" shall mean [Delaware Trustee], a Delaware banking corporation, or any successor thereto.

"Trustee" shall mean [Delaware Trustee], a Delaware banking corporation, not in its individual capacity but solely as owner trustee under this Agreement, and any successor Trustee hereunder.

"Underwriter" shall mean Citigroup Global Markets Inc., as representative of the underwriters specified in the Contract of Purchase.

SECTION 1.02. Other Definitional Provisions.

(a) Capitalized terms used herein and not otherwise defined herein have the meanings assigned to them in the Sale Agreement or, if not defined therein, in the Indenture.

(b) All terms defined in this Agreement shall have the defined meanings when used in any certificate or other document made or delivered pursuant hereto unless otherwise defined therein.

(c) As used in this Agreement and in any certificate or other document made or delivered pursuant hereto or thereto, accounting terms not defined in this Agreement or in any such certificate or other document, and accounting terms partly defined in this Agreement or in any such certificate or other document to the extent not defined, shall have the respective meanings given to them under generally accepted accounting principles. To the extent that the definitions of accounting terms in this Agreement or in any such certificate or other document are inconsistent with the meanings of such terms under generally accepted accounting principles, the definitions contained in this Agreement or in any such certificate or other document shall control.

(d) The words "hereof," "herein," "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement; Section and Exhibit references contained in this Agreement are references to Sections and Exhibits in or to this Agreement unless otherwise specified; and the term "including" shall mean "including without limitation".

(e) The definitions contained in this Agreement are applicable to the singular as well as the plural forms of such terms and to the masculine as well as to the feminine and neuter genders of such terms.

(f) Any agreement, instrument or statute defined or referred to herein or in any instrument or certificate delivered in connection herewith means such agreement, instrument or statute as from time to time amended, modified or supplemented and includes (in the case of agreements or instruments) references to all attachments thereto and instruments incorporated therein; references to a Person are also to its permitted successors and assigns.

ARTICLE II

ORGANIZATION

SECTION 2.01. Name of Trust; Statement of Intent. The Trust created pursuant to this Agreement shall be known as "Los Angeles County Securitization Corporation Residual Trust," in which name the Trust may engage in the transactions contemplated hereby. It is the intention of the parties hereto that the Trust constitute a not-for-profit business trust under the Statutory Trust Statute and that this Agreement constitute the governing instrument of such business trust. Effective as of the date hereof, the Trustee shall have all rights, powers and duties set forth herein and in the Statutory Trust Statute with respect to accomplishing the purposes of the Trust.

SECTION 2.02. Declaration of Trust. The Trustee hereby declares itself as trustee of the Trust effective as of the date hereof, to have all the rights, powers and duties set forth herein. The Trustee hereby declares that it shall hold the Residual Certificate in trust upon and subject to the conditions set forth herein for the use and benefit of the Owner, subject to the obligations of the Trust hereunder.

SECTION 2.03. Initial Capital Contribution. The Owner hereby sells, assigns, transfers, conveys and sets over to the Trust, as of the date hereof, the sum of $1.00. The Trustee on behalf of the Trust hereby acknowledges receipt in trust from the Owner, as of the date hereof, of the foregoing contribution, which shall constitute the initial property of the Trust and shall be made part of the property of the Trust.

SECTION 2.04. Tax Treatment; Construction.

(a) It is the intention of the parties hereto that, solely for income and franchise tax purposes, the Trust shall be treated as either a grantor trust as defined under the Code or an organization the entire income of which is excluded from gross income under Section 115 of the Code, and all transactions contemplated by this Agreement will be reported consistently with such treatment.

(b) The provisions of this Agreement shall be construed, and the affairs of the Trust shall be conducted, so as to achieve treatment of the Trust as a grantor trust under the Code or an organization the entire income of which is excluded from gross income under Section 115 of the Code.

SECTION 2.05. Title to Trust Property. Legal title to all of the property of the Trust shall be vested at all times in the Trust as a separate legal entity except where applicable law in any jurisdiction requires title to any part of such property to be vested in a trustee or trustees, in which case title shall be deemed to be vested in the Trustee, a co-trustee and/or a separate trustee, as the case may be.

SECTION 2.06. Purposes, Powers and Procedures.

(a) The purpose of the Trust is to acquire, hold and dispose of the Residual Certificate and proceeds therefrom and, in furtherance thereof, to engage in the following activities:

(i) to accept the deposit of the Residual Certificate from the Corporation and to hold and dispose of all or a portion of the Residual Certificate and the proceeds therefrom;

(ii) to pay the organizational, start-up and transactional expenses of the Trust;

(iii) to engage in those activities, including entering into agreements, that are necessary, suitable or convenient to accomplish the foregoing or are incidental thereto or connected therewith, including establishing corporate entities and entering into agreements with financial advisors and other professionals with respect to matters involving the Trust; and

(iv) subject to compliance with this Agreement, to engage in such other activities as may be required in connection with conservation of the property of the Trust and the making of distributions to the Owner.

(b) The Trust is hereby authorized to engage in the foregoing activities. The Trust shall not engage in any activity other than in connection with the foregoing or other than as required or authorized by the terms of this Agreement.

(c) The Trust and the parties to this Agreement shall be subject to the following provisions regarding the purposes, powers and procedures of the Trust:

(i) other than with respect to the transfer to the Trust of the Residual Certificate, the Trust will acquire no obligations of, shall not make loans or advances to, will not borrow funds from, shall not assume or guarantee the obligations or liabilities of, shall not have its obligations or liabilities guaranteed by, and shall not hold itself out as responsible for the debts and obligations of the Trustee, any Owner, the County, the Corporation, the Agency, the Indenture Trustee or any other person or entity;

(ii) the Trust shall, in all dealings with the public, identify itself under the name of the Trust and as a separate and distinct entity from any other Person or entity. All transactions and agreements between the Trust and third parties shall be conducted in the name of the Trust as an entity separate and independent from the Trustee, the County, the Corporation, the Agency and any Owner;

(iii) all transactions and agreements between the Trust on the one hand, and any of the Trustee, the County, the Corporation, the Agency or any Owner on the other hand, shall reflect the separate legal existence of each entity and will be formally documented in writing. The pricing and other material terms of all such transactions and agreements shall be on terms substantially similar to those that would be available on an arm's-length basis with unaffiliated third parties;

(iv) the Trust shall not commingle its funds and other assets with those of any other Person or business entity and shall maintain its assets and liabilities in such a manner that it shall not be unduly costly or difficult to segregate, ascertain or identify its individual assets and liabilities from those of any other person or entity. The Trustee shall hold the Residual Certificate on behalf of the Trust;

(v) the Trust shall pay its liabilities and losses as they become due from payments received by it with respect to the Residual Certificate, provided, however, that the Residual Certificate shall not operate to pay the liabilities (including liability in respect of guaranties) and losses of any Owner. The Trust has been structured to maintain capital in an amount reasonably sufficient to meet the anticipated needs of the Trust;

(vi) the Trust shall not share any of the same officers or other employees with the County, the Corporation, the Agency or any Owner.

(vii) the Trust shall not jointly with the County, the Corporation, the Agency or any Owner contract or do business with vendors or service providers or share overhead expenses;

(viii) the Trust shall maintain its own bank accounts, books and records and annual financial statements prepared in accordance with generally accepted accounting principles, separate from those of the County, the Corporation, the Agency, the Trustee or any Owner. The foregoing will reflect that the assets and liabilities of and all transactions and transfers of funds involving the Trust shall be separate from those of each such other entity, and the Trust shall pay or bear the cost of the preparation of its own financial statements and shall not pay or bear the cost of the preparation of the financial statements of any such other entity. Neither the accounting records nor the financial statements of the Trust will indicate that the Residual Certificate is available to pay creditors of the County, the Corporation, the Agency or any Owner or any other person or entity;

(ix) to the fullest extent permitted by applicable law, the Trustee shall not have the power to (i) institute proceedings to have the Trust declared or adjudicated a bankruptcy or insolvent, (ii) consent to the institution of bankruptcy or insolvency proceedings against the Trust, (iii) file a petition or consent to a petition seeking reorganization or relief on behalf of the Trust under any applicable federal or state law relating to bankruptcy, (iv) consent to the appointment of a receiver, liquidator, assignee, trustee, sequestrator (or any similar official) of the Trust or a substantial portion of the property of the Trust, (v) make any assignment for the benefit of the Trust's creditors, (vi) cause the Trust to admit in writing its inability to pay its debts generally as they become due, (vii) take any action, or cause the Trust to take any action, in furtherance of any of the foregoing (any of the above, a "Bankruptcy Action");

(x) the Trustee covenants and agrees that, to the fullest extent permitted by law, it will not at any time institute against any Owner, or join in any institution against any Owner of any bankruptcy, reorganization, arrangement, insolvency or liquidation proceeding or other proceeding under any United States federal or state bankruptcy or similar law in connection with any obligations relating to this Agreement;

(xi) the Corporation, in its capacity as depositor, covenants and agrees that it will not at any time institute against any Owner, or join in any institution against any Owner of any bankruptcy, reorganization, arrangement, insolvency or liquidation proceeding or other proceeding under any United States federal or state bankruptcy or similar law in connection with any obligations relating to this Agreement. The Corporation, in its capacity as depositor, further covenants and agrees that it will not, in any capacity, seek the substantive consolidation of the assets of the Trust with those of any Owner; and

(xii) the property of the Trust may not inure to the benefit of any Person other than the Owner and the Trustee.

SECTION 2.07. Income of the Trust.

(a) The Income (as defined in paragraph (c) below) of the Trust shall accrue and inure only to the benefit of the Owner.

(b) The Trust shall promptly after the receipt thereof distribute all of its Income to the Owner; provided, however, that to the extent the Trust does not have sufficient funds available (after the payment in full of all obligations of the Trust of whatever kind or nature) to make the required distribution of Income to the Owner, the Trust shall make an entry on its books and records reflecting a current obligation of the Trust to pay to the Owner the remainder of the Income in a subsequent taxable year once funds become available to the Trust.

(c) For purposes of this Section 2.07, "Income" shall mean all payments made with respect to the Residual Certificate that have been received by the Trust, as holder of the Residual Certificate, since the last distribution of such payments, less the expenses of the Trust and other allowable deductions of the Trust that have properly accrued for such period.

SECTION 2.08. Liability of the Owner. The Owner shall be entitled to the protections and limitations of liability as set forth in Section 3803 of the Statutory Trust Statute.

SECTION 2.09. Situs of Trust. The Trust will be located and administered in the State of Delaware at the Corporate Trust Office of the Trustee. All bank accounts maintained by the Trustee on behalf of the Trust shall be located in the State of Delaware or the State of California. The Trust may have one or more managers or employees within or without the State of Delaware. Payments will be received by the Trust only in Delaware or California, and payments will be made by the Trust only from Delaware or California. The only office of the Trust will be at the Corporate Trust Office in Delaware.

ARTICLE III

OWNERSHIP INTEREST

SECTION 3.01. Ownership. On the Closing Date and simultaneously with the issuance by the Agency of the Tobacco Bonds pursuant to the Indenture and the deposit of the Residual Certificate by the Corporation with the Trust, the Ownership Interest shall, without any further act by any Person, be deemed to be validly issued to, or upon the written order of, the Corporation. Pursuant to Section 2 of the Sale Agreement, the Corporation shall also deliver to the County on the Closing Date the Ownership Interest and hereby requests and directs the Trustee, upon such delivery, to reflect on the books and records of the Trust the County as the Owner.

SECTION 3.02. Registration of Ownership Interest. Upon the written request of the Owner, the Ownership Interest may be evidenced by one or more certificates; provided, however, no certificate evidencing the ownership of the Ownership Interest shall be issued while the County is the Owner. The Trustee shall reflect on the books and records of the Trust the name and address of the Owner, which shall serve as conclusive evidence of the ownership of the Ownership Interest. Upon any transfer of or succession to the Ownership Interest, the Trustee shall reflect on the books and records of the Trust the name and address of the new Owner of the Ownership Interest. A written request from an Owner to the Trustee shall be sufficient instruction to the Trustee to transfer the Ownership Interest. The books and records of the Trust shall be conclusive as to the identity of the Owner for the purpose of receiving

distributions pursuant to this Agreement and for all other purposes whatsoever, and the Trustee shall not be affected by notice to the contrary.

ARTICLE IV

CERTAIN RIGHTS OF OWNER

SECTION 4.01. Prior Notice to Owner with Respect to Certain Matters. With respect to the following matters, the Trustee shall take action only in accordance with written instructions from the Owner or, if before the taking of such action, the Trustee shall have notified the Owner in writing of the proposed action (which notice shall refer to this Section of the Agreement and shall specify that failure to respond shall be deemed a withholding of consent) and the Owner shall have notified the Trustee in writing prior to the 30th day after such notice is given that the Owner has consented to:

(a) the initiation of any claim or lawsuit by the Trust and the compromise of any action, claim or lawsuit brought by or against the Trust; or

(b) the election by the Trust to file an amendment to the Certificate of Trust (unless such amendment is required to be filed under the Statutory Trust Statute).

SECTION 4.02. Consent by Owner with Respect to Certain Matters. The Trustee shall not have the power to sell the Residual Certificate or the proceeds thereof except upon written instructions signed by the Owner.

SECTION 4.03. Action by Owner with Respect to Bankruptcy. It is the intention of the parties hereto that the Trust not constitute a "business trust" within the meaning of Title 11 of the United States Code entitled "Bankruptcy," and that the Trust not have the benefit of the provisions thereof.

SECTION 4.04. Restrictions on Owner's Power. The Owner shall not direct the Trustee to take or to refrain from taking any action if such action or inaction would be contrary to any obligation of the Trust or the Trustee under this Agreement or would be contrary to Section 2.06, nor shall the Trustee be obligated to follow any such direction, if given.

SECTION 4.05. Owner's Instruction.

(a) The Trustee shall not be required to take any action hereunder if the Trustee shall have reasonably determined, or shall have been advised by counsel, that such action is likely to result in liability on the part of the Trustee or is contrary to the terms hereof or is otherwise contrary to law.

(b) In the event that the Trustee is unable to decide between alternative courses of action permitted or required by, or is unsure as to the application of, any provision of this Agreement, or any such provision is ambiguous as to its application, or is, or appears to be, in conflict with any other applicable provision, or in the event that this Agreement permits any determination by the Trustee or is silent or is incomplete as to the course of action that the Trustee is required to take with respect to a particular set of facts, the Trustee may give notice (in

such form as shall be appropriate under the circumstances) to the Owner requesting instruction and, to the extent that the Trustee acts or refrains from acting in good faith in accordance with any such instruction received, the Trustee shall not be liable, on account of such action or inaction, to any Person. If the Trustee shall not have received appropriate instruction within 10 days of such notice (or within such shorter period of time as reasonably may be specified in such notice or may be necessary under the circumstances) it may, but shall be under no duty to, take or refrain from taking such action not inconsistent with this Agreement, as it shall deem to be in the best interests of the Owner, and shall have no liability to any Person for such action or inaction.

SECTION 4.06. The Authorized Financial Officer of the Owner. So long as the County shall be the Owner, the Authorized Financial Officer of the Owner shall have and exercise all rights and responsibilities on behalf of the Owner hereunder, including the right to give and receive instructions and notices.

ARTICLE V

APPLICATION OF TRUST FUNDS; CERTAIN DUTIES

SECTION 5.01. Establishment of Trust Account.

(a) The Trustee shall establish and maintain in the name of the Trust an Eligible Deposit Account known as the Los Angeles County Securitization Corporation Residual Trust Distribution Account (the "Distribution Account"), bearing an additional designation clearly indicating that the funds deposited therein are held for the benefit of the Trust.

(b) The Trust shall possess all right, title and interest in all funds on deposit from time to time in the Distribution Account and in all proceeds thereof. Except as otherwise expressly provided herein, the Distribution Account shall be under the sole dominion and control of the Trustee. If, at any time, the Distribution Account ceases to be an Eligible Deposit Account, the Trustee shall establish a new Distribution Account as an Eligible Deposit Account and shall transfer any cash and/or any investments to such new Distribution Account.

SECTION 5.02. Application of Trust Funds. All moneys received by the Trustee in respect of the Residual Certificate shall be deposited in the Distribution Account and distributed by the Trustee to the Owner in accordance with Section 2.07. After all amounts due with respect of the Tobacco Bonds have been paid in full, the Owner shall have the ability to direct the Trustee with respect to all matters relating to the Trust, including dissolution and termination of the Trust pursuant to Section 9.01 of this Agreement.

SECTION 5.03. Method of Payment. Any distributions required to be made to the Owner pursuant to Sections 5.02 and 9.01 shall be made to the Owner either by wire transfer, in immediately available funds, to the account of the Owner at a bank or other entity having appropriate facilities therefor, if the Owner shall have provided to the Trustee appropriate written instructions at least five Business Days prior to distribution or, if not, by check mailed to the Owner at the address specified in Section 11.04.

SECTION 5.04. No Segregation of Moneys; No Interest. Subject to Section 5.02, money received by the Trustee hereunder need not be segregated in any manner except to the extent required by law and may be deposited under such general conditions as may be prescribed by law, and the Trustee shall not be liable for any interest thereon.

SECTION 5.05. Accounting and Reports.

(a) The Trustee shall (i) maintain (or cause to be maintained) the books of the Trust on a fiscal year basis, with a fiscal and taxable year ending June 30 and using the accrual method of accounting, (ii) cause to be filed such tax returns relating to the Trust and make such elections as directed in writing by the Owner as required or appropriate from time to time under any applicable state or federal statute or any rule or regulation thereunder so as to maintain the Trust's characterization as a grantor trust for federal income tax purposes and (iii) cause such tax returns to be signed in the manner required by law.

(b) The Trustee shall satisfy its obligations with respect to this Section and Section 7.02 by retaining, at the expense of the Trust, a firm of independent public accountants or other Person (the "Accountants") which shall perform the obligations of the Trustee under this Section. The Accountants will provide a letter in form and substance satisfactory to the Trustee and the Owner, agreeing to perform such obligations.

ARTICLE VI

AUTHORITY AND DUTIES OF TRUSTEE

SECTION 6.01. General Duties. It shall be the duty of the Trustee to discharge (or cause to be discharged) all of its responsibilities pursuant to the terms of this Agreement and to administer the Trust in the interest of the Owner, in accordance with the provisions of this Agreement.

SECTION 6.02. No Duties Except as Specified in this Agreement or in Instructions. The Trustee shall not have any duty or obligation to manage, make any payment with respect to, register, record, sell, dispose of, or otherwise deal with the Residual Certificate, or to otherwise take or refrain from taking any action under, or in connection with, any document contemplated hereby to which the Trustee is a party, except as expressly provided by the terms of this Agreement or in any document or written instruction received by the Trustee pursuant to Article IV; and no implied duties or obligations shall be read into this Agreement against the Trustee. The Trustee shall have no responsibility for filing any financing or continuation statement in any public office at any time or to otherwise perfect or maintain the perfection of any security interest or lien or to record this Agreement. The Trustee nevertheless agrees that it will, at its own cost and expense, promptly take all action as may be necessary to discharge any liens on any part of the property of the Trust that result from actions by, or claims against, the Trust Company that are not related to the ownership or the administration of the property of the Trust.

SECTION 6.03. No Action Except Under Specified Documents or Instructions. The Trustee shall not manage, control, use, sell, dispose of or otherwise deal with any part of the property of the Trust except (i) in accordance with the powers granted to and the authority

conferred upon the Trustee pursuant to this Agreement and (ii) in accordance with any document or instruction delivered to the Trustee pursuant to Article IV.

SECTION 6.04. Restrictions. The Trustee shall not take any action (a) that is inconsistent with the purposes of the Trust set forth in Section 2.06 or (b) that, to the actual knowledge of the Trustee, would result in the Trust being treated as an association or other entity subject to federal income tax. The Owner shall not direct the Trustee to take action that would violate the provisions of this Section.

ARTICLE VII

CONCERNING THE TRUSTEE

SECTION 7.01. Acceptance of Trusts and Duties. The Trustee accepts the trusts hereby created and agrees to perform its duties hereunder with respect to such trusts but only upon the terms of this Agreement. The Trustee also agrees to disburse all moneys actually received by it constituting part of the property of the Trust upon the terms of this Agreement. It is expressly understood and agreed that (i) any Person having any claim against the Trustee or the Trust by reason of the transactions contemplated in this Agreement shall have recourse solely against the assets of the Trust, and (ii) under no circumstances shall the Trust Company in its individual capacity or in its capacity as Trustee be liable for the payment of any indebtedness, costs or expenses of the Trustee or the Trust or be liable for the breach or failure of any obligation, representation, warranty or covenant made or undertaken by the Trustee or the Trust in this Agreement or otherwise; but this limitation on liability shall not protect the Trust Company against any liability to the Owner to which it would otherwise be subject by reason of (x) its willful misconduct or gross negligence in the performance of its duties under this Agreement or (y) the inaccuracy of any representation or warranty contained in Section 7.04 hereof expressly made by the Trust Company. In particular, but not by way of limitation (and subject to the exceptions set forth in the preceding sentence):

(a) the Trustee shall not be liable with respect to any action taken or omitted to be taken by it in accordance with the instructions of the Owner;

(b) no provision of this Agreement shall require the Trustee to expend or risk funds or otherwise incur any financial liability in the performance of any of its rights or powers hereunder if the Trustee shall have reasonable grounds for believing that repayment of such funds or adequate indemnity against such risk or liability is not reasonably assured or provided to it;

(c) under no circumstances shall the Trustee be liable for indebtedness evidenced by or arising under any of the Transaction Documents;

(d) the Trustee shall not be responsible for or in respect of the validity or sufficiency of this Agreement or for the form, character, genuineness, sufficiency, value or validity of any of the property of the Trust, and the Trustee shall in no event assume or incur any liability, duty, or obligation, to any Bondholder or, other than as expressly provided for herein, to the Owner;

(e) the Trustee shall not be liable for the default or misconduct of, or the monitoring or supervising, or the ensuring compliance by, the Owner, the County, the Corporation, the

Agency or the Indenture Trustee under any of the Transaction Documents or otherwise and the Trustee shall have no obligation or liability to perform the obligations of the Trust under this Agreement that are delegated to or required to be performed by any other Person; and

(f) the Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Agreement, or to institute, conduct or defend any litigation under this Agreement or otherwise or in relation to this Agreement, at the request, order or direction of the Owner or any other Person, unless the Trustee receives security or indemnity reasonably satisfactory to it against the costs, expenses and liabilities that may be incurred by the Trustee therein or thereby. The right of the Trustee to perform any discretionary act enumerated in this Agreement shall not be construed as a duty, and the Trustee shall not be answerable to the Owner for other than its negligence or willful misconduct in the performance of any such act.

SECTION 7.02. Tax Returns and Information Returns. Subject to Section 5.05(b), the Trustee (a) shall prepare or cause to be prepared, signed and filed, all tax returns, including all applicable statements or schedules thereto, on behalf of the Trust (including federal and state income tax returns) and (b) to the extent required by law, shall prepare, or cause to be prepared, the applicable state or local information returns with respect to the Trust and all applicable statements or schedules thereto, and shall file or cause to be filed with the Internal Revenue Service or applicable state or local authorities and furnish to each Owner such information returns, statements and schedules at the time and in the manner required by the Code or applicable state or local law.

SECTION 7.03. Books and Records. The Trustee shall maintain, in the name of the Trust, all of the books and financial records of the Trust, including the Distribution Account.

SECTION 7.04. Representations and Warranties. The Trust Company hereby represents and warrants to the Owner, that:

(a) it is a banking corporation duly organized and validly existing in good standing under the laws of the State of Delaware. It has all requisite corporate power and authority to execute, deliver and perform its obligations under this Agreement.

(b) it has taken all corporate action necessary to authorize the execution and delivery by it of this Agreement, and this Agreement will be executed and delivered by one of its officers who is duly authorized to execute and deliver this Agreement on its behalf.

(c) neither the execution nor the delivery by it of this Agreement, nor the consummation by it of the transactions contemplated hereby nor compliance by it with any of the terms or provisions hereof will contravene any federal or Delaware law, governmental rule or regulation governing the banking or trust powers of the Trustee or any judgment or order binding on it, or constitute any default under its charter documents or bylaws or any indenture, mortgage, contract, agreement or instrument to which it is a party or by which any of its properties may be bound.

(d) on the Closing Date, it will have adequate capital to carry on its business and will be able to pay anticipated liabilities as and when they become due.

SECTION 7.05. Covenants. The Trustee hereby covenants to the Owner that:

(a) it will observe all applicable corporate or trust procedures and formalities; representatives, employees and agents of the Trust will hold themselves out to third parties as being representatives of the Trust and not representatives of the Owner;

(b) it will, through its officers and directors, act independently and in the best interests of the Trust and will conduct the Trust's business functions and operations and will manage the Trust's assets so as to fulfill the fiduciary and contractual obligations owed to the Trust and the Owner; and

(c) it will not take any action that is inconsistent with any of the terms or provisions of this Agreement and that would give (i) any future creditor of either the Trustee, in its individual capacity, or the Owner cause to believe mistakenly that any obligation to such creditor incurred by the Trust Company or the Owner would be not only the obligation of the Trust Company or the Owner, but also of the Trust, or (ii) any future creditor of either the Trust Company or the Owner cause to believe mistakenly that the Trust Company and the Owner were not or would not continue to remain separate and distinct from the Trust.

SECTION 7.06. Reliance; Advice of Counsel.

(a) The Trustee shall incur no liability to anyone in acting upon any signature, instrument, notice, resolution, request, consent, order, certificate, report, opinion, bond, or other document or paper reasonably believed by it to be genuine and reasonably believed by it to be signed by the proper party or parties. The Trustee may accept a certified copy of a resolution of the board of directors or other governing body of any party as conclusive evidence that such resolution has been duly adopted by such body and that the same is in full force and effect. As to any fact or matter the method of the determination of which is not specifically prescribed herein, the Trustee may for all purposes hereof rely on a certificate, signed by the president or any vice president or by the treasurer or other authorized officers of the relevant party, as to such fact or matter and such certificate shall constitute full protection to the Trustee for any action taken or omitted to be taken by it in good faith in reliance thereon.

(b) In the exercise or administration of the trusts hereunder and in the performance of its duties and obligations under this Agreement, the Trustee (i) may act directly or through its agents or attorneys pursuant to agreements entered into with any of them, and (ii) may consult with counsel, accountants and other skilled persons to be selected in good faith and employed by it.

SECTION 7.07. Not Acting in Individual Capacity. Except as otherwise expressly provided in this Article VII, in accepting the trusts hereby created the Trust Company acts solely as Trustee hereunder and not in its individual capacity, and all Persons having any claim against the Trustee by reason of the transactions contemplated by this Agreement shall look only to the property of the Trust for payment or satisfaction thereof.

SECTION 7.08. Trustee Not Liable for Residual Certificate Payments. The Trustee shall at no time have any responsibility or liability for or with respect to the sufficiency of the property

of the Trust or its ability to generate the payments to be distributed to the Owner under this Agreement.

SECTION 7.09. Trustee May Not Own Tobacco Bonds. The Trustee in its individual or any other capacity may not become the owner or pledgee of Tobacco Bonds. However, the Trustee may deal with the Owner, the Indenture Trustee, the Corporation and the Agency in banking transactions with the same rights and in the same manner as it would have if it were not Trustee.

ARTICLE VIII

COMPENSATION OF TRUSTEE

SECTION 8.01. Trustee's Fees and Expenses. The Trustee shall receive as compensation for its services hereunder such fees as have been separately agreed upon with the Owner, and the Trustee shall be entitled to be reimbursed from the Owner for its other reasonable expenses hereunder, including the reasonable compensation, expenses and disbursements of such agents, representatives, experts and counsel as the Trustee may employ in connection with the exercise and performance of its rights and its duties hereunder. Such fees and expenses of the Trustee shall be referred to herein as the "Expenses." The Owner hereby agrees, whether or not any of the transactions contemplated by the Agreement shall be consummated, to assume liability for, and hereby indemnifies, protects, saves and keeps harmless the Trustee (including in its individual capacity), and its officers, directors, successors, assigns, legal representatives, agents and servants (each an "Indemnified Person"), from and against any and all liabilities, obligations, losses, damages, penalties, taxes (excluding any taxes payable by the Trustee on or measured by any compensation received for its services as Trustee), claims, actions, investigations, proceedings, costs, expenses or disbursements (including reasonable fees and expenses) of any kind and nature whatsoever which may be imposed on, incurred by or asserted at any time against an Indemnified Person (whether or not also indemnified against by any other person) in any way relating to or arising out of the Agreement or any of the other agreements to which the Trust is or becomes a party or the enforcement of any of the terms of any thereof or the administration of the assets of the Trust or the action or inaction of the Trustee under the Agreement, except where any such claim for indemnification has arisen as a result of the willful misconduct or gross negligence on the part of [Delaware Trustee] in the performance or nonperformance of its duties under the Agreement.

SECTION 8.02. Payments to the Trustee. Any amounts paid to the Trustee or the Trust Company pursuant to this Article VIII shall be deemed not to be a part of the property of the Trust immediately after such payment.

SECTION 8.03. Lien to Secure Payment. The Trustee and the Trust Company are hereby granted and shall be deemed to have a lien on, and a security interest in, the property of the Trust, to the extent of any such amounts from time to time due and unpaid.

ARTICLE IX

TERMINATION OF TRUST AGREEMENT

SECTION 9.01. Termination of Trust Agreement.

(a) Neither the bankruptcy, liquidation or dissolution of the Owner nor the transfer, by operation of law or otherwise, of any right, title and interest of the Owner in and to its undivided beneficial interest in the property of the Trust shall (x) operate to dissolve the Trust or terminate this Agreement or (y) entitle such transferee or the Owner's legal representatives to claim an accounting or to take any action or proceeding in any court for a partition or winding up of all or any part of the Trust or its property or (z) otherwise affect the rights, obligations and liabilities of the parties hereto. No creditor of the Owner shall obtain legal title to or exercise legal or equitable remedies with respect to the property of the Trust as a result of the Owner holding a beneficial interest in the Trust.

(b) This Trust shall not be subject to dissolution while any Tobacco Bonds remain Outstanding and thereafter shall be dissolved solely upon the direction of the Owner pursuant to Section 5.02 of this Agreement.

(c) Upon the dissolution of the Trust, and upon completion of winding up in accordance with the Statutory Trust Statute, any remaining property of the Trust shall be distributed to the Owner and the Trustee shall cause the Certificate of Trust to be canceled by filing a certificate of cancellation with the Secretary of State in accordance with the provisions of Section 3810 of the Statutory Trust Statute. Upon such certificate of cancellation becoming effective, the Trust and this Agreement shall terminate and be of no further force or effect.

ARTICLE X

SUCCESSOR TRUSTEES AND ADDITIONAL TRUSTEES

SECTION 10.01. Eligibility Requirements for Trustee. The Trustee shall at all times be a Person satisfying the provisions of Section 3807(a) of the Statutory Trust Statute; authorized to exercise corporate trust powers; having a combined capital and surplus of at least $50,000,000 (or whose obligations hereunder are guaranteed by a bank or trust company authorized to exercise corporate trust powers and subject to examination by Federal or state authority, of good standing and having a combined capital and surplus aggregating at least such amount) and subject to supervision or examination by federal or state authorities; and having (or having a parent that has) at least an investment grade rating on its long-term unsecured debt from at least one nationally recognized statistical rating organization; and not affiliated directly or indirectly with the Owner or involved in the organization of the Owner. If such Person shall publish reports of condition at least annually, pursuant to law or to the requirements of the aforesaid supervising or examining authority, then for the purpose of this Section, the combined capital and surplus of such Person shall be deemed to be its combined capital and surplus as set forth in its most recent report of condition so published. In case at any time the Trustee shall cease to be eligible in accordance with the provisions of this Section, the Trustee shall resign immediately in the manner and with the effect specified in Section 10.02.

SECTION 10.02. Resignation or Removal of Trustee.

(a) The Trustee may at any time resign and be discharged from the trusts hereby created by giving written notice thereof to the Owner. Upon receiving such notice of resignation, the Owner shall promptly appoint a successor Trustee by written instrument, in duplicate, one copy of which instrument shall be delivered to the resigning Trustee and one copy to the successor Trustee. If no successor Trustee shall have been so appointed and have accepted appointment within 30 days after the giving of such notice of resignation, the resigning Trustee may petition any court of competent jurisdiction for the appointment of a successor Trustee.

(b) If at any time the Trustee shall cease to be eligible in accordance with the provisions of Section 10.01 and shall fail to resign after written request therefor, or if at any time the Trustee shall be legally unable to act, or shall be adjudged insolvent, or a receiver of the Trustee or of its property shall be appointed, or any public officer shall take charge or control of the Trustee or of its property or affairs for the purpose of rehabilitation, conservation or liquidation, then the Owner may remove the Trustee. If the Owner shall remove the Trustee under the authority of the immediately preceding sentence, the Owner shall promptly appoint a successor Trustee by written instrument, in duplicate, one copy of which instrument shall be delivered to the outgoing Trustee so removed and one copy to the successor Trustee.

(c) In addition to (a) and (b) above, the Owner may remove the Trustee at any time with or without cause.

(d) Any resignation or removal of the Trustee and appointment of a successor Trustee pursuant to any of the provisions of this Section shall not become effective until acceptance of appointment by the successor Trustee pursuant to Section 10.03 and payment of all fees and expenses owed to the outgoing Trustee.

SECTION 10.03. Successor Trustee.

(a) Any successor Trustee appointed pursuant to Section 10.02 shall execute, acknowledge and deliver to the Owner and to its predecessor Trustee an instrument accepting such appointment under this Agreement, and thereupon the resignation or removal of the predecessor Trustee shall become effective, and such successor Trustee, without any further act, deed or conveyance, shall become fully vested with all the rights, powers, duties and obligations of its predecessor under this Agreement, with like effect as if originally named as Trustee. The predecessor Trustee shall upon payment of its fees and expenses deliver to the successor Trustee all documents and statements and monies held by it under this Agreement; and the Owner and the predecessor Trustee shall execute and deliver such instruments and do such other things as may reasonably be required for fully and certainly vesting and confirming in the successor Trustee all such rights, powers, duties and obligations.

(b) No successor Trustee shall accept appointment as provided in this Section unless at the time of such acceptance such successor Trustee shall be eligible pursuant to Section 10.01.

(c) Upon acceptance of appointment by a successor Trustee pursuant to this Section, the successor Trustee shall mail notice thereof to the Indenture Trustee.

SECTION 10.04. Merger or Consolidation of Trustee. Any Person into which the Trustee may be merged or converted or with which it may be consolidated, or any Person resulting from any merger, conversion or consolidation to which the Trustee shall be a party, or any Person succeeding to all or substantially all of the corporate trust business or municipal trust and agency business of the Trustee, shall be the successor of the Trustee hereunder if eligible pursuant to Section 10.01, without the execution or filing of any instrument or any further act on the part of any of the parties hereto, anything herein to the contrary notwithstanding.

SECTION 10.05. Appointment of Co-Trustee or Separate Trustee.

(a) Notwithstanding any other provisions of this Agreement, at any time, for the purpose of meeting any legal requirements of any jurisdiction in which any part of the property of the Trust may at the time be located, the Owner and the Trustee acting jointly shall have the power and may execute and deliver all instruments to appoint one or more Persons approved by the Owner and Trustee to act as co-trustee, jointly with the Trustee, or as separate trustee or separate trustees, of all or any part of the property of the Trust, and to vest in such Person, in such capacity, such title to the Trust or any part thereof and, subject to the other provisions of this Section, such powers, duties, obligations, rights and trusts as the Owner and the Trustee may consider necessary or desirable. If the Owner shall not have joined in such appointment within 15 days after the receipt by it of a request so to do, the Trustee alone shall have the power to make such appointment. No co-trustee or separate trustee under this Agreement shall be required to meet the terms of eligibility as a successor Trustee pursuant to Section 10.01 and no notice of the appointment of any co-trustee or separate trustee shall be required pursuant to Section 10.03.

(b) Each separate trustee and co-trustee shall, to the extent permitted by law, be appointed and act subject to the following provisions and conditions:

(i) all rights, powers, duties, and obligations conferred or imposed upon the Trustee shall be conferred upon and exercised or performed by the Trustee and such separate trustee or co-trustee jointly (it being understood that such separate trustee or co-trustee is not authorized to act separately without the Trustee joining in such act), except to the extent that under any law of any jurisdiction in which any particular act or acts are to be performed, the Trustee shall be incompetent or unqualified to perform such act or acts, in which event such rights, powers, duties and obligations (including the holding of title to the Trust or any portion thereof in any such jurisdiction) shall be exercised and performed singly by such separate trustee or co-trustee, but solely at the direction of the Trustee;

(ii) no trustee under this Agreement shall be personally liable by reason of any act or omission of any other trustee under this Agreement; and

(iii) the Owner and the Trustee acting jointly may at any time accept the resignation of or remove any separate trustee or co-trustee.

(c) Any notice, request or other writing given to the Trustee shall be deemed to have been given to each of the then separate trustees and co-trustees, as effectively as if actually given

to each of them. Every instrument appointing any separate trustee or co-trustee shall refer to this Agreement and the conditions of this Article. Each separate trustee and co-trustee, upon its acceptance of the trusts conferred, shall be vested with the estates or property specified in its instrument of appointment, either jointly with the Trustee or separately, as may be provided therein, subject to all the provisions of this Agreement, specifically including every provision of this Agreement relating to the conduct of, affecting the liability of, or affording protection to, the Trustee. Each such instrument shall be filed with the Trustee and a copy thereof given to the Owner.

(d) Any separate trustee or co-trustee may at any time appoint the Trustee as its agent or attorney-in-fact with full power and authority, to the extent not prohibited by law, to do any lawful act under or in respect of this Agreement on its behalf and in its name. If any separate trustee or co-trustee shall die, become incapable of acting, resign or be removed, all of its estates, properties, rights, remedies and trusts shall vest in and be exercised by the Trustee, to the extent permitted by law, without the appointment of a new or successor co-trustee or separate trustee.

ARTICLE XI

MISCELLANEOUS

SECTION 11.01. Amendments.

(a) This Agreement may be amended by the Owner and the Trustee if the Trustee has received an Opinion of Counsel stating that the amendment (i) will have no material adverse tax consequences to the Trust or to Tobacco Bondholders and (ii) will not materially adversely affect the bankruptcy opinions of transaction counsel to the Agency delivered in connection with the issuance of the Tobacco Bonds.

(b) Promptly after the execution of any amendment to the Certificate of Trust, the Trustee shall cause the filing of such amendment with the Secretary of State.

(c) Prior to the execution of any amendment to this Agreement or the Certificate of Trust, the Trustee shall be entitled to receive and rely upon an Opinion of Counsel stating that the execution of such amendment is authorized or permitted by this Agreement. The Trustee may, but shall not be obligated to, enter into any such amendment that affects the Trustee's own rights, duties or immunities under this Agreement or otherwise.

SECTION 11.02. No Legal Title to the Property of the Trust in Owner. The Owner shall not have legal title to any part of the property of the Trust. The Owner shall be entitled to receive distributions with respect to its undivided beneficial ownership interest therein only in accordance with Articles V and IX.

SECTION 11.03. Limitations on Rights of Others. The provisions of this Agreement are solely for the benefit of the Trust Company, the Trustee and the Owner and nothing in this Agreement, whether express or implied, shall be construed to give to any other Person any legal or equitable right, remedy or claim in the property of the Trust or under or in respect of this Agreement or any covenants, conditions or provisions contained herein.

SECTION 11.04. Notices.

(a) Unless otherwise expressly specified or permitted by the terms hereof, all notices shall be in writing and shall be deemed given upon receipt by the intended recipient or three Business Days after mailing if mailed by certified mail, postage prepaid (except that notice to the Owner and the Trustee shall be deemed given only upon actual receipt by the Owner or the Trustee), if to the Trustee, addressed to the Corporate Trust Office, Attention: Corporate Trust Administration; if to the Owner, addressed to the address listed in the books and records of the Trust maintained by the Trustee pursuant to Section 3.02; if to the Indenture Trustee, addressed to it as specified in the Indenture; or, as to each party, at such other address as shall be designated by such party in a written notice to each other party.

(b) Upon its receipt of written notice thereof or upon a Trust Officer of the Trustee having actual knowledge thereof, the Trustee shall promptly notify [Rating Agency] of (i) any transfer of the Ownership Interest, (ii) the taking of any of the actions specified in Section 4.01 hereof, (iii) any sale of the Residual Certificate, (iv) the appointment of any successor Trustee, (v) any merger or consolidation of the Trustee, (vi) any appointment of a co-trustee or separate trustee and (vii) any amendment of this Agreement.

SECTION 11.05. Severability. Any provision of this Agreement that is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof, and any such prohibition or unenforceability in any jurisdiction shall not invalidate or render unenforceable such provision in any other jurisdiction.

SECTION 11.06. Separate Counterparts. This Agreement may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

SECTION 11.07. Successors and Assigns. All covenants and agreements contained herein shall be binding upon, and inure to the benefit of, the Trustee and its successors and assigns and the Owner and its successors and permitted assigns, all as herein provided. Any request, notice, direction, consent, waiver or other instrument or action by the Owner shall bind the successors and assigns of the Owner.

SECTION 11.08. Headings. The headings of the various Articles and Sections herein are for convenience of reference only and shall not define or limit any of the terms or provisions hereof.

SECTION 11.09. Governing Law. THIS AGREEMENT SHALL BE GOVERNED BY AND CONSTRUED IN ACCORDANCE WITH THE LAWS OF THE STATE OF DELAWARE, WITHOUT REFERENCE TO ITS CONFLICT OF LAW PROVISIONS, AND THE OBLIGATIONS, RIGHTS AND REMEDIES OF THE PARTIES HEREUNDER SHALL BE DETERMINED IN ACCORDANCE WITH SUCH LAWS; EXCEPT THAT MATTERS REGARDING THE AUTHORITY OF THE OWNER AND THE VALIDITY OF ACTIONS TAKEN BY THE OWNER HEREUNDER SHALL BE GOVERNED BY CALIFORNIA LAW OR THE LAW OF THE JURISDICTION OF ITS ORGANIZATION.

IN WITNESS WHEREOF, the Trustee has caused this Declaration and Agreement of Trust to be duly executed by its appropriate officer hereunto duly authorized, as of the day and year first above written.

[DELAWARE TRUSTEE], as Trustee

By: _____
Name:
Title:

LOS ANGELES COUNTY SECURITIZATION CORPORATION, as initial Owner of the Ownership Interest

By: _____
Name: [_____]
Title: [_____]

EXHIBIT A

REGISTERED
NUMBER 1

LOS ANGELES COUNTY SECURITIZATION CORPORATION

RESIDUAL CERTIFICATE

REGISTERED OWNER: LOS ANGELES COUNTY SECURITIZATION CORPORATION RESIDUAL TRUST

LOS ANGELES COUNTY SECURITIZATION CORPORATION (the "Corporation"), a non-profit corporation duly organized and existing under the laws of the State of California (the "State"), for value received promises to pay to the registered owner of this Residual Certificate, promptly upon its receipt thereof, the revenues of the Corporation that are in excess of the Corporation's expenses, debt service and contractual obligations pursuant to the Loan Agreement dated as of [Date], as the same may be amended or supplemented from time to time (the "Loan Agreement"), between the Corporation and THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY, by wire transfer, at the discretion of the Corporation, or by check mailed to the address of the registered owner hereof.

This Residual Certificate shall not be a debt of either the State or the County of Los Angeles, California (the "County"), and neither the State nor the County shall be liable hereon, nor shall it be payable out of any funds other than those of the Corporation. Neither the Directors of the Corporation nor any person executing this Residual Certificate shall be liable personally thereon or be subject to any personal liability or accountability solely by reasons of the issuance hereof.

Reference is made to the Loan Agreement for a description of the sources of funds for the payment of this Residual Certificate and for the provisions with respect to the rights, limitations of rights, duties, obligations and immunities of the Corporation. Definitions given or referred to in the Loan Agreement are incorporated herein by this reference.

This Residual Certificate is issuable only in fully registered form and may not be converted into bearer form. The Corporation may treat the registered owner as the absolute owner of this Residual Certificate for all purposes, notwithstanding any notice to the contrary.

IN WITNESS WHEREOF, the Corporation has caused this Residual Certificate to be executed in its name by its President, all as of the [__] day of [____], 2006.

LOS ANGELES COUNTY SECURITIZATION CORPORATION

BY: _____
President

INDENTURE

by and between

THE CALIFORNIA COUNTY TOBACCO
SECURITIZATION AGENCY

and

[INDENTURE TRUSTEE]

as Indenture Trustee

Dated as of [DATE]

Tobacco Settlement Asset-Backed Bonds
(Los Angeles County Securitization Corporation)

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ARTICLE I

INTRODUCTION AND DEFINITIONS

SECTION 101. This Indenture and the Parties. This INDENTURE (this "Indenture") dated as of [Date], is by and between THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY, a public entity of the State of California (the "Issuer"), and [INDENTURE TRUSTEE], as Indenture Trustee (the "Indenture Trustee").

The Issuer recites and represents to the Indenture Trustee for the benefit of the Beneficiaries that it has authorized this Indenture.

This Indenture provides for the following transactions:

(a) the Issuer's issue of the Bonds; and

(b) the Issuer's assignment and pledge to the Indenture Trustee in trust for the benefit and security of the Beneficiaries of the Revenues, the Accounts and the assets thereof to be received and held hereunder, the rights to receive the same, and the other rights assigned and pledged herein, to the extent specified in this Indenture.

In consideration of the mutual agreements contained in this Indenture and other good and valuable consideration, the receipt of which is hereby acknowledged, the Issuer and the Indenture Trustee agree as set forth herein for their own benefit and for the benefit of the Beneficiaries, as aforesaid.

SECTION 102. Definitions and Interpretation. (a) Capitalized terms have the respective meanings set forth below, unless the context otherwise requires:

"Accounts" means the accounts established and maintained by the Indenture Trustee hereunder.

"Accreted Value" means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest accrued thereon from its date compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through the maturity date of such Bond or in the case of a Convertible Bond, through the applicable Conversion Date) at the Accretion Interest Rate for such Bond, as set forth in the applicable Series Supplement; provided, however, that the Indenture Trustee shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the applicable Series Supplement by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Date. In performing such calculation, the Indenture Trustee shall be entitled to engage and rely upon a firm of accountants, consultants or financial advisors with appropriate knowledge and experience.

"Accretion Interest Rate" has the meaning set forth in the applicable Series Supplement with respect to Capital Appreciation Bonds or Convertible Bonds.

"Additional Bonds" has the meaning given to such term in Section 301(b) of this Indenture.

"Agency Agreement" means the Joint Exercise of Powers Agreement, dated as of its effective date, creating the Issuer, among the Counties of Stanislaus, Sonoma, Kern, Merced, Marin, Placer, Fresno, Alameda and Los Angeles, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"ARIMOU" means the Agreement Regarding the Interpretation of the Memorandum of Understanding, among the State of California and certain other signatories thereto, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Authorized Officer" means: (i) in the case of the Issuer, the President, any Vice President, the Treasurer, and any other person authorized to act hereunder by appropriate Written Notice to the Indenture Trustee, and (ii) in the case of the Indenture Trustee, any officer assigned to the Corporate Trust Office, including any managing director, vice president, assistant vice president, assistant treasurer, assistant secretary or any other officer of the Indenture Trustee customarily performing functions similar to those performed by any of the above designated officers and having direct responsibility for the administration of this Indenture, and also, with respect to a particular matter, any other officer, to whom such matter is referred because of such officer's knowledge of and familiarity with the particular subject.

"Basic Documents" means this Indenture, the Sale Agreement, the Loan Agreement, the Issuer Tax Certificate, the Corporation Tax Certificate and the Seller Tax Certificate.

"Beneficiaries" means Bondholders.

"Bondholders", "Holders" and similar terms mean the registered owners of the Bonds from time to time as shown on the books of the Indenture Trustee.

"Bonds" means the Series 2006A Bonds and any Additional Bonds, including in each case any Bonds issued in exchange or replacement therefor.

"Borrower" means the Corporation.

"Business Day" means any day other than (i) a Saturday or a Sunday or (ii) a day on which banking institutions in New York, New York, Los Angeles, California, or San Francisco, California, or where the Corporate Trust Office is otherwise located, are required or authorized by law to be closed.

"California Escrow Agent" means Citibank, N.A., acting in its capacity as escrow agent under the California Escrow Agreement, or its successor in such capacity, as provided in the California Escrow Agreement.

"California Escrow Agreement" means that certain escrow agreement, dated April 12, 2000, as amended by the first amendment to escrow agreement, dated July 19, 2001,

between the Attorney General of the State of California, on behalf of the State and the California Escrow Agent, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Capital Appreciation Bond" means a Bond (including, as the context requires, a Convertible Bond prior to the applicable Conversion Date), the interest on which is payable at maturity (or, in the case of a Convertible Bonds, the interest on which accrues until the Conversion Date) and compounded semiannually on each Distribution Date to the Maturity Date, Conversion Date or redemption date thereof, as the case may be.

"Capitalized Interest Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Code" means the Internal Revenue Code of 1986, as amended.

"Collateral" shall have the meaning ascribed thereto in Section 201.

"Collection Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Consent Decree" means that certain consent decree and final judgment entered by the Superior Court of the State of California, County of San Diego on December 9, 1998 in Case No. J.C.C.P. 4041.

"Conversion Date" means the date set forth in a Series Supplement on and after which a Convertible Bond is deemed to be a Current Interest Bond.

"Convertible Bond" means a Capital Appreciation Bond which is deemed to be a Current Interest Bond on and after the applicable Conversion Date.

"Corporate Trust Office" means the office of the Indenture Trustee at which the corporate trust business of the Indenture Trustee related hereto shall, at any particular time, be principally administered, which office is, at the date of this Indenture, located at [Indenture Trustee Address], except that with respect to presentation of Bonds for payment or for registration of transfer and exchange such term shall mean the office or agency of the Indenture Trustee at which, at any particular time, its corporate trust agency business shall be conducted.

"Corporation" means the Los Angeles County Securitization Corporation, a nonprofit public benefit corporation created under the California Nonprofit Public Benefit Corporation Law.

"Corporation Tax Certificate" means the Corporation Tax Certificate executed by the Corporation at the time of the issuance of the Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Corporation Tobacco Assets" has the meaning ascribed thereto in Section 3.01 of the Loan Agreement.

"Costs of Issuance" means any item of expense directly or indirectly payable or reimbursable by the Issuer and related to the authorization, sale and issuance of Bonds, including underwriting fees, auditors' or accountants' fees, printing costs, costs of reproducing documents, filing and recording fees, fees and expenses of fiduciaries, legal fees and charges, professional consultants' fees, costs of credit ratings, fees and charges for execution, transportation and safekeeping of Bonds, governmental charges and other costs, charges and fees in connection with the foregoing.

"Costs of Issuance Account" means the account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Counsel" means nationally recognized bond counsel or such other counsel as may be selected by the Issuer for a specific purpose hereunder.

"County Tobacco Assets" has the meaning ascribed thereto in the Sale Agreement.

"Current Interest Bond" means a Bond (including, as the context requires, a Convertible Bond on and after the applicable Conversion Date), the interest on which is payable on each Distribution Date.

"Debt Service Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Debt Service Reserve Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Debt Service Reserve Requirement" means an amount equal to $[_____].

"Default" means an Event of Default without regard to any declaration, notice or lapse of time.

"Defeasance Collateral" means money and (i) non-callable direct obligations of the United States of America, non-callable and non-prepayable direct federal agency obligations the timely payment of principal of and interest on which are fully and unconditionally guaranteed by the United States of America, non-callable direct obligations of the United States of America which have been stripped by the United States Treasury itself or by any Federal Reserve Bank (not including "CATS," "TIGRS" and "TRS'' unless the Issuer obtains Rating Confirmation with respect thereto) and the interest components of REFCORP bonds for which the underlying bond is non-callable (or non-callable before the due date of such interest component) for which separation of principal and interest is made by request to the Federal Reserve Bank of New York in book-entry form, and shall exclude investments in mutual funds and unit investment trusts;

(ii) obligations timely maturing and bearing interest (but only to the extent that the full faith and credit of the United States of America are pledged to the timely payment thereof);

(iii) certificates evidencing ownership of the right to the payment of the principal of and interest on obligations described in clause (ii), provided, that such obligations are held in the custody of a bank or trust company satisfactory to the Indenture Trustee in a segregated trust account in the trust department separate from the general assets of such custodian; and

(iv) bonds or other obligations of any state of the United States of America or any agency, instrumentality or local governmental unit of any such state (y) which are not callable at the option of the obligor or otherwise prior to maturity or as to which irrevocable notice has been given by the obligor to call such bonds or obligations on the date specified in the notice, and (z) timely payment of which is fully secured by a fund consisting only of cash or obligations of the character described in clause (i), (ii) or (iii) which fund may be applied only to the payment when due of such bonds or other obligations;

provided, that Defeasance Collateral shall not include obligations of the County of Los Angeles.

"Defeased Bonds" means Bonds that remain in the hands of their Holders but are no longer deemed Outstanding.

"Deposit Date" means a date no later than 2 Business Days following each deposit of Revenues in the Collection Account.

"Distribution Date" means each June 1 and December 1, commencing on [____] 1, 20[__].

"DTC" means The Depository Trust Company, a limited-purpose trust company organized under the laws of the State of New York, and includes any nominee of DTC in whose name any Bonds are then registered.

"Eligible Investments" means:

(i) Defeasance Collateral;

(ii) direct obligations of, or obligations guaranteed as to timely payment of principal and interest by, the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association or the Federal Farm Credit System;

(iii) demand and time deposits in or certificates of deposit of, or bankers' acceptances issued by, any bank or trust company, savings and loan association or savings bank (which may include the Indenture Trustee and its affiliates), payable on demand or on a specified date no more than three months after the date of issuance thereof, if such deposits or instruments are rated at least A-1+ by S&P, P-1 by Moody's and F1 by Fitch (if then rated by Fitch);

(iv) certificates, notes, warrants, bonds, obligations or other evidences of indebtedness of a state or a political subdivision thereof receiving one of the two highest long term unsecured debt ratings (without regard to rating subcategories) by Moody's and Fitch (if then rated by Fitch);

(v) commercial or finance company paper (including both non-interest-bearing discount obligations and interest bearing obligations payable on demand or on a specified date not more than three months after the date of issuance thereof) that is rated at the time of purchase A-1+ by S&P, P-1 by Moody's and F1 by Fitch (if then rated by Fitch);

(vi) repurchase obligations with respect to any security described in clause (i) or (ii) above entered into with a primary dealer, depository institution or trust company (acting as principal) rated at least A-1+ by S&P, P-1 by Moody's and F1 by Fitch (if then rated by Fitch) (if payable on demand or on a specified date no more than three months after the date of issuance thereof), or rated at least Aa1 by Moody's and in one of the two highest long-term rating categories by S&P and Fitch (if then rated by Fitch), or collateralized by securities described in clause (i) or (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each of Moody's, S&P and Fitch (if then rated by Fitch); provided, that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Indenture Trustee or an independent third party acting solely as agent for the Indenture Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Indenture Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Indenture Trustee, (3) the agreement has a term of thirty days or less, or the Indenture Trustee will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored within five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102 percent;

(vii) securities bearing interest or sold at a discount (payable on demand or on a specified date no more than three months after the date of issuance thereof) that are issued by any corporation incorporated under the laws of the United States of America or any state thereof and rated at least P-1 by Moody's, A-1+ by S&P and F1 by Fitch (if then rated by Fitch) at the time of such investment or contractual commitment providing for such investment; provided, that securities issued by any such corporation will not be Eligible Investments to the extent that investment therein would cause the then outstanding principal amount of securities issued by such corporation that are then held to exceed 20 percent of the aggregate principal amount of all Eligible Investments then held;

(viii) units of taxable money market funds which funds are regulated investment companies and seek to maintain a constant net asset value per share and have been rated at least Aa1 by Moody's and at least AAm or AAm-G by S&P and at least AA by Fitch (if then rated by Fitch), including if so rated any such fund which the Indenture Trustee or an affiliate of the Indenture Trustee serves as an investment advisor, administrator, shareholder, servicing agent and/or custodian or sub-custodian, notwithstanding that (x) the Indenture Trustee or an affiliate of the Indenture Trustee charges and collects fees and expenses (not exceeding current income) from such funds for services rendered, (y) the Indenture Trustee charges and collects fees and expenses for services rendered pursuant to this Indenture, and (z) services performed for such funds and pursuant to this Indenture may converge at any time (the Issuer specifically authorizes the Indenture Trustee or an affiliate of the Indenture Trustee to charge and collect all fees and

expenses from such funds for services rendered to such funds, in addition to any fees and expenses the Indenture Trustee may charge and collect for services rendered pursuant to this Indenture);

(ix) investment agreements or guaranteed investment contracts rated, or with any financial institution or corporation whose senior long-term debt obligations are rated, or guaranteed by a financial institution whose senior long-term debt obligations are rated, at the time such agreement or contract is entered into, at least Aa1 by Moody's and in one of the two highest long-term rating categories by S&P and Fitch (if then rated by Fitch) if the Issuer has an option to terminate such agreement in the event that either such rating is downgraded below the then rating on the Bonds, or if not so rated, then collateralized by securities described in clause (i) or (ii) above with any registered broker/dealer or with any domestic commercial bank whose long-term debt obligations are rated "investment grade" by each of Moody's, S&P and Fitch (if then rated by Fitch); provided, that (1) a specific written agreement governs the transaction, (2) the securities are held, free and clear of any lien, by the Indenture Trustee or an independent third party acting solely as agent for the Indenture Trustee, and such third party is (a) a Federal Reserve Bank, or (b) a member of the Federal Deposit Insurance Corporation that has combined surplus and undivided profits of not less than $25 million, and the Indenture Trustee shall have received written confirmation from such third party that it holds such securities, free and clear of any lien, as agent for the Indenture Trustee, (3) the agreement has a term of thirty days or less, or the Indenture Trustee or its custodian will value the collateral securities no less frequently than monthly and will liquidate the collateral securities if any deficiency in the required collateral percentage is not restored with five Business Days of such valuation, and (4) the fair market value of the collateral securities in relation to the amount of the obligation, including principal and interest, is equal to at least 102 percent; and

(x) other obligations or securities that are non-callable and that are acceptable to each Rating Agency;

provided, that no Eligible Investment may (a) except for Defeasance Collateral, evidence the right to receive only interest with respect to the obligations underlying such instrument or (b) be purchased at a price greater than par if such instrument may be prepaid or called at a price less than its purchase price prior to its stated maturity, and provided further, that Eligible Investments shall not include any obligations of the County of Los Angeles.

"Event of Default" means an event specified in Section 801.

"Extraordinary Prepayment" means payment of Bonds pursuant to Section 802(b).

"Extraordinary Prepayment Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Fiduciary" means the Indenture Trustee and each Paying Agent, if any.

"Fiscal Year" means each 12-month period ending each June 30.

"Fitch" means Fitch Ratings or its successor; references to Fitch are effective so long as Fitch is a Rating Agency.

"Indenture" means this Indenture, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms hereof.

"Indenture Trustee" means [Indenture Trustee], a [_____] organized and existing under the laws of [_____], acting in its capacity as trustee under this Indenture, or its successor, as provided in this Indenture.

"Issuer" means The California County Tobacco Securitization Agency, a public entity of the State, its successors or assigns.

"Issuer Tax Certificate" means the Issuer Tax Certificate executed by the Issuer at the time of issuance of the Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Lender" means the Issuer.

"Loan" has the meaning ascribed thereto in Section 2.01 of the Loan Agreement.

"Loan Agreement" means the Secured Loan Agreement, dated as of [Date], between the Issuer, as Lender, and the Corporation, as Borrower, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Loan Payments" has the meaning ascribed thereto in Section 2.02 of the Loan Agreement.

"Lump Sum Payment" means a payment received by the Indenture Trustee from one or more of the PMs that results in, or is due to, a release of such PMs from all or any portion of their future payment obligations under the MSA.

"Lump Sum Prepayment Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Master Settlement Agreement" or "MSA" means the Master Settlement Agreement entered into on November 23, 1998, among the attorneys general of 46 states, the District of Columbia, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, American Samoa and the Commonwealth of the Northern Mariana Islands and the OPMs, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Maturity Date" means, with respect to any Bond, the final date on which all remaining principal of such Bond is due and payable.

"Moody's" means Moody's Investors Service or its successor; references to Moody's are effective so long as Moody's is a Rating Agency.

"MOU" means the Memorandum of Understanding, dated August 5, 1998, among the Attorney General's Office of the State of California and certain other signatories thereto, as

originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Officer's Certificate" means a certificate signed by an Authorized Officer of the Issuer.

"Operating Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Operating Cap" means $[_____] in the 2006 calendar year, of which $[_____] is inflated in each following calendar year by the Inflation Adjustment Percentage as defined in the MSA, plus arbitrage payments, rebate, and penalties specified in an Officer's Certificate.

"Operating Expenses" means operating and administrative expenses of each of the Issuer and the Corporation (including the cost of preparation of accounting and other reports, costs of maintenance of the ratings on the Bonds, arbitrage payments and rebate penalties, insurance premiums and costs of annual meetings or other required activities of the Issuer or the Corporation), fees and expenses incurred for the Indenture Trustee, any Paying Agents, professional consultants and fiduciaries, termination payments on investment contracts or investment agreements for Accounts or on forward purchase contracts for investments in Accounts, enforcement related costs with federal and state agencies incurred, as determined by the Seller, in order to preserve the tax-exempt status of any Bonds, and the costs related to enforcement of the Seller's rights under the MOU or the ARIMOU, or the Corporation's, the Issuer's or the Indenture Trustee's enforcement rights with respect to the Basic Documents or the Bonds, and all other expenses so identified as Operating Expenses in this Indenture.

"OPM" means an Original Participating Manufacturer, as defined in the MSA.

"Outstanding," when used as to Bonds, or a Series thereof, as the context requires, means Bonds issued under this Indenture, excluding: (i) Bonds that have been exchanged or replaced, or delivered to the Indenture Trustee for credit against a principal payment; (ii) Bonds that have been paid in full; (iii) Bonds that have become due and for the payment of which money has been duly provided to the Indenture Trustee for deposit in the Debt Service Account; (iv) Bonds the payment of which shall have been provided for pursuant to Section 202; and (v) for purposes of any consent or other action to be taken by a specified percentage of Bondholders hereunder, Bonds held by or for the account of the Issuer, or any Person controlling, controlled by or under common control with the Issuer. For the purposes of this definition, "control," when used with respect to any specified Person, means the power to direct the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, and the terms "controlling" and "controlled" have meanings correlative to the foregoing.

"Paying Agent" means each Paying Agent designated from time to time pursuant to Section 603.

"Person" means any individual, corporation, estate, partnership, joint venture, association, joint stock company, limited liability company, trust, unincorporated organization, government or any agency or political subdivision thereof, or any other entity of any type.

"PM" means a Participating Manufacturer, as defined in the MSA.

"Pro Rata" means, for an allocation of available amounts to any payment of interest or principal to be made under this Indenture, the application of a fraction to such available amounts (a) the numerator of which is equal to the amount due to the respective Holders to whom such payment is owing, and (b) the denominator of which is equal to the total amount due to all Holders to whom such payment is owing.

"Purchase Price" has the meaning ascribed thereto in Section 2 of the Sale Agreement.

"Purchaser" means the Corporation.

"Rating Agency" means, with respect to the Bonds, each nationally recognized securities rating service that has, at the request of the Issuer, a rating then in effect for the Bonds.

"Rating Confirmation" means, with respect to the Bonds, written evidence from a Rating Agency that no Bond rating then in effect from such Rating Agency will be withdrawn, reduced or suspended solely as a result of an action to be taken hereunder.

"Rebate Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 403.

"Rebate Requirement" shall have the meaning ascribed thereto in the Issuer Tax Certificate.

"Record Date" means the 15th day of the calendar month preceding a Distribution Date, and the Issuer or the Indenture Trustee may in its discretion establish special record dates for the determination of the Bondholders for various purposes hereof, including giving consent or direction to the Indenture Trustee.

"Residual Trust" shall have the meaning ascribed thereto in the Sale Agreement.

"Revenues" means the Tobacco Settlement Revenues and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts paid or payable to the Issuer or the Indenture Trustee for the account of the Issuer or the Beneficiaries.

"S&P" means Standard & Poor's Ratings Services, a division of The McGraw-Hill Companies, Inc., or its successor; references to S&P are effective so long as S&P is a Rating Agency.

"Sale Agreement" means the Sale Agreement, dated as of [Date], between the Seller and the Corporation, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Securities Depository" means DTC, or if DTC resigns from its functions as depository of the Bonds or the Issuer discontinues the use of DTC as a depository of the Bonds, then any other securities depository designated in an Officer's Certificate.

"Seller" means the County of Los Angeles, a political subdivision of the State of California.

"Seller Tax Certificate" means the County Tax Certificate executed by the Seller at the time of issuance of the Bonds, as originally executed and as it may be amended or supplemented from time to time in accordance with the terms thereof.

"Series 2006A Bonds" means the Issuer's $[_____] Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A, including any Bonds issued in exchange or replacement therefor.

"Series 2006A Supplement" means the Series Supplement authorizing the Bonds.

"Series Supplement" means the Series 2006A Supplement and any other Supplemental Indenture.

"Sold County Tobacco Assets" has the meaning ascribed thereto in the Sale Agreement.

"State" means the State of California.

"Supplemental Indenture" means a Series Supplement or supplement hereto executed and delivered in accordance with the terms hereof. Any provision that may be included in a Series Supplement or Supplemental Indenture is also eligible for inclusion in the other subject to the provisions hereof.

"Term Bonds" means the Bonds so identified in a Series Supplement.

"Tobacco Settlement Revenues" means, without duplication, such of the Collateral as consists of payments received pursuant to the MOU, the ARIMOU, the MSA and the Consent Decree.

"Turbo Redemption Account" means the Account of that name established and maintained by the Indenture Trustee pursuant to Section 401.

"Turbo Redemption Payments" means the payments to redeem Term Bonds from amounts on deposit in the Turbo Redemption Account pursuant to Section 405(e) of this Indenture.

"Unsold County Tobacco Assets" has the meaning ascribed thereto in the Sale Agreement.

"Written Notice", "written notice" or "notice in writing'' means notice in writing which may be delivered by hand or first class mail and also means facsimile transmission.

(b) The word "principal" shall include Accreted Value of any Bond.

(c) Articles and Sections referred to by number shall mean the corresponding Articles and Sections of this Indenture.

(d) Words of the masculine gender shall mean and include correlative words of the feminine and neuter genders and words importing the singular number shall mean and include the plural number and vice versa.

(e) The terms "hereby", "hereof", "herein", "hereunder" and any similar terms, as used in this Indenture, refer to this Indenture; and the term "date hereof" means, the term "hereafter'' means after, and the term "heretofore" means before, the date of execution and delivery of this Indenture.

(f) The word "including" means "including without limitation".

(g) The word "or" is used in its inclusive sense.

(h) Any headings preceding the texts of the several Articles and Sections of this Indenture, and any table of contents, shall be solely for convenience of reference, and shall not constitute a part of this Indenture, nor shall they affect its meaning, construction or effect.

(i) As used in this Indenture and in any certificate or other document made or delivered pursuant hereto or thereto, accounting terms not defined in this Indenture or in any such certificate or other document, and accounting terms partly defined in this Indenture or in any such certificate or other document to the extent not defined, shall have the respective meanings given to them under generally accepted accounting principles. To the extent that the definitions of accounting terms in this Indenture or in any such certificate or other document are inconsistent with the meanings of such terms under generally accepted accounting principles, the definitions contained in this Indenture or in any such certificate or other document shall control.

SECTION 103. Directors and State Not Liable on Bonds; Limited Obligation of Issuer.

Neither the directors or officers of the Issuer nor any person executing Bonds or other obligations of the Issuer shall be liable personally thereon or be subject to any personal liability or accountability solely by reason of the issuance thereof.

The Bonds are limited obligations of the Issuer, payable from and secured solely by Revenues and the other Collateral pledged hereunder. The Bondholders have no recourse to other assets of the Issuer, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Issuer. If, notwithstanding the limitation on recourse described in the preceding sentence, any Bondholders are deemed to have an interest in any asset of the Issuer pledged to the payment of other debt obligations of the Issuer, the Bondholders' interest in such asset shall be subordinate to the claims and rights of the holders of such other debt

obligations and this Indenture will constitute a subordination agreement for purposes of Section 510(a) of the U.S. Bankruptcy Code. The Bonds do not constitute a charge against the general credit of the Issuer or any of its members, including the County of Los Angeles, and under no circumstances shall the Issuer or any member, including the County of Los Angeles, be obligated to pay the principal of or redemption premiums, if any, or interest on the Bonds, except from the Collateral pledged therefor hereunder. Neither the credit of the State, nor any public agency of the State (other than the Issuer), nor any member of the Issuer, including the County of Los Angeles, is pledged to the payment of the principal of or redemption premiums, if any, or interest on the Bonds. The Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Issuer) or any member of the Issuer, including the County of Los Angeles. The County of Los Angeles is under no obligation to make payments of the principal, interest, redemption premium, if any, with respect to the Bonds in the event that Revenues are insufficient for the payment thereof.

ARTICLE II

GRANT OF SECURITY INTEREST

SECTION 201. Security Interest and Pledge. In order to secure payment of the Bonds, all with the respective priorities specified herein, the Issuer hereby pledges to the Indenture Trustee, and grants to the Indenture Trustee a first lien and security interest in, all of the Issuer's right, title and interest, whether now owned or hereafter acquired, in, to and under: (a) the Issuer's rights with respect to the Loan Agreement, including but not limited to the right to receive Loan Payments and to enforce the obligations of the Borrower pursuant to the Loan Agreement; (b) the Corporation Tobacco Assets; (c) the Accounts, all money, instruments, investment property, or other property credited to or on deposit in the Accounts, and all investment earnings on amounts on deposit in or credited to the Accounts; (d) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments and other property which at any time constitute all or part of or are included in the proceeds of any of the foregoing and (e) all proceeds of the foregoing. The property described in the preceding sentence is referred to herein as the "Collateral." Except as specifically provided herein, the Collateral does not include (i) the rights of the Issuer pursuant to provisions for consent or other action by the Issuer, notice to the Issuer, indemnity or the filing of documents with the Issuer, or otherwise for its benefit and not for that of the Beneficiaries or (ii) the Rebate Account, and all money, instruments, investment property or other property credited to or on deposit in the Rebate Account. The Issuer will implement, protect and defend this grant of a security interest and pledge by all appropriate legal action, the cost thereof to be an Operating Expense.

The right of the Indenture Trustee to receive the Sold County Tobacco Assets pledged to it is equal to and on a parity with, and is not inferior or superior to, the right of the Seller to receive the Unsold County Tobacco Assets. Neither the Issuer nor the Indenture

Trustee shall have the right to make a claim to mitigate all or any part of an asserted deficiency in the Sold County Tobacco Assets from the Unsold County Tobacco Assets and, likewise, shall not have any right to make a claim to mitigate all or any part of an asserted deficiency in the Unsold County Tobacco Assets from the Sold County Tobacco Assets. Nothing herein shall be deemed to prevent the Seller from hereafter selling all or a portion of the Unsold County Tobacco Assets to the Borrower for assignment to a trustee under a separate indenture. In such case, the right of the trustee under the separate indenture to receive the Unsold County Tobacco Assets so sold shall be equal to and on a parity with, and shall not be inferior or superior to, the right of the Indenture Trustee to receive the Sold County Tobacco Assets pledged to it and the right of the Seller to receive any Unsold County Tobacco Assets not so sold.

SECTION 202. Defeasance. When (a) there is held by or for the account of the Indenture Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities, including any applicable redemption or prepayment premiums as will provide sufficient funds to pay or redeem or prepay all obligations to Beneficiaries in full (to be verified by a nationally recognized firm of independent certified public accountants), (b) any required notice of redemption or prepayment shall have been duly given in accordance with this Indenture or irrevocable instructions to give notice shall have been given to the Indenture Trustee, and (c) all the rights hereunder of the Fiduciaries have been provided for, then upon written notice from the Issuer to the Indenture Trustee, such Beneficiaries shall cease to be entitled to any benefit or security under this Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with termination of the lien hereof, the security interests created by this Indenture (except in such funds and investments) shall terminate, and the Issuer and the Indenture Trustee shall execute and deliver such instruments as may be necessary to discharge the Indenture Trustee's lien and security interests created hereunder and to make the Collateral payable to the order of the Issuer. Upon such defeasance, the funds and investments required to pay or redeem or prepay the Bonds and other obligations to such Beneficiaries shall be irrevocably set aside for that purpose, subject, however, to Section 407, and money held for defeasance shall be invested only as provided above in this section and applied by the Indenture Trustee and other Paying Agents, if any, to the retirement of the Bonds and such other obligations. Any funds or property held by the Indenture Trustee and not required for payment or redemption or prepayment of the Bonds and such other obligations to Beneficiaries and Fiduciaries shall be distributed to the order of the Issuer. Upon the discharge of the Indenture Trustee's lien and security interests created hereunder, the Indenture Trustee shall cooperate in delivering instructions to the Attorney General of the State to instruct the California Escrow Agent to transfer the Tobacco Settlement Revenues to or upon the order of the Corporation.

Subject to the requirements of federal tax law and to the right of the Issuer to defease the Bonds in accordance with the optional redemption provisions of this Indenture, when all Bonds are to be defeased, the Issuer shall provide for Turbo Redemption Payments of the principal of the Bonds, based on the assumption that the Outstanding principal balance on certain Distribution Dates (taking such Turbo Redemption Payments into account) for the Bonds shall equal the Term Bond redemption payments as provided in the applicable Series Supplement. If on the date of defeasance the principal amount of Bonds Outstanding is greater than the scheduled principal balance as provided in the applicable Series Supplement (constituting an "Excess"), such excess balance must be redeemed within not more than 30 days of the date of

defeasance. If on the date of defeasance the principal amount of Bonds Outstanding is less than the scheduled principal balance as provided in the applicable Series Supplement (constituting a "Deficiency"), no principal payment of the Bonds shall occur until the Distribution Date on which the scheduled principal outstanding is attained, and after such date the Turbo Redemptions shall occur in the amounts and on the dates shown in the applicable Series Supplement.

ARTICLE III

THE BONDS

SECTION 301. Bonds of the Issuer.

(a) At any time after the execution and delivery of this Indenture, the Issuer may issue and the Indenture Trustee shall authenticate and, upon written request of the Issuer, deliver the Series 2006A Bonds and any Additional Bonds with such aggregate principal amount or initial principal amount as the Issuer shall determine and as specified in a Series Supplement.

(b) One of more Series of Bonds (the "Additional Bonds") may be issued, on a parity or subordinate basis, upon receipt by the Trustee of (i) a Rating Confirmation from each Rating Agency then rating the Outstanding Bonds and (ii) a certificate of the Issuer that (x) no Event of Default has occurred hereunder, (y) the Debt Service Reserve Account is, after giving effect to the issuance of such Additional Bonds and the application of the proceeds thereof, funded at the Debt Service Reserve Requirement, and (z) as a result of the issuance of such Additional Bonds, the weighted average life of each Bond then Outstanding, projected in years from its date of issuance, will not exceed the sum of (i) the weighted average life of each such Outstanding Bond as projected at the time such Bond was issued and set forth in the Series Supplement relating thereto and (ii) one. In calculating the weighted average life of each of the Outstanding Bonds for the purpose of the certificate required by clause (z) of the preceding sentence, the Issuer shall take into consideration (1) the amount of Turbo Redemptions of such Bonds that have been paid prior to and including the date of issuance of the Additional Bonds and (2) the amount of Turbo Redemptions projected by the Issuer to be paid on each Distribution Date subsequent to the issuance of such Additional Bonds based upon the amount of Revenues then expected to be received by the Issuer and available for payment of Turbo Redemptions of each Outstanding Bond.

(c) Each Series of Bonds shall bear such dates, mature at such times, subject to such terms of payment, bear or accrete interest at such fixed rates, be in such form and denomination, carry such registration privileges, be executed in such manner, and be payable in such medium of payment, at such place and subject to such terms of redemption, as the Issuer may provide herein and in a related Series Supplement. The proceeds of each Series of Bonds shall be applied as provided in the Series Supplement authorizing the particular Series of Bonds.

(d) The Bonds shall be executed in the name of the Issuer by the signature or facsimile signature of its President, and attested by the signature or facsimile signature of its Secretary. The authenticating certificate of the Indenture Trustee shall be manually signed. Bonds executed as set forth above shall be valid and binding obligations when duly delivered,

notwithstanding the fact that before the delivery thereof the persons executing the same shall have ceased in office or others may have been designated to perform such functions.

SECTION 302. Transfer and Replacement of Bonds. (a) *Transfer*. A registered Bond shall be transferable upon presentation to the Indenture Trustee with a written transfer of title of the registered owner. Such transfer shall be dated, and signed by such registered owner, or such registered owner's legal representatives, and shall be signature guaranteed by a guarantor institution participating in a guarantee program acceptable to the Indenture Trustee. The name of the transferee shall be entered in the books kept by the Indenture Trustee and:

(1) the transferee shall be provided with a new Bond, of substantially the same form and tenor as the Bond presented, except as provided below;

(2) the new Bond shall be signed and attested, either (i) by manual or facsimile signature by the appropriate persons in office at the time of delivery to the transferee, or (ii) by facsimile signature of the appropriate persons in office at the time of issuance;

(3) the new Bond shall be executed as of the date of the Bond presented and shall be authenticated as of the date of delivery of the new Bond;

(4) the Bond presented shall be cancelled and destroyed and a certificate of destruction shall be filed with the Issuer and the Indenture Trustee;

(5) no interest shall be paid on a Bond issued in registered form until the name of the payee has been inserted therein and such Bond has been registered as provided herein; and

(6) the principal of, premium, if any, and interest on a Bond which has been registered shall be payable only to the registered owner, or such registered owner's legal representatives, successors or transferees.

(b) *Replacement*. The Issuer and the Indenture Trustee may issue a new Bond to replace one lost, stolen, destroyed, partially destroyed or defaced, in accordance with the following:

(1) If the Bond is claimed to be lost, stolen or destroyed, the owner shall furnish:

(i) Proof of ownership.

(ii) Proof of loss, theft or destruction.

(iii) Payment of the cost of preparing, issuing, mailing, shipping or insuring the new Bond.

(2) If the Bond is defaced or partially destroyed, the owner shall surrender such Bond and pay the cost of preparing and issuing the new Bond.

(3) The new Bond shall be of substantially the same form and tenor as the one originally issued, except that it shall be signed either by (i) the manual or facsimile signature of the appropriate person or persons in the office at the time of the reissuance, or (ii) the facsimile signature of the appropriate person or persons in office at the time of the original issuance or any time between original issuance and reissuance. The new Bond shall be authenticated in the manner provided herein. If the Bond is issued in the place of one claimed to be lost, stolen or destroyed, it shall in addition state upon the back thereof that it is issued in the place of such Bond claimed to have been lost, stolen or destroyed, and, where applicable, that adequate security or indemnity for its payment in full at maturity is filed with the Indenture Trustee. The Indenture Trustee shall make an appropriate entry in its records of any new Bond issued pursuant to this section.

SECTION 303. Securities Depositories.

(a) *Immobilized Bonds*. The Bonds, upon original issuance, will be issued in the form of typewritten Bonds, to be delivered to the order of DTC by or on behalf of the Issuer. Such Bonds shall initially be registered in the name of Cede & Co., as nominee of DTC, and no beneficial owner will receive a certificate representing an interest in any Bond, except as provided in Section 303(b). Unless and until Bonds have been issued to Bondholders other than DTC:

(1) the Issuer and each Fiduciary shall be entitled to deal with DTC for all purposes of this Indenture (including the payment of principal of and interest on such Bonds and the giving of notices, instructions or directions hereunder) as the sole Bondholder; and

(2) the rights of beneficial owners shall be exercised only through DTC.

(b) *Withdrawal from DTC*. If (1) DTC is no longer willing or able to properly discharge its responsibilities with respect to the Bonds or other portion thereof, and the Issuer advises the Indenture Trustee in writing that it is unable to locate a qualified successor Securities Depository, (2) the Issuer at its option advises the Indenture Trustee in writing that it elects to terminate the book-entry system through DTC or (3) after the occurrence of any Event of Default, beneficial owners representing a majority of the principal amount of the Bonds held by DTC advise DTC in writing that the continuation of a book-entry system through DTC is no longer in the best interests of the beneficial owners, then DTC shall notify its Participants and the Indenture Trustee of the occurrence of any such event and of the availability of Bonds to registered owners requesting the same. Upon surrender to the Indenture Trustee of the typewritten Bonds held by DTC, accompanied by registration instructions, the Issuer shall execute and provide to the Indenture Trustee, and the Indenture Trustee shall authenticate, Bonds in accordance with the instructions of DTC. Neither the Issuer nor the Indenture Trustee shall be liable for any delay in delivery of such instructions and may conclusively rely on, and shall be fully protected in relying on, such instructions. Unless otherwise specified in an Officer's Certificate, the regular record date shall in that event be the close of business on the tenth Business Day preceding a Distribution Date.

ARTICLE IV

ACCOUNTS; FLOW OF FUNDS

SECTION 401. Establishment of Accounts. The Indenture Trustee shall establish and maintain the following segregated trust accounts in the Indenture Trustee's name:

(a) the Collection Account;

(b) the Operating Account;

(c) the Debt Service Account;

(d) the Debt Service Reserve Account;

(e) the Extraordinary Prepayment Account;

(f) the Turbo Redemption Account;

(g) the Lump Sum Prepayment Account;

(h) the Capitalized Interest Account; and

(i) the Costs of Issuance Account.

SECTION 402. Application of Revenues.

(a) Any Tobacco Settlement Revenues shall be promptly (and in no event later than two Business Days after receipt by the Indenture Trustee) deposited by the Indenture Trustee in the Collection Account. Unless otherwise specified in this Indenture, the Indenture Trustee will deposit all Revenues received by it in the Collection Account.

As soon as possible following each deposit of Revenues to the Collection Account pursuant to this Indenture, the Indenture Trustee will withdraw remaining Revenues on deposit in the Collection Account and transfer such amounts as follows (provided, however, that all Tobacco Settlement Revenues that have been identified by an Officer's Certificate as consisting of Lump Sum Payments received by the Indenture Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Lump Sum Prepayment Account, in accordance with instructions received by the Indenture Trustee pursuant to an Officer's Certificate):

(1) to the Operating Account, an amount specified in an Officer's Certificate (or certificate of an authorized officer of the Borrower, as appropriate), but not exceeding, when taken together with other applicable transfers, the Operating Cap for the then current calendar year;

(2) to the Debt Service Account, an amount sufficient to cause the amount therein, together with any amounts held therefor in the Capitalized Interest

Account and investment earnings transferred from the Debt Service Reserve Account, to equal interest (including interest on (i) the principal of any Outstanding Current Interest Bonds, (ii) overdue interest on any Outstanding Current Interest Bonds, (iii) interest on overdue interest on any Outstanding Current Interest Bonds (to the extent legally permissible), and (iv) if no Current Interest Bonds are Outstanding, interest on Capital Appreciation Bonds at the applicable Accretion Interest Rate after the Maturity Date thereof, together with interest on any such interest (to the extent legally permissible)) due on the next succeeding Distribution Date;

(3) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to Section 402(a)(2) above) to equal the principal of Outstanding Bonds due on the next succeeding Distribution Date;

(4) unless an Event of Default has occurred and is continuing, to the Debt Service Reserve Account, an amount sufficient to cause the amounts therein to equal the Debt Service Reserve Requirement;

(5) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to Sections 402(a)(2) and (3) above), together with any amounts held therefor in the Capitalized Interest Account (and not allocated pursuant to Section 402(a)(2) above) and investment earnings transferred from the Debt Service Reserve Account, to equal interest on Outstanding Current Interest Bonds due on the second succeeding Distribution Date;

(6) if an Event of Default has occurred and is continuing, to the Extraordinary Prepayment Account all amounts remaining in the Collection Account;

(7) to the Operating Account, an amount specified by an Officer's Certificate (or certificate of an authorized officer of the Borrower, as appropriate) to pay for any Operating Expenses in excess of the Operating Cap for the then current calendar year;

(8) if any Bonds are subject to redemption from amounts on deposit in the Turbo Redemption Account on the next succeeding Distribution Date, to the Turbo Redemption Account, the amount remaining in the Collection Account; and

(9) if no Bonds are subject to redemption from amounts on deposit in the Turbo Redemption Account on the next succeeding Distribution Date, to the Residual Trust, the amount remaining in the Collection Account.

Except as otherwise provided in this Indenture, investment earnings on the Accounts shall be deposited in the Collection Account. Investment earnings on the Debt Service Reserve Account shall be deposited in the Debt Service Account as received.

(b) On each Distribution Date, the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(1) from the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account, in that order, to pay interest (including interest on (i) the principal of any Outstanding Current Interest Bonds, (ii) overdue interest on any Outstanding Current Interest Bonds, (iii) interest on overdue interest on any Outstanding Current Interest Bonds (to the extent legally permissible), and (iv) if no Current Interest Bonds are Outstanding, interest on Capital Appreciation Bonds at the applicable Accretion Interest Rate after the Maturity Date thereof, together with interest on any such interest (to the extent legally permissible)) due on such Distribution Date;

(2) unless an Event of Default has occurred and is continuing, from the Debt Service Account and the Debt Service Reserve Account, in that order, to pay the principal of Outstanding Bonds due on such Distribution Date;

(3) unless an Event of Default has occurred and is continuing, from the Debt Service Reserve Account, any amount remaining in excess of the Debt Service Reserve Requirement, to the Debt Service Account;

(4) if an Event of Default has occurred and is continuing, from the Extraordinary Prepayment Account, the Debt Service Account and the Debt Service Reserve Account to pay Extraordinary Prepayments on Bonds pursuant to Section 802(b); and

(5) from the Turbo Redemption Account, to redeem Term Bonds pursuant to Section 405(e).

(c) The Indenture Trustee shall apply on any day amounts from the Operating Account to the parties entitled thereto to pay Operating Expenses.

The Issuer covenants in Article V, for the benefit of the Beneficiaries, to pay its Operating Expenses to the parties entitled thereto, but only to the extent that funds are available for such purpose as provided herein.

(d) The Indenture Trustee shall deposit into the Costs of Issuance Account all amounts designated in the applicable Series Supplement authorizing the issuance of the Bonds as available for the payment of Costs of Issuance. The Indenture Trustee shall pay Costs of Issuance as directed by an Officer's Certificate. Any amounts remaining in the Costs of Issuance Account six months after the related deposit thereof shall be paid to the Corporation as additional Loan proceeds.

SECTION 403. Rebate. (a) The Indenture Trustee shall establish and maintain when required an account separate from any other account established and maintained hereunder designated as the Rebate Account. Subject to the transfer provisions provided in paragraph (e) below, all money at any time deposited in the Rebate Account shall be held by the Indenture Trustee in trust, to the extent required to satisfy the Rebate Requirement (as defined, computed and provided to the Indenture Trustee in accordance with the Issuer Tax Certificate), for payment

to the federal government of the United States of America. Neither the Issuer nor any Beneficiary shall have any rights in or claim to such money. All amounts deposited into or on deposit in the Rebate Account shall be governed by this Section, by Section 503 hereof and by the Issuer Tax Certificate (which is incorporated herein by reference). The Indenture Trustee shall be deemed conclusively to have complied with such provisions if it follows such directions of the Issuer, and shall have no liability or responsibility to enforce compliance by the Issuer with the terms of the Issuer Tax Certificate.

(b) Upon the Issuer's written direction, an amount shall be deposited to the Rebate Account by the Indenture Trustee from amounts on deposit in the Operating Account so that the balance in the Rebate Account shall equal the Rebate Requirement. Computations of the Rebate Requirement shall be furnished by or on behalf of the Issuer in accordance with the Issuer Tax Certificate. The Indenture Trustee shall supply to the Issuer all information requested by the Issuer to the extent such information is reasonably available to the Indenture Trustee.

(c) The Indenture Trustee shall have no obligation to rebate any amounts required to be rebated pursuant to this Section other than from moneys held in the Operating Account or the Rebate Account created under this Indenture.

(d) At the written direction of the Issuer, which shall comply with the Issuer's Tax Certificate, the Indenture Trustee shall invest all amounts held in the Rebate Account in Eligible Investments, subject to the restrictions set forth in the Issuer Tax Certificate. Moneys shall not be transferred from the Rebate Account except as provided in paragraph (e) below. The Indenture Trustee shall not be liable for any consequences arising from such investment.

(e) Upon receipt of the Issuer's written directions, the Indenture Trustee shall remit part or all of the balances in the Rebate Account to the United States, as directed in writing by the Issuer. In addition, if the Issuer so directs, the Indenture Trustee will deposit money into or transfer money out of the Rebate Account from or into such accounts or funds as directed by the Issuer's written directions; provided, that only moneys in excess of the Rebate Requirement may, at the written direction of the Issuer, be transferred out of the Rebate Account to such other accounts or funds or to anyone other than the United States in satisfaction of the arbitrage rebate obligation. Any funds remaining in the Rebate Account after each five year remittance to the United States, redemption and payment of all of the Bonds and payment and satisfaction of any Rebate Requirement, or provision made therefor satisfactory to the Indenture Trustee, shall be withdrawn and deposited in the Collection Account.

(f) Notwithstanding any other provision of this Indenture, the obligation to remit the Rebate Requirement to the United States and to comply with all other requirements of this Section, Section 503 and the Issuer Tax Certificate shall survive the defeasance or payment in full of the Bonds.

SECTION 404. [Reserved].

SECTION 405. Redemption and Prepayment of the Bonds.

(a) The Issuer may redeem or prepay Bonds at its option in accordance with their terms and the terms of this Indenture and shall redeem or prepay Bonds as provided herein

and therein. When Current Interest Bonds are called for redemption or prepayment, the accrued interest thereon shall become due on the redemption or prepayment date. To the extent not otherwise provided, the Issuer shall deposit with the Indenture Trustee on or prior to the redemption or prepayment date a sufficient sum to pay principal of, redemption or prepayment premium, if any, and accrued interest on, the Bonds to be redeemed on such redemption or prepayment date.

(b) There shall be applied to or credited against the principal amount of Outstanding Bonds the principal amount of any such Bonds that have been defeased, purchased, prepaid or redeemed and not previously so applied or credited.

(c) When a Bond is to be redeemed or prepaid prior to its stated maturity date, the Indenture Trustee shall give notice in the name of the Issuer, which notice shall identify the Bonds to be redeemed or prepaid, state the date fixed for redemption or prepayment and state that such Bonds will be redeemed or prepaid at the Corporate Trust Office of the Indenture Trustee or a Paying Agent. The notice shall further state that on such date there shall become due and payable upon each Bond to be redeemed or prepaid the redemption or prepayment price thereof, together with interest accrued to the redemption or prepayment date, and that money therefor having been deposited with the Indenture Trustee or Paying Agent, from and after such date, interest thereon shall cease to accrue. The Indenture Trustee shall give 15 days' notice by mail, or otherwise transmit the redemption or prepayment notice in accordance with any appropriate provisions hereof, to the registered owners of any Bonds which are to be redeemed or prepaid, at their addresses shown on the registration books of the Issuer. Such notice may be waived by any Bondholders holding Bonds to be redeemed or prepaid. Failure by a particular Bondholder to receive notice, or any defect in the notice to such Bondholder, shall not affect the redemption or prepayment of any other Bond. The Indenture Trustee shall not send notice to Bondholders of any optional redemption of Bonds unless the Indenture Trustee has on deposit a sum sufficient to pay principal of, redemption premium, if any, and accrued interest on, the Bonds to be redeemed on such redemption date. Any notice of redemption or prepayment given pursuant to this Indenture may be rescinded by written notice to the Indenture Trustee by the Issuer no later than 5 days prior to the date specified for redemption or prepayment. The Indenture Trustee shall give notice of such rescission as soon as thereafter as practicable in the same manner and to the same persons, as notice of such redemption or prepayment was given as described in this subsection (c).

(d) The Bonds are subject to mandatory prepayment, in whole or in part prior to their stated maturity dates from amounts on deposit in the Lump Sum Prepayment Account on any date at the prepayment price of 100 percent of the principal amount thereof together with interest accrued thereon to the date fixed for prepayment without premium. Any prepayments of Bonds pursuant to this subsection (d) shall prepay the Bonds Pro Rata without regard to their order of maturity.

(e) The Term Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity dates from amounts on deposit in the Turbo Redemption Account on each Distribution Date, commencing with the Distribution Date specified therefor in the applicable Series Supplement, at the redemption price of 100 percent of the principal amount thereof together with interest accrued thereon to the date fixed for redemption without premium.

Amounts in the Debt Service Reserve Account shall not be available to make Turbo Redemption payments on the Bonds, unless such amounts together with all available Revenues are sufficient to retire all Bonds still Outstanding, in which event such amounts shall be transferred to the Turbo Redemption Account. Any redemption of Term Bonds pursuant to this subsection (e) shall redeem Term Bonds in order of maturity. Moneys in the Turbo Redemption Account shall not be used to make open-market purchases of Term Bonds.

(f) Unless otherwise specified herein or in a Series Supplement, if less than all the Outstanding Bonds of a maturity are to be redeemed or prepaid, the particular Bonds to be redeemed or prepaid shall be selected by the Indenture Trustee by such method as it shall deem fair and appropriate, including by lot, and the Indenture Trustee may provide for the selection for redemption or prepayment of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

SECTION 406. Investments.

(a) Pending its use under this Indenture, money in the Accounts may be invested by the Indenture Trustee in Eligible Investments and shall be so invested pursuant to written direction of the Issuer if there is not then an Event of Default actually known to an Authorized Officer of the Indenture Trustee. The proceeds of the Bonds to be loaned to the Borrower under the Loan Agreement and used by the Borrower to purchase the Sold County Tobacco Assets from the Seller under the Sale Agreement or delivered to the Seller pursuant to the Residual Trust continue to be proceeds of the Bonds in the hands of the Seller and the Seller has agreed in the Sale Agreement to invest such proceeds solely in Eligible Investments and subject to the further restrictions of the Seller Tax Certificate to the extent that such proceeds are subject to the investment limitation requirements of the Seller Tax Certificate. The Indenture Trustee will be deemed to have complied with the investment restrictions of the Seller's Tax Certificate if it follows the investment direction of the Seller. Eligible Investments shall mature or be redeemable at the option of the Issuer on or before the Business Day preceding each next succeeding Distribution Date, except to the extent that other Eligible Investments timely mature or are so redeemable in an amount sufficient to make payments under clauses and (2) of Section 402(b) on each such next succeeding Distribution Date. Investments shall be held by the Indenture Trustee in the respective Accounts and shall be sold or redeemed to the extent necessary to make payments or transfers from each Account. The Indenture Trustee shall not be liable for any losses on investments made at the direction of the Issuer.

(b) In computing the amount in any Account, the value of Eligible Investments shall be determined as of each Deposit Date and shall be calculated as follows:

(1) As to investments the bid and asked prices of which are published on a regular basis in The Wall Street Journal (or, if not there, then in The New York Times): the average of the bid and asked prices for such investments so published on or most recently prior to such time of determination;

(2) As to investments the bid and asked prices of which are not published on a regular basis in The Wall Street Journal or The New York Times: the average bid price at such time of determination for such investments by any two

nationally recognized dealers making a market in such investments (selected by the Indenture Trustee in its absolute discretion) or the bid price published by a nationally recognized pricing service;

(3) As to certificates of deposit and bankers acceptances: the face amount thereof, plus accrued interest;

(4) As to any investment not specified above: the value thereof established by prior agreement between the Issuer and the Indenture Trustee (with written notice to each Rating Agency of such agreement); and

(5) Alternatively, the value of the above investments shall be determined as of the end of each month by the manner currently employed by the Indenture Trustee or any other manner consistent with industry standard.

(c) The Indenture Trustee may hold undivided interests in Eligible Investments for more than one Account (for which they are eligible, but not including the Rebate Account) and may make interfund transfers in kind.

(d) In respect of Defeasance Collateral held for Defeased Bonds, this Section 406 shall be effective only to the extent it is consistent with other applicable provisions of this Indenture or any separate escrow agreement.

(e) The Indenture Trustee shall not in any way be held liable for any loss on any investment included therein made in accordance with this Section.

(f) If the Issuer shall have failed to give investment directions to the Indenture Trustee, then the Indenture Trustee shall invest the funds in the Accounts in investments specified in subsection (viii) of the definition of Eligible Investments and that mature on or prior to the next Distribution Date.

(g) All income or other gain from investments in an Account held by the Indenture Trustee shall be deposited in such Account immediately on receipt, and any loss resulting from such investments shall be charged to the Issuer.

(h) The Issuer acknowledges that to the extent regulations of the Comptroller of the Currency or other applicable regulatory entity grant the Issuer the right to receive brokerage confirmations of security transactions as they occur, the Issuer specifically waives receipt of such confirmations to the extent permitted by law. The Indenture Trustee will furnish the Issuer periodic cash transaction statements which include detail for all investment transactions made by the Indenture Trustee hereunder.

SECTION 407. Unclaimed Money. Except as may otherwise be required by applicable law, in case any money deposited with the Indenture Trustee or a Paying Agent for the payment of the principal of, or interest or premium, if any, on any Bond remains unclaimed for two years and nine months after such principal, interest or premium has become due and payable, the Fiduciary shall pay over to the Issuer the amount so deposited and thereupon the Fiduciary shall be released from any further liability hereunder with respect to the payment of

principal, interest or premium and the owner of such Bond shall be entitled (subject to any applicable statute of limitations) to look only to the Issuer as an unsecured creditor for the payment thereof.

ARTICLE V

COVENANTS

SECTION 501. Contract; Obligations to Beneficiaries.

(a) In consideration of the purchase and acceptance by those who hold the same of any or all of the Bonds by the parties thereto from time to time, the provisions of this Indenture shall be a part of the contract of the Issuer with the Beneficiaries. The pledge and grant of a security interest made in this Indenture and the covenants herein set forth to be performed by the Issuer shall be for the equal benefit, protection and security of the Beneficiaries of the same priority. All of the Bonds of the same priority, regardless of the time or times of their maturity, shall be of equal rank without preference, priority or distinction of any thereof over any other except as expressly provided pursuant hereto.

(b) The Issuer covenants to pay when due all sums payable on the Bonds, but only from the Revenues and other Collateral designated herein, subject only to this Indenture. The obligation of the Issuer to pay principal, interest and premium, if any, to the Beneficiaries shall be absolute and unconditional, shall be binding and enforceable in all circumstances whatsoever, and shall not be subject to setoff, recoupment or counterclaim.

(c) The Issuer represents that it is duly authorized pursuant to law to create and issue the Bonds, to enter into this Indenture and to pledge and grant a security interest in the Revenues and other Collateral as provided in Section 201 hereof. The Revenues and other Collateral are and will be free and clear of any pledge, lien, security interest, charge or encumbrance thereon or with respect thereto prior to, or of equal rank with, the pledge and security interest created hereby, and all action on the part of the Issuer to that end has been duly and validly taken. The Bonds and the provisions hereof are and will be the valid and binding obligations of the Issuer in accordance with their terms, subject to bankruptcy, insolvency, reorganization, arrangement, fraudulent conveyance, moratorium and other laws relating to or affecting creditors' rights, to the application of equitable principles and to the exercise of judicial discretion in appropriate cases.

SECTION 502. Operating Expenses. The Issuer shall pay its Operating Expenses to the parties entitled thereto, but only to the extent that funds are available for such purpose as provided herein.

SECTION 503. Tax Covenants. The Issuer shall at all times do and perform all acts and things permitted by law and this Indenture which are necessary or desirable in order to assure that interest paid on the Bonds (or any of them) designated as tax-exempt bonds in the Series Supplement therefore will be excluded from gross income for federal income tax purposes and shall take no action that would result in such interest not being excluded from gross income for federal income tax purposes. Without limiting the generality of the foregoing, the Issuer

agrees that it will comply with the provisions of the Issuer Tax Certificate which are incorporated by this reference herein. This covenant shall survive defeasance or redemption or prepayment of such Bonds.

SECTION 504. Accounts and Reports. The Issuer shall:

(a) cause to be kept books of account in which complete and accurate entries shall be made of its transactions relating to all Accounts hereunder, which books shall at all reasonable times be subject to the inspection of the Indenture Trustee and the Holders of an aggregate of not less than 25 percent in principal amount of Bonds then Outstanding or their representatives duly authorized in writing;

(b) annually, within 210 days after the close of each Fiscal Year, deliver to the Indenture Trustee and each Rating Agency, a copy of its financial statements for such Fiscal Year, as audited by an independent certified public accountant or accountants;

(c) cause the Indenture Trustee to keep in effect (which the Indenture Trustee hereby agrees to keep in effect) at all times an accurate and current schedule of all debt service paid or to be payable during the life of then Outstanding Bonds; and

(d) at least one Business Day prior to each Distribution Date, cause the Indenture Trustee to provide (which the Indenture Trustee hereby agrees to provide) to each Rating Agency and the Issuer a statement indicating:

(1) the Outstanding Bonds on such Distribution Date;

(2) the amount of interest to be paid to Bondholders of the Bonds on such Distribution Date;

(3) the Term Bonds to be redeemed from amounts on deposit in the Turbo Redemption Account on such Distribution Date; and

(4) the amount on deposit in each Account as of such Distribution Date.

SECTION 505. Continuing Disclosure Undertaking. If (and to the extent that) (x) a Series of Bonds is purchased from the Issuer by a broker, dealer or municipal securities dealer (each a "Dealer") subject to Rule 15c2-12 (the "Rule") of the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "1934 Act"), (y) the Rule requires Dealers to determine, as a condition to purchasing such Bonds, that the Issuer will covenant to the effect of this Section 505, and (z) the Rule as so applied is authorized by federal law that as so construed is within the powers of Congress, then the Issuer covenants, for the sole benefit of the Holders (and, to the extent specified in this Section 505, the beneficial owners) of the Outstanding Bonds of each such Series and subject (except to the extent otherwise expressly provided in this Section 505) to the remedial provisions of this Indenture, that:

(a) The Issuer shall provide:

(1) within 210 days after the end of each Fiscal Year, to each nationally recognized municipal securities information repository and to any State information depository, (a) core financial information and operating data for the prior Fiscal Year, including its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (b) an update of operating data for the preceding Fiscal Year set forth under the last three columns titled "Total Payments" in the table captioned "Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Trustee" in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" in the Offering Circular of the Issuer dated [____] , 2006, and (c) the actual debt service coverage ratio for such preceding fiscal year, determined in substantially the manner described in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS – Structuring Assumptions - Debt Service Coverage Ratios" in the Offering Circular; and

(2) in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any State information depository, notice of any of the following events with respect to the Outstanding Bonds, if material:

(a) principal, scheduled mandatory redemption and interest payment delinquencies;

(b) non-payment related Defaults;

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

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

(e) adverse tax opinions or events affecting the tax-exempt status of the Bonds;

(f) modifications to rights of Holders;

(g) bond calls;

(h) defeasances;

(i) release, substitution or sale of property securing repayment of the Bonds;

(j) rating changes; and

(k) failure to comply with clause (1) of this Section 505(a).

(3) The Issuer does not undertake to provide such notice with respect to:

(a) credit enhancement if:

(i) the enhancement is added after the primary offering of the Bonds,

(ii) the Issuer does not apply for or participate in obtaining the enhancement and

(iii) the enhancement is not described in the applicable offering circular of the Issuer;

(b) a mandatory, schedule redemption not otherwise contingent upon the occurrence of an event, if:

(i) the terms, dates and amounts of redemption are set forth in detail in the offering circular,

(ii) the only open issue is which Bonds will be redeemed in the case of a partial redemption,

(iii) notice of redemption is given to the Holders as required under the terms of this Indenture and

(iv) public notice of the redemption is given pursuant to Release No. 23856 of the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934, as amended (the "1934 Act"), event if the originally scheduled amounts may be reduced by prior optional redemptions or purchases; or

(c) tax exemption other than pursuant to Section 103 of the Code.

(4) In addition to the Indenture Trustee's and Holders' remedies specified in Article VIII, any beneficial owner of Bonds of a Series described in this Section 505 may bring a Proceeding to enforce the Undertaking set forth in this section without acting in concert if:

(a) such owner shall have filed with the Issuer:

(i) evidence of beneficial ownership, and

(ii) written notice of, and request to cure, the alleged breach,

(b) the Issuer shall have failed to comply within a reasonable time, and

(c) such beneficial owner stipulates that:

(i) no challenge is made to the adequacy of any information provided in accordance with the Undertaking and

(ii) no remedy is sought other than substantial performance of the Undertaking. To the extent permitted by law, each beneficial owner agrees that all Proceedings shall be instituted only for the equal benefit of all such owners of the Outstanding Bonds benefited by the same or a substantially similar undertaking.

(5) For the purposes of this section, a beneficial owner of a security includes any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares investment power which includes the power to dispose, or to direct the disposition of, such security, except that a person who in the ordinary course of business is a pledgee of securities under a written pledge agreement shall not be deemed to be the beneficial owner of such pledged securities until the pledgee has taken all formal steps to declare a default and determines that the power to dispose or to direct the disposition of such pledged securities will be exercised, provided that:

(a) the pledge agreement is bona fide:

(b) the pledgee is:

(i) a broker or dealer registered under Section 15 of the 1934 Act;

(ii) a bank as defined in Section 3(a)(6) of the 1934 Act;

(iii) an insurance company as defined in Section 3(a)(19) of the 1934 Act;

(iv) an investment company registered under Section 8 of the Investment Company Act of 1940;

(v) an investment adviser registered under Section 203 of the Investment Advisers Act of 1940;

(vi) an employee benefit plan, or pension fund which is subject to the provisions of the Employee Retirement Income Security Act of 1974 or an endowment fund;

(vii) a parent holding company, provided the aggregate amount held directly by the parent, and directly and indirectly by its subsidiaries which are not persons specified in items (a) though (f) of this clause (2) does not exceed 1 percent of the securities of the subject class; or

(viii) a group, provided that all the members are persons specified in items (a) through (g) of this clause (2); and

(c) the pledge agreement, prior to default, does not grant to the pledgee the power to dispose or direct the disposition of the pledged securities, other than the grant of such power(s) pursuant to a pledge agreement under which credit is extended subject to Regulation T (12 CFR 220.1 to 220.8) and in which the pledgee is a broker or dealer registered under Section 15 of the 1934 Act.

(6) Any Supplement Indenture amending the Undertaking may only be entered into if all or any part of Rule 15c2-12 (the "Rule") of the SEC under the 1934 Act, as interpreted by the staff of the SEC at the date hereof, ceases to be in effect for any reason and the Issuer elects that this Undertaking shall be deemed terminated or amended (as the case may be) accordingly, or if:

(a) the amendment is made in connection with a change in circumstances that arises from a change in legal requirements, change in law, or change in the identity, nature, or status of the Issuer, or type of business conducted,

(b) the Undertaking, as amended, would have complied with the requirements of the Rule at the date hereof, after taking into account any amendments or interpretations of the Rule, as well as any change in circumstances,

(c) the amendment does not materially impair the interests of the Holders of each affected Series, as determined by parties unaffiliated with the Issuer (such as, but without limitation, the Issuer's financial advisor or bond counsel) or by Holder consent to Section 901 of this Indenture, and

(d) the annual financial information containing (if applicable) the amended operating data or financial information will explain, in narrative form, the reasons for the amendment and the "impact" (as that word is used in the letter from the staff of the SEC to the National Association of Bond Lawyers dated June 23, 1995) of the change in the type of operating data or financial information being provided.

(7) The Indenture Trustee hereby agrees to serve as dissemination agent for the Issuer for purposes of transmitting filings pursuant to the continuing disclosure undertakings set forth in this Section 505 provided to the Indenture Trustee by the Issuer for such purpose until the Issuer appoints another agent or assumes such role itself.

(8) Any filing under this Section 505 may be made solely by transmitting such filing to the Texas Municipal Advisory Council (the "MAC") as provided at www.DisclosureUSA.org unless the Securities and Exchange Commission has withdrawn the interpretive advise in its letter to the MAC dated September 7, 2004.

SECTION 506. Ratings. The Issuer shall pay such reasonable fees and provide such available information as may be necessary to obtain and keep in effect ratings on all the Outstanding Bonds from at least one nationally recognized statistical rating organization.

SECTION 507. Affirmative Covenants.

(a) *Punctual Payment.* The Issuer shall duly and punctually pay debt service on the Bonds in accordance with the terms of the Bonds and this Indenture.

(b) *Maintenance of Existence*. The Issuer shall keep in full effect its existence, rights and franchises as a public entity under the laws of the State.

(c) *Protection of Collateral*. The Issuer shall from time to time execute and deliver all documents and instruments, and will take such other action, as is necessary or advisable to: (1) maintain or preserve the lien and security interest (and the priority thereof) of this Indenture; (2) perfect or protect the validity of any grant made or to be made by this Indenture; (3) preserve and defend title to the Revenues and the Collateral and the rights of the Indenture Trustee, on behalf of the Beneficiaries, in the Collateral against the claims of all Persons and parties, including the challenge by any party to the validity or enforceability of the MSA, the MOU and the ARIMOU, the Basic Documents or the performance by any party thereunder; (4) enforce the Loan Agreement and the Sale Agreement; (5) pay any and all taxes levied or assessed upon all or any part of the Collateral; or (6) carry out more effectively the purposes of this Indenture.

(d) *Performance of Obligations*. The Issuer (1) shall diligently pursue any and all actions to enforce its rights under each instrument or agreement included in the Collateral and (2) shall not take any action and will use its best efforts not to permit any action to be taken by others that would release any Person from any of such Person's covenants or obligations under any such instrument or agreement or that would result in the amendment, hypothecation, subordination, termination or discharge of, or impair the validity or effectiveness of, any such instrument or agreement, except, in each case, as expressly provided in the Basic Documents, the MOU or the ARIMOU.

(e) *Notice of Events of Default*. The Issuer shall give the Indenture Trustee and the Rating Agencies prompt written notice of each Event of Default under this Indenture.

(f) *Other*. The Issuer shall:

(i) conduct its own business in its own name and not in the name of any other Person and correct any known misunderstandings regarding its separate identity;

(ii) maintain or contract for a sufficient number of employees and compensate all employees, consultants and agents directly, from the Issuer's bank accounts, for services provided to the Issuer by such employees, consultants and agents and, to the extent any employee, consultant or agent of the Issuer is also an employee, consultant or agent of another Person, allocate the

compensation of such employee, consultant or agent between the Issuer and such Person on a basis that reflects the services rendered to the Issuer and such Person;

(iii) have a separate telephone number, which will be answered only in its name and separate stationery, invoices and checks in its own name;

(iv) conduct all transactions with any other Person strictly on an arm's-length basis, allocate all overhead expenses (including telephone and other utility charges) for items shared between the Issuer and such Person on the basis of actual use to the extent practicable and, to the extent such allocation is not practicable, on a basis reasonably related to actual use;

(v) observe all formalities as a distinct entity, and ensure that all actions relating to (1) the dissolution or liquidation of the Issuer or (2) the initiation of, participation in, acquiescence in or consent to any bankruptcy, insolvency, reorganization or similar proceeding involving the Issuer, are duly authorized by unanimous vote of its Commissioners;

(vi) maintain its books and records separate from those of any other Person and maintain its assets readily identifiable as its own assets rather than assets of any other Person and not commingle its assets with those of any other Person;

(vii) prepare its financial statements separately from those of any other Person and not prepare any financial statements that are consolidated with those of any other Person;

(viii) only maintain bank accounts or other depository accounts to which the Issuer alone is the account party, and from which only the Issuer has the power to make withdrawals;

(ix) pay all of the Issuer's operating expenses from the Issuer's own assets (except for expenses incurred prior to the date of issuance of the Bonds);

(x) operate its business and activities such that: it does not engage in any business or activity of any kind, or enter into any transaction or indenture, mortgage, instrument, agreement, contract, lease or other undertaking, other than the transactions contemplated and authorized by its organizational documents; and does not create, incur, guarantee, assume or suffer to exist any indebtedness or other liabilities, whether direct or contingent, other than (1) as a result of the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business, (2) the incurrence of obligations under the Basic Documents, (3) the incurrence of operating expenses in the ordinary course of business of the type otherwise contemplated by the Basic Documents, and (4) the incurrence of obligations payable solely from specified assets of the Issuer not subject to the lien of this Indenture and the holders of

which expressly have no recourse to any other assets of the Issuer in the event of non-payment;

(xi) maintain its organization in conformity with this Indenture and shall not allow any parties to the Agency Agreement to amend, restate, supplement or otherwise modify the Agency Agreement in any respect that would impair its ability to comply with the terms or provisions of any of the Basic Documents, including this Section; and

(xii) object in any relevant bankruptcy case to the consolidation of the assets of the Corporation or the Issuer with those of the Seller.

SECTION 508. Negative Covenants.

(a) *Sale of Assets*. Except as expressly permitted by this Indenture, the Issuer shall not sell, transfer, exchange or otherwise dispose of any of its properties or assets that are subject to the lien of this Indenture.

(b) *No Setoff*. The Issuer shall not claim any credit on, or make any deduction from the principal of or premium, if any, or interest on, the Bonds or assert any claim against any present or former Bondholder by reason of payment of taxes levied or assessed upon any part of the Collateral.

(c) *Liquidation*. The Issuer shall not terminate its existence or dissolve or liquidate in whole or in part.

(d) *Limitation of Liens*. The Issuer shall not (1) permit the validity or effectiveness of this Indenture to be impaired, or permit the lien of this Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit any Person to be released from any covenants or obligations with respect to the Bonds under this Indenture except as may be expressly permitted hereby, (2) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of this Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof or any interest therein or the proceeds thereof or (3) permit the lien of this Indenture not to constitute a valid first priority security interest in the Collateral.

(e) *Limitations on Consolidation, Merger, Sale of Assets, Etc*. The Issuer shall not consolidate or merge with or into any other Person, or convey or transfer all or substantially all of its properties or assets.

(f) *Restricted Payments*. The Issuer shall not, directly or indirectly, make distributions from the Collection Account except in accordance with this Indenture.

SECTION 509. Prior Notice. The Indenture Trustee shall give each Rating Agency 30 days' prior written notice of any amendment to this Indenture, the Loan Agreement or the Sale Agreement or the defeasance of Bonds.

ARTICLE VI

THE FIDUCIARIES

SECTION 601. Trustee's Organization, Authorization, Capacity and Responsibility.

(a) The Indenture Trustee represents and warrants that it is duly organized and validly existing under the laws of the jurisdiction of its organization, having the authority to engage in the trust business within the State, including the capacity to exercise the powers and duties of the Indenture Trustee hereunder, and that by proper corporate action it has duly authorized the execution and delivery of this Indenture.

(b) The duties and responsibilities of the Indenture Trustee shall be as provided by law and as set forth herein. Notwithstanding the foregoing, no provision of this Indenture shall require the Indenture Trustee to expend or risk its own funds or otherwise incur any financial liability in the performance of any of its duties hereunder, or in the exercise of any of its rights or powers, unless it receives indemnity satisfactory to it against any loss, liability or expense; provided, that the Indenture Trustee shall make the payments and distributions required by this Indenture without requiring that any indemnity be provided to it. Whether or not therein expressly so provided, every provision of this Indenture relating to the conduct or affecting the liability of or affording protection to the Indenture Trustee shall be subject to the provisions of this Article.

(c) As Trustee hereunder:

(1) the Indenture Trustee may conclusively rely and shall be fully protected in acting or refraining from acting upon any Officer's Certificate, opinion of Counsel (or both), resolution, certificate, statement, instrument, opinion, report, notice, request, direction, consent, order, facsimile transmission, electronic mail, bond, debenture, note, other evidence of indebtedness or other paper or document believed by it to be genuine and to have been signed or presented by the proper person or persons. The Indenture Trustee need not investigate any fact or matter stated in the document, but the Indenture Trustee, in its discretion, may make such further inquiry or investigation into such facts or matters as it may see fit;

(2) before the Indenture Trustee acts or refrains from acting, it may require an Officers' Certificate and/or an opinion of Counsel. The Indenture Trustee shall not be liable for any action it takes or omits to take in good faith in reliance on such certificate or opinion. Whenever in the administration of the trusts of this Indenture the Indenture Trustee shall deem it necessary or desirable that a matter be proved or established prior to taking or suffering or omitting to take any action hereunder, such matter (unless other evidence in respect thereof be herein specifically prescribed) may, in the absence of negligence or bad faith on the part of the Indenture Trustee, be deemed to be conclusively proved and established by an Officers' Certificate delivered to the Indenture Trustee, and such certificate, in the absence of negligence or bad faith on the part of the Indenture Trustee, shall be full warrant to the Indenture Trustee for any action

taken, suffered or omitted to be taken by it under the provisions of this Indenture upon the faith thereof;

(3) any request, direction, order or demand of the Issuer mentioned herein shall be sufficiently evidenced by an Officers' Certificate (unless other evidence in respect thereof be herein specifically prescribed); and any Issuer resolution may be evidenced to the Indenture Trustee by a copy thereof certified by the secretary or an assistant secretary of the Issuer;

(4) prior to the occurrence of an Event of Default hereunder and after the curing or waiving of all Events of Default, the Indenture Trustee shall not be bound to make any investigation into the facts or matters stated in any resolution, certificate, Officers' Certificate, opinion of Counsel, Issuer resolution, statement, instrument, opinion, report, notice, request, consent, order, facsimile transmission, electronic mail, approval, appraisal, bond, debenture, note, coupon, security, or other paper or document unless requested in writing so to do by a majority of the principal amount of the Bonds affected and then Outstanding; and if the payment within a reasonable time to the Indenture Trustee of the costs, expenses or liabilities likely to be incurred by it in the making of such investigation is, in the opinion of the Indenture Trustee, not reasonably assured to the Indenture Trustee by the security afforded to it by the terms of this Indenture, the Indenture Trustee may require indemnity satisfactory to it against such expenses or liabilities as a condition to proceeding;

(5) the Indenture Trustee shall be under no obligation to exercise any of the rights or powers vested in it by this Indenture at the request or direction of the Issuer or Holders, unless the Issuer or Holders shall have offered to the Indenture Trustee reasonable security or indemnity against the costs, expenses and liabilities which might be incurred by it in compliance with such request or direction; provided, that the Indenture Trustee shall make the payments and distributions required by this Indenture without requiring any indemnity be provided to it;

(6) the Indenture Trustee may execute any of the trusts or powers hereunder or perform any duties hereunder either directly or by or through agents or attorneys;

(7) the recitals contained herein, except any such recitals relating to the Indenture Trustee, shall be taken as the statements of the Issuer, and the Indenture Trustee assumes no responsibility for their correctness. The Indenture Trustee makes no representation as to the validity or sufficiency of this Indenture;

(8) money held by the Indenture Trustee in trust hereunder shall be segregated from other trust funds to the extent required herein or if required by law;

(9) the Indenture Trustee , in the absence of negligence, bad faith or willful misconduct on its part, may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon certificates or opinions furnished pursuant to and conforming to the requirements of this Indenture; but in the case of any

such certificates or opinions which by any provision hereof are specifically required to be furnished to the Indenture Trustee, shall be under a duty to examine the same to determine whether or not they conform to the requirements of this Indenture; and

(10) the Indenture Trustee shall, prior to an Event of Default, and after the curing of all Events of Default which may have occurred, perform such duties and only such duties as are specifically set forth in this Indenture. The Indenture Trustee shall, during the existence of any Event of Default (which has not been cured), exercise such of the rights and powers vested in it by this Indenture, and use the same degree of care and skill in their exercise, as prudent persons would exercise or use under the circumstances in the conduct of their own affairs.

SECTION 602. Rights and Duties of the Fiduciaries.

(a) All money and investments received by the Fiduciaries under this Indenture shall be held in trust, in a segregated trust account in the trust department of such Fiduciary, not commingled with any other funds, and applied solely pursuant to the provisions hereof.

(b) The Fiduciaries shall keep proper accounts of their transactions hereunder (separate from its other accounts), which shall be open to inspection on reasonable notice by the Issuer and its representatives duly authorized in writing.

(c) The Fiduciaries shall not be required to monitor the financial condition of the Issuer and, unless otherwise expressly provided, shall not have any responsibility with respect to reports, notices, certificates or other documents filed with them hereunder, except to make them available for inspection by Beneficiaries.

(d) Each Fiduciary shall be entitled to the advice of counsel (who may be counsel for any party) and shall not be liable for any action taken in good faith in reliance on such advice. Each Fiduciary may rely conclusively on any notice, certificate or other document furnished to it under this Indenture and reasonably believed by it to be genuine. A Fiduciary shall not be liable for any action taken or omitted to be taken by it in good faith and reasonably believed by it to be within the discretion or power conferred upon it, or taken by it pursuant to any direction or instruction by which it is governed under this Indenture or omitted to be taken by it by reason of the lack of direction or instruction required for such action, or be responsible for the consequences of any error of judgment reasonably made by it. When any payment or consent or other action by a Fiduciary is called for by this Indenture, the Fiduciary may defer such action pending receipt of such evidence, if any, as it may reasonably require in support thereof; except that the Indenture Trustee and any Paying Agent shall make the payments and distributions required by this Indenture without requiring that any further evidence be provided to it. A permissive right or power to act shall not be construed as a requirement to act.

(e) Nothing in this Indenture shall obligate any Fiduciary to pay any debt or meet any financial obligations to any Person in relation to the Bonds except from money received for such purposes under the provisions hereof or from the exercise of the Indenture Trustee's rights hereunder.

(f) The Fiduciaries may be or become the owner of or trade in the Bonds with the same rights as if they were not the Fiduciaries.

(g) Unless otherwise specified by Series Supplement, the Fiduciaries shall not be required to furnish any bond or surety.

(h) The Issuer shall, as and only as an Operating Expense, indemnify and save each Fiduciary harmless against any expenses and liabilities (including reasonable legal fees and expenses) that it may incur in the exercise of its duties hereunder and that are not due to its negligence, willful misconduct or bad faith. This paragraph (h) shall survive the discharge of this Indenture or the earlier resignation or removal of such Fiduciary.

(i) Nothing herein shall relieve any Fiduciary of responsibility for its negligence, bad faith or willful misconduct.

(j) The Indenture Trustee agrees to accept and act upon facsimile transmission of written instructions and/or directions pursuant to this Indenture provided, however, that: (1) if requested by the Indenture Trustee, subsequent to such facsimile transmission of written instructions and/or directions the Indenture Trustee shall forthwith receive the originally executed instructions and/or directions, (2) such originally executed instructions and/or directions shall be signed by a person as may be designated and authorized to sign for the party signing such instructions and/or directions, and (3) the Indenture Trustee shall have received a current incumbency certificate containing the specimen signature of such designated person.

(k) The Indenture Trustee shall have no responsibility or liability with respect to any information, statements or recital in any offering memorandum or other disclosure material prepared or distributed with respect to the issuance of these Bonds.

(l) The Issuer shall pay, as and only as an Operating Expense, to the Indenture Trustee compensation for its services rendered by it in the execution of the trusts hereby created and in the exercise and performance of any of the powers and duties hereunder of the Indenture Trustee, which compensation shall not be limited by any provision of law with respect to the compensation of a trustee of an express trust, and the Issuer will reimburse the Indenture Trustee for all its advances and expenditures, including but not limited to advances to and fees and expenses of independent accountants, counsel (including in-house counsel to the extent not duplicative of other counsel's work) and engineers or other experts employed by it, and reasonably required, in the exercise and performance of its powers and duties hereunder.

(m) The Indenture Trustee shall not be deemed to have knowledge of any event of default of the type described in Section 8.01(b), (c) or (d) unless and until it shall have actual knowledge thereof by receipt of written notice thereof at its Corporate Trust Office.

SECTION 603. Paying Agents. The Issuer designates the Indenture Trustee as Paying Agent. The Issuer may appoint additional Paying Agents, generally or for specific purposes, may discharge a Paying Agent from time to time and may appoint a successor, in each case with written notice to each Rating Agency. The Issuer shall designate a successor if the Indenture Trustee ceases to serve as Paying Agent. Each Paying Agent shall be a bank, national

banking association or trust company eligible under the laws of the State, and shall have (together with its corporate parent, if applicable) a capital and surplus of not less than $50,000,000 and be registered as a transfer agent with the Securities and Exchange Commission. The Issuer shall give notice of the appointment of a successor to the Indenture Trustee as Paying Agent in writing to each Beneficiary shown on the books of the Indenture Trustee. A Paying Agent may but need not be the same Person as the Indenture Trustee. Unless otherwise provided by the Issuer, the Indenture Trustee as Paying Agent shall act as registrar and transfer agent, in accordance with Section 302.

SECTION 604. Resignation or Removal of the Indenture Trustee. The Indenture Trustee may resign on not less than 30 days' written notice to the Issuer, the Beneficiaries and each Rating Agency. The Indenture Trustee will promptly certify to the Issuer that it has given written notice to all Beneficiaries and such certificate will be conclusive evidence that such notice was given as required hereby. The Indenture Trustee shall be removed if rated below investment grade by each Rating Agency and each successor Trustee shall have an investment grade rating from each Rating Agency. The Indenture Trustee may be removed by written notice from the Issuer (if not in Default) or a majority of the principal amount of the Outstanding Bonds to the Indenture Trustee and the Issuer. Such resignation or removal shall not take effect until a successor has been appointed and has accepted the duties of Indenture Trustee.

SECTION 605. Successor Fiduciaries.

(a) Any corporation or association into which the Indenture Trustee may be merged or converted or with which it may be consolidated, or any corporation or association resulting from any merger, conversion or consolidation to which the Indenture Trustee shall be a party, or any corporation or association succeeding to all or substantially all of the corporate trust business of the Indenture Trustee, shall be the successor of the Indenture Trustee hereunder, without the execution or filing of any paper or any further act on the part of any of the parties hereto.

(b) In case a Fiduciary resigns or is removed or becomes incapable of acting, or becomes bankrupt or insolvent, or if a receiver, liquidator or conservator of a Fiduciary or of its property is appointed, or if a public officer takes charge or control of a Fiduciary, or of its property or affairs, then such Fiduciary shall with due care terminate its activities hereunder and a successor may, or in the case of the Indenture Trustee shall, be appointed by the Issuer. The Issuer shall notify the Beneficiaries and each Rating Agency of the appointment of a successor Trustee in writing within 20 days from the appointment. The Issuer will promptly certify to the successor Trustee that it has given such notice to all Beneficiaries and such certificate will be conclusive evidence that such notice was given as required hereby. If no appointment of a successor Trustee is made within 45 days after the giving of written notice in accordance with Section 604 or after the occurrence of any other event requiring or authorizing such appointment, the outgoing Trustee or any Beneficiary may apply to any court of competent jurisdiction for the appointment of such a successor, and such court may thereupon, after such notice, if any, as such court may deem proper, appoint such successor. Any successor Trustee appointed under this section shall be a trust company, national banking association or a bank having the powers of a trust company, having (together with its corporate parent, if applicable) a capital and surplus of not less than $50,000,000. Any such successor Trustee shall notify the Issuer of its acceptance

of the appointment and, upon giving such notice, shall become the Indenture Trustee, vested with all the property, rights, powers and duties of the Indenture Trustee hereunder, without any further act or conveyance. Such successor Indenture Trustee shall execute, deliver, record and file such instruments as are required to confirm or perfect its succession hereunder and any predecessor Indenture Trustee shall from time to time execute, deliver, record and file such instruments as the incumbent Indenture Trustee may reasonably require to confirm or perfect any succession hereunder.

SECTION 606. Reports by Trustee to Bondholders and Rating Agencies. The Indenture Trustee shall deliver to each Bondholder and each Rating Agency on or prior to each Distribution Date therefor a statement prepared by the Indenture Trustee containing the information required pursuant to Section 504(d).

SECTION 607. Nonpetition Covenant. Notwithstanding any prior termination of this Indenture, no Fiduciary or Beneficiary shall, prior to the date which is one year and one day after the termination of this Indenture, acquiesce, petition or otherwise invoke or cause the Issuer or the Borrower to invoke the process of any court or government authority for the purpose of commencing or sustaining a case against the Issuer or the Borrower under any federal or state bankruptcy, insolvency or similar law or appointing a receiver, liquidator, assignee, trustee, custodian, sequestrator or other similar official of the Issuer or the Borrower or any substantial part of its property, or ordering the winding up or liquidation of the affairs of the Issuer or the Borrower.

SECTION 608. Compliance Certificates and Opinions. Upon any application or request by the Issuer to the Indenture Trustee to take any action under any provision of this Indenture, the Issuer shall furnish to the Indenture Trustee a certificate stating that all conditions precedent, if any, provided for in this Indenture relating to the proposed action have been complied with, except that in the case of any such application or request as to which the furnishing of any documents is specifically required by any provision of this Indenture relating to such particular application or request, no additional certificate need be furnished.

Except as otherwise specifically provided herein, each certificate or opinion with respect to compliance with a condition or covenant provided for in this Indenture shall include:

(1) a statement that each individual signing such certificate or opinion has read such covenant or condition and the definitions herein relating thereto;

(2) a brief statement as to the nature and scope of the examination or investigation upon which the statements or opinions contained in such certificate or opinion are based; and

(3) a statement as to whether, in the opinion of each such individual, such condition or covenant has been complied with.

SECTION 609. Form of Documents Delivered to the Indenture Trustee. (a) In any case where several matters are required to be certified by, or covered by an opinion of, any specified Person, it is not necessary that all such matters be certified by, or covered by the opinion of, only one such Person, or that they be so certified or covered by only one document,

but one such Person may certify or give an opinion with respect to some matters and one or more other such Persons as to other matters, and any such Person may certify or give an opinion as to such matters in one or several documents.

(b) Any certificate of an Authorized Officer of the Indenture Trustee may be based, insofar as it relates to legal matters, upon an opinion of counsel, unless such Authorized Officer knows, or in the exercise of reasonable care should know, that the opinion is erroneous. Any such certificate of an Authorized Officer of the Indenture Trustee or any opinion of counsel may be based, insofar as it relates to factual matters upon a certificate or opinion of, or representations by, one or more Authorized Officers of the Issuer, stating that the information with respect to such factual matters is in the possession of the Issuer, unless such Authorized Officer or counsel knows, or in the exercise of reasonable care should know, that the certificate or opinion or representations with respect to such matters are erroneous. Any opinion of counsel may also be based, insofar as it relates to factual matters, upon a certificate or opinion of, or representations by, an Authorized Officer of the Indenture Trustee, stating that the information with respect to such matters is in the possession of the Indenture Trustee, unless such counsel knows, or in the exercise of reasonable care should know, that the certificate or opinion or representations with respect to such matters are erroneous. Any opinion of counsel may be based on the written opinion of other counsel, in which event such opinion of counsel shall be accompanied by a copy of such other counsel's opinion and shall include a statement to the effect that such counsel believes that such counsel and the Indenture Trustee may reasonably rely upon the opinion of such other counsel. In no event shall any opinion of counsel required by this Indenture be at the expense of the Indenture Trustee.

(c) Where any Person is required to make, give or execute two or more applications, requests, consents, certificates, statements, opinions or other instruments under this Indenture, they may, but need not, be consolidated and form one instrument.

ARTICLE VII

THE BONDHOLDERS

SECTION 701. Action by Bondholders. Any request, authorization, direction, notice, consent, waiver or other action provided by this Indenture to be given or taken by Bondholders may be contained in and evidenced by one or more writings of substantially the same tenor signed by the requisite number of Bondholders or their attorneys duly appointed in writing. Proof of the execution of any such instrument, or of an instrument appointing any such attorney, shall be sufficient for any purpose of this Indenture (except as otherwise herein expressly provided) if made in the following manner, but the Issuer or the Indenture Trustee may nevertheless in its discretion require further or other proof in cases where it deems the same desirable. The fact and date of the execution by any Bondholder or its attorney of such instrument may be proved by the certificate or signature guarantee by a guarantor institution participating in a guarantee program acceptable to the Indenture Trustee; or of any notary public or other officer authorized to take acknowledgements of deeds to be recorded in the jurisdiction in which such notary public or other officer purports to act, that the person signing such request or other instrument acknowledged to such notary public or other officer the execution thereof; or by an affidavit of a witness of such execution, duly sworn to before such notary public or other

officer. The authority of the person or persons executing any such instrument on behalf of a corporate Bondholder may be established without further proof if such instrument is signed by a person purporting to be the president or a vice president of such corporation with a corporate seal affixed and attested by a person purporting to be its clerk or secretary or an assistant clerk or secretary. Any action of a Bondholder shall be irrevocable and bind all future record and beneficial owners thereof.

SECTION 702. Registered Owners. The enumeration in Section 303(a) of certain provisions applicable to DTC as Holder of immobilized Bonds shall not be construed in limitation of the rights of the Issuer and each Fiduciary to rely upon the registration books in all circumstances and to treat the registered owners of Bonds as the owners thereof for all purposes not otherwise specifically provided for by law or in this Indenture. Notwithstanding any other provisions hereof, any payment to the registered owner of a Bond shall satisfy the Issuer's obligations thereon to the extent of such payment.

ARTICLE VIII

DEFAULT AND REMEDIES

SECTION 801. Events of Default. "Event of Default" in this Indenture means any one of the events set forth below.

(a) failure to pay when due interest on any payment date or principal on the applicable Maturity Date of any Bonds or failure to pay when due interest on and principal of any Bonds in accordance with any notice of redemption or prepayment;

(b) failure of the Issuer to observe or perform any other provision of this Indenture which is not remedied within 60 days after written notice thereof is given to the Issuer by the Indenture Trustee or to the Issuer and the Indenture Trustee by the Holders of at least 25 percent in principal amount of the Bonds then Outstanding;

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

(d) an event of default has occurred and is continuing under the Loan Agreement.

SECTION 802. Remedies.

(a) *Remedies of the Indenture Trustee*. If an Event of Default occurs and is continuing:

(1) The Indenture Trustee may, and upon written request of the Holders of at least 25 percent in principal amount of the Bonds Outstanding shall, in its own name by action or proceeding in accordance with law:

(i) enforce all rights of the Bondholders and require the Issuer to carry out its agreements with the Bondholders;

(ii) sue upon such Bonds;

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

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

(2) The Indenture Trustee shall, in addition to the other provisions of this Section, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Bondholders in the enforcement and protection of their rights.

(3) Upon a Default of the Issuer under Section 801(a) or a failure actually known to an Authorized Officer of the Indenture Trustee to make any other payment required hereby within 7 days after the same becomes due and payable, the Indenture Trustee shall give written notice thereof to the Issuer. The Indenture Trustee shall give Default notices under paragraph (b) of Section 801 when instructed to do so by the written direction of another Fiduciary or the Holders of at least 25 percent in principal amount of the Outstanding Bonds. The Indenture Trustee shall proceed under Section 802 for the benefit of the Bondholders in accordance with the written direction of at least 25 percent in principal amount of the Outstanding Bonds. The Indenture Trustee shall not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Indenture Trustee shall promptly pursue the remedies provided by this Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Bondholders, and shall act for the protection of the Bondholders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

(b) *Extraordinary Prepayment*. If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the principal amount thereof without premium.

(c) *Individual Remedies*. No one or more Bondholders shall by its or their action affect, disturb or prejudice the pledge created by this Indenture, or enforce any right under this Indenture, except in the manner herein provided; and all proceedings at law or in equity to enforce any provision of this Indenture shall be instituted, had and maintained in the manner provided herein and for the equal benefit of all Bondholders of the same class; but nothing in this Indenture shall affect or impair the right of any Bondholder to enforce payment of the principal

of, premium, if any, or interest thereon at and after the same comes due pursuant to this Indenture, or the obligation of the Issuer to pay such principal, premium, if any, and interest on each of the Bonds to the respective Bondholders thereof at the time, place, from the source and in the manner expressed herein and in the Bonds.

(d) *Venue*. The venue of every action, suit or special proceeding against the Issuer shall be laid in the federal or state courts located in Los Angeles County, California or that have jurisdiction over actions arising in Los Angeles County.

(e) *Waiver*. If the Indenture Trustee determines that a Default has been cured before becoming an Event of Default and before the entry of any final judgment or decree with respect to it, the Indenture Trustee may waive the Default and its consequences, by written notice to the Issuer, and shall do so upon written instruction of the Holders of at least 25 percent in principal amount of the Outstanding Bonds.

SECTION 803. Remedies Cumulative. The rights and remedies under this Indenture shall be cumulative and shall not exclude any other rights and remedies allowed by law, provided there is no duplication of recovery. The failure to insist upon a strict performance of any of the obligations of the Issuer or to exercise any remedy for any violation thereof shall not be taken as a waiver for the future of the right to insist upon strict performance by the Issuer or of the right to exercise any remedy for the violation.

SECTION 804. Delay or Omission Not Waiver. (a) No delay or omission of the Indenture Trustee or of any Bondholder to exercise any right or remedy accruing upon any Event of Default shall impair any such right or remedy or constitute a waiver of any such Event of Default or an acquiescence therein. Every right and remedy given hereby or by law to the Indenture Trustee or to the Bondholders may be exercised from time to time, and as often as may be deemed expedient, by the Indenture Trustee or by the Bondholders, as the case may be.

(b) Any request, demand, authorization, direction, notice, consent, waiver or other action by the Issuer shall bind any successors or assigns of the Issuer in respect of anything done, omitted or suffered to be done by the Indenture Trustee in reliance thereon.

(c) Where this Indenture provides for notice in any manner, such notice may be waived in writing by any Person entitled to receive such notice, either before or after the event, and such waiver shall be the equivalent of such notice.

ARTICLE IX

MISCELLANEOUS

SECTION 901. Supplements and Amendments to this Indenture.

(a) This Indenture may be:

(1) supplemented in writing by the Issuer and the Indenture Trustee to (i) provide for the issuance of Bonds in accordance with Section 301, (ii) provide for earlier or greater deposits into the Debt Service Account, (iii) subject any additional

property to the lien hereof, (iv) add to the covenants and agreements of the Issuer or surrender or limit any right or power of the Issuer, (v) identify particular Bonds for purposes not inconsistent herewith, including remarketing, serialization and defeasance, or (vi) cure any ambiguity or defect, (vii) protect the exclusion of interest on the Bonds from gross income for federal income tax purposes, or the exemption from registration of the Bonds under the Securities Act of 1933, as amended, or of this Indenture under the Trust Indenture Act of 1939, as amended, and any other things relative to such Bonds that are not materially adverse to the Holders of Outstanding Bonds; or

(2) amended in writing by the Issuer and the Indenture Trustee, (i) to add provisions that are not materially adverse to the Bondholders, (ii) to adopt amendments that do not take effect unless and until (y) no Bonds Outstanding prior to the adoption of such amendment remain Outstanding or (z) such amendment is consented to by such Bondholders in accordance with the further provisions hereof, or (iii) pursuant to the following paragraph (b).

(b) Except as provided in the foregoing paragraph (a), this Indenture may be amended in writing by the Issuer and the Indenture Trustee:

(1) only with written notice to the Rating Agencies and the written consent of a majority of the principal amount of the Bonds to be Outstanding at the effective date thereof and affected thereby; but

(2) only with the unanimous written consent of the affected Bondholders for any of the following purposes: (i) to extend the stated maturity date of any Bond, (ii) to reduce the principal amount, applicable premium or interest rate of any Bond, (iii) to make any Bond redeemable or prepayable other than in accordance with its terms, or (iv) to reduce the percentage of the Bonds required to be represented by the Bondholders giving their consent to any amendment.

(c) Any amendment of this Indenture shall be accompanied by an opinion of Counsel to the effect that the amendment is permitted by law and does not, in and of itself, result in the inclusion of interest on the Bonds in gross income for federal income tax purposes.

(d) When the Issuer determines that the requisite number of consents have been obtained for an amendment hereto or to the agreement which requires consents, it shall file a certificate to that effect in its records and give notice to the Indenture Trustee and the Bondholders. The Indenture Trustee will promptly certify to the Issuer that it has given such notice to all Bondholders and such certificate will be conclusive evidence that such notice was given in the manner required hereby. It shall not be necessary for the consent of Bondholders pursuant to this Section to approve the particular form of any proposed amendment, but it shall be sufficient if such consent shall approve the substance thereof.

SECTION 902. Supplements and Amendments to the Sale Agreement and the Loan Agreement. The Sale Agreement and the Loan Agreement provide that such documents shall not be amended under certain circumstances without the written consent of the Indenture Trustee. The Indenture Trustee shall give such written consent only if: (1) in the opinion of

nationally recognized bond counsel, such amendment is necessary to preserve the exclusion of interest on the Bonds from gross income for purposes of federal income taxation or the exemption of interest on the Bonds from State income taxation; (2) in the opinion of Counsel, such amendment, modification or termination will not materially adversely affect the interests of the Bondholders or result in any material impairment of the security hereby given for the payment of the Bonds; or (3) the Holders of a majority of the principal amount of the Bonds then Outstanding consent in writing to such amendment, modification or termination. No amendment, modification or termination of the Sale Agreement or the Loan Agreement shall reduce the amount of Loan Payments to be made to the Issuer or the Indenture Trustee by the Corporation pursuant to the Loan Agreement, or extend the time for making such payments, without the written consent of all of the Bondholders then Outstanding. It shall not be necessary for the consent of Bondholders pursuant to this Section to approve the particular form of any proposed amendment, but it shall be sufficient if such consent shall approve the substance thereof.

SECTION 903. Rating Confirmation. The Sale Agreement, the Loan Agreement and this Indenture require delivery to the Indenture Trustee of a Rating Confirmation prior to certain actions being undertaken thereunder and hereunder.

SECTION 904. Notices. Unless otherwise expressly provided, all notices to the Issuer or the Indenture Trustee shall be in writing and shall be deemed sufficiently given if sent by registered or certified mail, postage prepaid, return receipt requested, or delivered during business hours as follows: (a) to the Issuer at 1221 Oak Street, Suite 536, Oakland, California, 94612, attention of the President, and (b) to the Indenture Trustee at [Indenture Trustee Address], attention of the Corporate Trust Department, or, as to all of the foregoing, to such other address as the addressee shall have indicated by prior written notice to the one giving notice. All notices to a Bondholder shall be in writing and (without limitation) shall be deemed sufficiently given if sent by mail, postage prepaid, to the Bondholder at the address shown on the registration books. A Bondholder may direct the registrar to change such Bondholder's address as shown on the registration books by written notice to the registrar.

Notice hereunder may be waived prospectively or retrospectively by the Person entitled to the notice, but no waiver shall affect any notice requirement as to other Persons.

SECTION 905. Beneficiaries. This Indenture is not intended for the benefit of and shall not be construed to create rights in parties other than the Issuer, the Fiduciaries and the Beneficiaries to the extent specified herein.

SECTION 906. Successors and Assigns. All covenants and agreements in this Indenture and the Bonds by the Issuer shall bind its successors and assigns, whether so expressed or not. All agreements of the Indenture Trustee in this Indenture shall bind its successors.

SECTION 907. Severability. In case any provision in this Indenture or in the Bonds shall be invalid, illegal or unenforceable, the validity, legality, and enforceability of the remaining provisions shall not in any way be affected or impaired thereby.

SECTION 908. Legal Holidays. In any case where the date on which any payment is due shall not be a Business Day, then (notwithstanding any other provision of the Bonds or this Indenture) payment need not be made on such date, but may be made on the next succeeding Business Day with the same force and effect as if made on the date on which nominally due, and no interest shall accrue for the period from and after any such nominal date.

SECTION 909. Governing Law. This Indenture shall be construed in accordance with the laws of the State, without reference to its conflict of law provisions, and the obligations, rights and remedies of the parties hereunder shall be determined in accordance with such laws.

SECTION 910. Limitation of Liability. No director, officer or employee of the Issuer shall be individually or personally liable for the payment of the interest on or principal of or the redemption price, if any, on the Bonds, but nothing contained herein shall relieve any director, officer or employee of the Issuer from the performance of any official duty provided by any applicable provisions of law or hereby.

SECTION 911. No Recourse to Issuer. Notwithstanding any provision of this Indenture or any Series Supplement or Bond to the contrary, Bondholders shall have no recourse against the Issuer, but shall look only to the Collateral, with respect to any amounts due to the Bondholders hereunder.

SECTION 912. Ability to Issue Bonds Secured by Other Assets. Nothing herein shall preclude the Issuer from issuing other bonds or other obligations secured by revenues or assets which do not constitute security under this Indenture.

SECTION 913. Signatures and Counterparts. This Indenture and each Supplemental Indenture may be executed and delivered in any number of counterparts, each of which shall be deemed to be an original, but such counterparts together shall constitute one and the same instrument.

SIGNATURES

IN WITNESS WHEREOF, the parties have caused this Indenture to be duly executed all as of the date first above written.

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

By: _____
Authorized Officer

[INDENTURE TRUSTEE], as Indenture Trustee

By: _____
Authorized Signatory

EXHIBIT A

SERIES SUPPLEMENT
AUTHORIZING THE ISSUANCE OF

$[_____]

TOBACCO SETTLEMENT ASSET-BACKED BONDS
SERIES 2006A

of

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

(LOS ANGELES COUNTY SECURITIZATION CORPORATION)

Dated as of [Date]

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ARTICLE I

DEFINITIONS AND AUTHORITY

SECTION 1.01. Definitions. Terms used herein and not otherwise defined shall have the respective meanings given or referred to in the Indenture, dated as of [Date] (as amended and supplemented by all Series Supplements, including this Series 2006A Supplement, the "Indenture") by and between The California County Tobacco Securitization Agency and [Indenture Trustee], as indenture trustee.

SECTION 1.02. Authority for this Series Supplement. This Series 2006A Supplement is executed and delivered pursuant to Sections 301 and 901(a) of the Indenture.

ARTICLE II

THE BONDS

SECTION 2.01. Principal Amount and Terms. Pursuant to the Indenture, a Series of Bonds is hereby authorized in the aggregate principal amount or initial principal amount of $[_____]. Such Bonds shall be distinguished from the Bonds of all other Series by the title "Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A."

(a) Details of the Series 2006A Bonds. The Series 2006A Bonds shall be issued in fully registered form and shall be numbered from R-1 upwards. The Series 2006A Bonds shall be Term Bonds.

The Series 2006A Bonds having Maturity Dates in the years [20__] through [20__] shall be issued as Capital Appreciation Bonds with the Maturity Dates, in the initial principal amounts and with the Accreted Values at maturity and the weighted average lives set forth in Exhibit 1, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Maturity Date thereof, and in substantially the form set forth in Exhibit 2 hereto, with appropriate or necessary insertions, omissions and variations as permitted or required by the Indenture. The Capital Appreciation Bonds shall accrue interest from their date of delivery, which interest shall be compounded on the first Distribution Date, and thereafter semiannually on the Distribution Dates in each year. Interest shall accrue at the Accretion Interest Rate on the Accreted Value of any Capital Appreciation Bonds that have not been paid on the Maturity Date therefor.

The Series 2006A Bonds having Maturity Dates in the years [20__] and [20__] shall be issued as Convertible Bonds with the Maturity Dates and Conversion Dates, in the initial principal amounts and with the Accreted Values at the Conversion Date thereof and the weighted averages lives set forth in Exhibit 1, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Conversion Date thereof. Prior to the Conversion Date, the Convertible Bonds shall accrue interest from their date of delivery, which interest shall be compounded on the first Distribution Date and thereafter semiannually on the Distribution Dates in each year. After the applicable Conversion Date, such Convertible Bonds shall become Current Interest Bonds with interest thereon payable on June 1 and December 1 of each year

following such Conversion Date, at the rates specified on Exhibit 1 hereto. The Convertible Bonds shall be in substantially the form set forth in Exhibit 3 hereto, with appropriate or necessary insertions, omissions and variations as permitted or required by the Indenture.

(b) Redemption and Prepayment. The Series 2006A Bonds shall be redeemable and prepayable prior to maturity in accordance with their terms and the terms of the Indenture and this Series 2006A Supplement.

(i) Optional Redemption. (1) The Capital Appreciation Bonds maturing on or prior to June 1, [20__] are not subject to optional redemption. The Capital Appreciation Bonds maturing on and after June 1, [20__] are subject to optional redemption, in whole or in part, on any date on or after June 1, [20__], at a redemption price of 100 percent of the Accreted Value thereof to the date fixed for redemption.

(2) The Convertible Bonds maturing on or prior to June 1, [20__] are not subject to optional redemption. The Convertible Bonds maturing on and after June 1, [20__] are subject to optional redemption, in whole or in part, on any date on or after June 1, [20__], at a redemption price of 100 percent of the principal amount or Accreted Value thereof together with accrued interest after the Conversion Date to the date fixed for redemption.

SECTION 2.02. Application of Proceeds. Upon receipt of the proceeds of the Series 2006A Bonds of the Issuer, the Indenture Trustee shall apply such proceeds as specified on Exhibit 4 hereto. The Indenture Trustee is authorized to establish and maintain an account in the name of the Issuer for the purpose of paying Costs of Issuance as directed in an Officer's Certificate.

IN WITNESS WHEREOF, the parties have caused this Series 2006A Supplement to be duly executed all as of the date first above written.

THE CALIFORNIA COUNTY TOBACCO
SECURITIZATION AGENCY

By:_____
Authorized Officer

[INDENTURE TRUSTEE],
as Indenture Trustee

By:_____
Authorized Signatory

EXHIBIT 1
to Series 2006A Supplement

Rates and Maturities; Weighted Average Lives

CAPITAL APPRECIATION BONDS:

Maturity Date (June 1)	Initial Principal Amount	Accreted Value at Maturity	Accretion Interest Rate	Weighted Average Life

CONVERTIBLE BONDS:

Maturity Date (June 1)	Initial Principal Amount	Conversion Date	Accreted Value at Conversion Date	Accretion Interest Rate	Weighted Average Life

EXHIBIT 2
to Series 2006A Supplement

FORM OF CAPITAL APPRECIATION BOND

REGISTERED NUMBER R-___ **ACCRETED VALUE AT MATURITY DATE $_____**

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
TOBACCO SETTLEMENT ASSET-BACKED BOND
(LOS ANGELES COUNTY SECURITIZATION CORPORATION)
SERIES 2006A
(CAPITAL APPRECIATION BOND)

ACCRETION INTEREST RATE	DATED DATE	MATURITY DATE	CUSIP

REGISTERED OWNER: CEDE & CO.

INITIAL PRINCIPAL AMOUNT: _____ DOLLARS

ACCRETED VALUE AT MATURITY DATE: _____ DOLLARS

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY (the "Issuer"), a public entity of the State of California (the "State"), for value received promises to pay to the registered owner of this Bond, on the payment date determined pursuant to the below-described Indenture, the initial principal amount set forth above, together with interest accrued thereon to Maturity Date identified above or such earlier redemption date at the Accretion Interest Rate set forth above from the date of authentication and delivery of this Bond, compounded semiannually on June 1 and December 1 of each year, beginning [____] 1, 20[__] (the "Accreted Value"). Interest shall be calculated on the basis of a year of 360 days and twelve 30-day months.

This Bond is not a debt or obligation of the State or any of its municipalities or other political subdivisions, other than the Issuer, and neither the State nor any of such municipalities or other subdivisions, other than the Issuer, shall be liable of the payment of the principal or Accreted Value of or interest on this Bond.

This Bond is a Bond of the Issuer entitled "The California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A" (the "Bonds"), representing a borrowing of $[_____] pursuant to an Indenture dated as of [Date], between the Issuer and the Indenture Trustee (the "Indenture"). Reference is made to the Indenture for a description of the funds pledged and to the rights, limitations of rights, duties, obligations and immunities of the Issuer, the Indenture Trustee and the Bondholders, including restrictions on the rights of the

Bondholders to bring suit. Definitions given or referred to in the Indenture are incorporated herein by this reference. The Indenture may be amended to the extent and in the manner provided therein.

This Bond is a Capital Appreciation Bond and a Term Bond.

The Accreted Value of this Bond and applicable premium, if any, are payable in any coin or currency of the United States of America which on the date of payment is legal tender for the payment of public and private debts, upon presentation and surrender of this Bond when due and payable at the office of the Indenture Trustee or of such other paying agent as may hereafter be designated by the Issuer (in either case, the "Paying Agent").

All money paid to the Paying Agent for the payment of the Accreted Value of, premium, if any, or interest on any bond that remains unclaimed at the end of two years and nine months after such Accreted Value or premium, if any, shall have become due and payable will be paid to the Issuer, and the holder of such bond shall thereafter look only to the Issuer for payment.

This Bond shall not be valid or become obligatory for any purpose until the certificate of authentication hereon has been dated and manually signed by the Indenture Trustee.

It is hereby certified and recited that all conditions, acts and things required by the Constitution and statutes of the State to exist, to have happened and to have been performed precedent to and in the issuance of this Bond, exist, have happened and have been performed, and that the Series of Bonds of which this is one, together with all other indebtedness of the Issuer, is within every debt and other limit prescribed by the Constitution and laws of the State.

Neither the Commissioners of the Issuer nor any person executing this Bond shall be liable personally thereon or be subject to any personal liability or accountability solely by reasons of the issuance hereof.

The Capital Appreciation Bonds are subject to redemption at the Issuer's option at any time on or after June 1, [____], in whole or in part, at a redemption price of 100 percent of the Accreted Value thereof to the date fixed for redemption. The Bonds for optional redemption shall be selected by the Issuer at its sole discretion.

There shall be applied to or credited against any of the required amounts the Accreted Value of any such Bonds that have been defeased, purchased or redeemed and not previously so applied or credited.

The Bonds are subject to mandatory prepayment, in whole or in part prior to their stated maturity dates from amounts on deposit in the Lump Sum Prepayment Account on any date at the prepayment price of 100 percent of the Accreted Value thereof to the date fixed for prepayment without premium. Any prepayments of Bonds pursuant to this paragraph shall be Pro Rata without regard to their order of maturity.

The Term Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity dates from amounts on deposit in the Turbo Redemption Account on each

June 1 and December 1, commencing ___ 1, ____, at the redemption price of 100 percent of the Accreted Value thereof to the date fixed for redemption without premium. Any redemption of Term Bonds pursuant to this paragraph shall be in order of maturity.

If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the Accreted Value thereof without premium.

If less than all the Outstanding Bonds of any maturity date are to be redeemed, the particular Bonds to be redeemed shall be selected by the Indenture Trustee by such method as it shall deem fair and appropriate and the Indenture Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the Accreted Value of Bonds of a denomination larger than the minimum authorized denomination.

This Bond shall be prepaid or redeemed upon the giving of notice as provided in the Indenture.

The Bonds are issuable only in fully registered form in the denomination of $5,000 or any integral multiple thereof of the Accreted Value at the Maturity Date. The Issuer, the Indenture Trustee and the Paying Agent may treat the registered owner as the absolute owner of this Bond for all purposes, notwithstanding any notice to the contrary. This Bond is transferable by the registered owner hereof in accordance with the Indenture.

The respective covenants of the Issuer with respect hereto shall be fully discharged and of no further force and effect at such time as this Bond, together with interest thereon, shall have been paid in full at maturity, or shall have otherwise been refunded, redeemed, defeased or discharged.

IN WITNESS WHEREOF, the Issuer has caused this Bond to be executed in its name by its President and attested by its Secretary by their facsimile signatures hereon, all as of the [_____].

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

By:_____
President

ATTEST:

_____
Secretary

CERTIFICATE OF AUTHENTICATION

This Bond is one of the Bonds described in and issued in accordance with the Indenture, including the Series 2006A Supplement.

[INDENTURE TRUSTEE], as Indenture Trustee

By:_____
Authorized Signatory

Date of Authentication: [_____]

ASSIGNMENT

For value received the undersigned do(es) hereby sell, assign and transfer unto _____ the within-mentioned registered Bond and hereby irrevocably constitute(s) and appoint(s) _____ attorney, to transfer the same on the books of the Bond Trustee with full power of substitution in the premises.

_____

NOTICE: The signature on this Assignment must correspond with the name as it appears on the face of the within Bond in every particular, without alteration or enlargement or any change whatsoever.

Dated: _____

Signature Guaranteed By:

_____

NOTICE: Signature guarantee should be made by a guarantor institution participating in the securities transfer agents medallion program or in such other guarantee program acceptable to the Bond Trustee.

Social Security or Other Taxpayer
Identification Number of Transferee:

_____

Addressee of Transferee:

_____

_____

_____

EXHIBIT 3
to Series 2006A Supplement

FORM OF CONVERTIBLE BOND

REGISTERED NUMBER R-___ **ACCRETED VALUE AT CONVERSION DATE $_____**

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
TOBACCO SETTLEMENT ASSET-BACKED BOND
(LOS ANGELES COUNTY SECURITIZATION CORPORATION)
SERIES 2006A
(CONVERTIBLE CAPITAL APPRECIATION BOND)

ACCRETION INTEREST RATE	DATED DATE	MATURITY DATE	CUSIP

REGISTERED OWNER: CEDE & CO.

INITIAL PRINCIPAL AMOUNT: _____ DOLLARS

ACCRETED VALUE AT CONVERSION DATE: _____ DOLLARS

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY (the "Issuer"), a public entity of the State of California (the "State"), for value received promises to pay to the registered owner of this Bond, on the payment date determined pursuant to the below-described Indenture, the Accreted Value (as that term is defined in the Indenture hereinafter referred to, and herein the "Accreted Value") at the Conversion Date specified below (which amount represents the initial principal amount hereof, together with accrued interest on such initial principal amount from the date hereof until June 1, [_____] (the "Conversion Date") at the Accretion Interest Rate specified above, compounded on [____] 1, 20[__], and semiannually thereafter on June 1 and December 1 of each year until the Conversion Date), together with interest on the Accreted Value at the Conversion Date paid at the Accretion Interest Rate specified above from the Conversion Date or from the most recent payment date to which interest has been paid, but if the date of authentication of this Bond is after the Record Date immediately preceding an interest payment date, interest will be paid from such interest payment date and if no interest has been paid on this Bond, interest will be paid from the Conversion Date. Interest after the Conversion Date at such rate will be paid currently on June 1 and December 1 of each year, beginning [June/December] 1, _____ (each, a "Distribution Date"), and at the Maturity Date, as set forth herein, by wire transfer, at the corporate trust office of [Indenture Trustee], as trustee (the "Indenture Trustee") or by check mailed on the applicable Distribution Date to the address of the registered owner hereof as shown on the registration books of the Issuer as maintained by the Indenture Trustee, as of the close of business on the Record Date immediately preceding the applicable interest payment date. Interest shall be calculated on the basis of a year of 360 days and twelve 30-day months.

This Bond is not a debt or obligation of the State or any of its municipalities or other political subdivisions, other than the Issuer, and neither the State nor any of such municipalities or other subdivisions, other than the Issuer, shall be liable of the payment of the principal or Accreted Value of or interest on this Bond.

This Bond is a Bond of the Issuer entitled "The California County Tobacco Securitization Agency Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A" (the "Bonds"), representing a borrowing of $[_____] pursuant to an Indenture dated as of [Date], between the Issuer and the Indenture Trustee (as further amended and supplemented, the "Indenture"). Reference is made to the Indenture for a description of the funds pledged and to the rights, limitations of rights, duties, obligations and immunities of the Issuer, the Indenture Trustee and the Bondholders, including restrictions on the rights of the Bondholders to bring suit. Definitions given or referred to in the Indenture are incorporated herein by this reference. The Indenture may be amended to the extent and in the manner provided therein.

This Bond is a Convertible Bond and a Term Bond.

The Accreted Value of this Bond and applicable premium, if any, and interest after the Conversion Date are payable in any coin or currency of the United States of America which on the date of payment is legal tender for the payment of public and private debts, upon presentation and surrender of this Bond when due and payable at the office of the Indenture Trustee or of such other paying agent as may hereafter be designated by the Issuer (in either case, the "Paying Agent").

All money paid to the Paying Agent for the payment of the Accreted Value of, premium, if any, or interest after the Conversion Date, on any bond that remains unclaimed at the end of two years and nine months after such Accreted Value of, premium, if any, or interest shall have become due and payable will be paid to the Issuer, and the holder of such bond shall thereafter look only to the Issuer for payment.

This Bond shall not be valid or become obligatory for any purpose until the certificate of authentication hereon has been dated and manually signed by the Indenture Trustee.

It is hereby certified and recited that all conditions, acts and things required by the Constitution and statutes of the State to exist, to have happened and to have been performed precedent to and in the issuance of this Bond, exist, have happened and have been performed, and that the Series of Bonds of which this is one, together with all other indebtedness of the Issuer, is within every debt and other limit prescribed by the Constitution and laws of the State.

Neither the Commissioners of the Issuer nor any person executing this Bond shall be liable personally thereon or be subject to any personal liability or accountability solely by reasons of the issuance hereof.

The Convertible Bonds are subject to redemption at the Issuer's option at any time on or after June 1, [____], in whole or in part, at a redemption price of 100 percent of the Accreted Value thereof together with interest accrued after the Conversion Date to the date fixed

for redemption. The Bonds for optional redemption shall be selected by the Issuer at its sole discretion.

There shall be applied to or credited against any of the required amounts the principal or Accreted Value of any such Bonds that have been defeased, purchased or redeemed and not previously so applied or credited.

The Bonds are subject to mandatory prepayment, in whole or in part prior to their stated maturity dates from amounts on deposit in the Lump Sum Prepayment Account on any date at the prepayment price of 100 percent of the Accreted Value together with interest accrued after the Conversion Date to the date fixed for prepayment without premium. Any prepayments of Bonds pursuant to this paragraph shall be Pro Rata without regard to their order of maturity.

The Term Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity dates from amounts on deposit in the Turbo Redemption Account on each June 1 and December 1, commencing ___ 1, ____, at the redemption price of 100 percent of the Accreted Value thereof together with interest accrued after the Conversion Date to the date fixed for redemption without premium. Any redemption of Term Bonds pursuant to this paragraph shall be in order of maturity.

If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the Accreted Value thereof without premium.

If less than all the Outstanding Bonds of any maturity date are to be redeemed, the particular Bonds to be redeemed shall be selected by the Indenture Trustee by such method as it shall deem fair and appropriate and the Indenture Trustee may provide for the selection for redemption of portions (equal to any authorized denominations) of the principal of Bonds of a denomination larger than the minimum authorized denomination.

This Bond shall be prepaid or redeemed upon the giving of notice as provided in the Indenture.

The Bonds are issuable only in fully registered form in the denomination of $5,000 or any integral multiple thereof of the Accreted Value at the Conversion Date. The Issuer, the Indenture Trustee and the Paying Agent may treat the registered owner as the absolute owner of this Bond for all purposes, notwithstanding any notice to the contrary. This Bond is transferable by the registered owner hereof in accordance with the Indenture.

The respective covenants of the Issuer with respect hereto shall be fully discharged and of no further force and effect at such time as this Bond, together with interest thereon, shall have been paid in full at maturity, or shall have otherwise been refunded, redeemed, defeased or discharged.

IN WITNESS WHEREOF, the Issuer has caused this Bond to be executed in its name by its President and attested by its Secretary by their facsimile signatures hereon, all as of the [_____].

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

By:_____
President

ATTEST:

_____
Secretary

CERTIFICATE OF AUTHENTICATION

This Bond is one of the Bonds described in and issued in accordance with the Indenture, including the Series 2006A Supplement.

[INDENTURE TRUSTEE], as Indenture Trustee

By:_____
Authorized Signatory

Date of Authentication: [_____]

ASSIGNMENT

For value received the undersigned do(es) hereby sell, assign and transfer unto _____ the within-mentioned registered Bond and hereby irrevocably constitute(s) and appoint(s) _____ attorney, to transfer the same on the books of the Bond Trustee with full power of substitution in the premises.

_____

NOTICE: The signature on this Assignment must correspond with the name as it appears on the face of the within Bond in every particular, without alteration or enlargement or any change whatsoever.

Dated: _____

Signature Guaranteed By:

_____

NOTICE: Signature guarantee should be made by a guarantor institution participating in the securities transfer agents medallion program or in such other guarantee program acceptable to the Bond Trustee.

Social Security or Other Taxpayer
Identification Number of Transferee:

_____

Addressee of Transferee:

_____

_____

_____

EXHIBIT 4
to Series 2006A Supplement

Application of Proceeds

To Accounts Held By Indenture Trustee

Debt Service Reserve:	$_____
Costs of Issuance:	$_____
Operating:	$_____

To Other Parties

To the Corporation for the Loan under the Loan Agreement:	$_____

$ _____

THE CALIFORNIA COUNTY TOBACCO
SECURITIZATION AGENCY

Tobacco Settlement Asset-Backed Bonds
(Los Angeles County Securitization Corporation)

$_____	**$_____**
Series 2006A Capital Appreciation Bonds	**Series 2006A Convertible Bonds**

CONTRACT OF PURCHASE

January ____, 2006

The California County Tobacco Securitization Agency
1221 Oak Street
Suite 536
Oakland, CA 94612

Ladies and Gentlemen:

Citigroup Global Markets Inc., (the "Representative"), acting on behalf of itself and the other underwriters named on the signature page hereof (collectively, the "Underwriters"), offers to enter into this contract of purchase (the "Contract of Purchase") with The California County Tobacco Securitization Agency (the "Agency") for the purchase by the Underwriters of $_____ aggregate principal amount of the Agency's Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A Bonds. The "Series 2006A Bonds" consist of the "Series 2006A Capital Appreciation Bonds" and the "Series 2006A Convertible Bonds."

The Series 2006A Bonds will be issued and secured under and pursuant to an Indenture, dated as of _____ 1, 2006, as supplemented in the case of each series by a Series Supplement, each dated as of _____ 1, 2006 (as supplemented, the "Indenture"), between the Agency and _____as indenture trustee (the "Indenture Trustee") for the purpose of making a loan to the Los Angeles County Securitization Corporation, a nonprofit public benefit corporation (the "Corporation") pursuant to a Secured Loan Agreement, dated as of _____ 1, 2006 (the "Loan Agreement"), between the Agency and the

Corporation. The Corporation has purchased all of the right, title and interest of the County of Los Angeles (the "County") in and to certain payments to be paid (such payments as more fully described in the Final Offering Circular, the "Sold County Tobacco Assets") pursuant to a Sale Agreement, dated as of _____ 1, 2006, between the Corporation and the County (the " Sale Agreement"). The proceeds of the Series 2006A Bonds are expected to be applied to (i) fund a liquidity reserve for the Series 2006A Bonds (as defined in the Final Offering Circular); (ii) make a deposit to the Operating Account (as defined in the Final Offering Circular); (iii) make a loan to the Corporation; and (iv) pay the costs of issuance incurred in connection with the issuance of the Series 2006A Bonds. The County has agreed to sell certain assets to the Corporation,, the proceeds of which will be used for the benefit of the County and its residents in connection with one or more specific capital projects.

The execution and delivery of the Indenture, the Loan Agreement, this Contract of Purchase, the Final Offering Circular, dated _____, 2006, relating to the Series 2006A Bonds (the "Final Offering Circular") and the Bonds have been authorized, as applicable, by a resolution of the Agency (the "Agency Resolution"), and by a resolution of the Corporation (the "Corporation Resolution").

The Indenture, the Loan Agreement, the Sale Agreement, the Tax Certificate of the County, the Tax Certificate of the Agency, the Tax Certificate of the Corporation, this Contract of Purchase, the Letter of Representations of the Corporation set forth in Exhibit A (the "Corporation Letter of Representations") and the Certificate of the County in substantially the form attached hereto as Exhibit B (the "County Certificate") hereto are referred to collectively herein as the "Legal Documents." Capitalized terms not otherwise defined herein shall have the meanings as defined in the Indenture.

This offer is made subject to the receipt of the Corporation Letter of Representations, the County Certificate and the written acceptance by the Agency at or prior to 5:00 p.m., California time, on the date hereof, and, if not so accepted, will be subject to withdrawal by the Underwriters upon notice delivered to the Agency at any time prior to the acceptance hereof by the Agency. Upon such acceptance by the Agency, this Contract of Purchase will be binding upon the Agency and the Underwriters.

1. Sale.

Upon the terms and conditions and in reliance on the representations, warranties and agreements hereinafter set forth, the representations, warranties and agreements of the Corporation set forth in the Corporation Letter of Representations and the representations, warranties and agreements of the County set forth in the County Certificate, the Underwriters hereby agree to purchase from the Agency for offering to the public, and the Agency hereby agrees to sell to the Underwriters for such purpose, all (but not less than all) of the $_____ aggregate principal amount of the Series 2006A Bonds, being payable as to principal (including sinking fund payments, if any,) or Accreted Value and bearing or accreting interest payable and having such dates and other terms as set forth in Exhibit D. The aggregate purchase price for the Series 2006A Bonds shall be $_____ (representing the aggregate principal amount of the Series 2006A Bonds, less an underwriting discount of

$_____ and less an original issue discount of $_____) (such purchase price shall be referred to herein as the "Purchase Price").

2. Delivery of the Final Offering Circular and Other Documents.

(a) Within seven (7) business days hereof the Agency agrees to deliver to the Underwriters, at such addresses as the Underwriters shall have specified, sufficient copies of the Final Offering Circular as the Underwriters shall have reasonably requested as necessary to comply with all applicable rules of the Municipal Securities Rulemaking Board and the Securities and Exchange Commission (the "SEC"), including Rule 15c2-12 promulgated under the Securities Exchange Act of 1934, as amended ("Rule 15c2-12"), with only such changes from the form of the Preliminary Offering Circular as shall have been accepted by the Representative. The Agency authorizes the use and distribution of copies of the Final Offering Circular by the Underwriters in connection with the public offering and sale of the Bonds.

(b) The Agency has previously authorized the approval of the Final Offering Circular by execution thereof by a duly authorized officer of the Agency. The Agency ratifies and consents to the use by the Underwriters, prior to the date hereof, of the Preliminary Offering Circular of the Agency, dated _____, 2006, relating to the Series 2006A Bonds (which, including all appendices thereto, is herein called the "Preliminary Offering Circular"), in connection with the prospective offering of the Series 2006A Bonds, including the electronic distribution of the Preliminary Offering Circular and the use of the disclaimer related thereto. Prior to the date hereof, the Agency delivered to the Underwriters the Preliminary Offering Circular together with a certificate of the Agency which stated that the Preliminary Offering Circular is deemed final as of its date for purposes of Rule 15c2-12, except for the information not required to be included therein under Rule 15c2-12.

(c) The Agency undertakes that for a period to and including the date that is 25 days from the "end of the underwriting period" (as defined below) it will (i) apprise the Underwriters of all material developments, if any, occurring with respect to the Agency after delivery of the Series 2006A Bonds to the Underwriters and (ii), if requested by the Representative, prepare a supplement to the Final Offering Circular in respect of any material event so that, as amended or supplemented, it will not contain any untrue statement of a material fact or omit to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading.

(d) Unless otherwise notified in writing by the Representative on or prior to the date of delivery of and payment for the Series 2006A Bonds (such date referred to herein as the "Closing"), the Agency can assume that the "end of the underwriting period" for the Series 2006A Bonds for all purposes of Rule 15c-12 is the date of the Closing. In the event notice is given in writing by the Representative that the underwriting period shall continue beyond the Closing, the Representative shall notify the Agency in writing following the occurrence of the "end of the underwriting period" for the Series 2006A Bonds as defined in Rule 15c2-12. The "end of the underwriting period" for the Series 2006A Bonds as used in this Contract of Purchase shall mean the Closing or such later date as to which notice is given by the Representative in accordance with the preceding sentence.

(e) The Agency will undertake pursuant to the provisions of the Indenture, for the benefit of holders of the Series 2006A Bonds, to provide annual reports and notices of certain events in order to assist the Underwriters in complying with Rule 15c2-12.

3. The Closing. At 8:00 a.m., California time, on _____, 2006, or at such other time or on such earlier or later date as the Agency and the Representative mutually agree upon, the Agency and the Indenture Trustee will deliver or cause to be delivered to the Underwriters in book-entry form through the facilities of The Depository Trust Company, New York, New York duly executed and authenticated and the other documents hereinafter mentioned shall be delivered at the offices of Sidley Austin Brown & Wood in Los Angeles, California or at such other location as shall have been mutually agreed upon by the Agency and the Representative. The Series 2006A Bonds shall be initially registered in the name of Cede & Co., as nominee for DTC. The Series 2006A Bonds will be made available for checking at least one business day prior to the Closing.

Subject to the terms and conditions hereof, the Underwriters will accept delivery of the Series 2006A Bonds and pay the purchase price thereof by federal funds to the order of the Indenture Trustee in an amount equal to the Purchase Price as set forth in Section 1 hereof on the Closing.

4. Public Offering. The Underwriters will make a bona fide public offering of all of the Series 2006A Bonds at a price not in excess of the initial public offering price or prices set on the inside cover page of the Final Offering Circular. The Underwriters may offer and sell the Series 2006A Bonds to certain dealers (including dealers depositing such Series 2006A Bonds into investment trusts) and others at prices lower than the public offering prices set forth on the inside cover page of the Final Offering Circular, and prices may be changed from time to time by the Underwriters.

5. Agency Representations, Warranties and Agreements. The Agency represents, warrants to and agrees with the Underwriters that, as of the date hereof and as of the date of the Closing:

(a) Due Organization and Authority; Legal, Valid and Binding Obligations. The Agency is duly created and established as a joint exercise of powers authority pursuant to Chapter 5 of Division 7 of Title 1 of the Government Code of the State of California (the "Act"), and a Joint Exercise of Powers Agreement, dated as of November 15, 2000 (the "Joint Powers Agreement"), as amended, by and among the County and the Counties of Merced, Kern, Stanislaus, Marin, Placer, Fresno, Alameda and Sonoma, California, and as such has and, at the Closing, will have the full legal right, power and authority to execute, deliver and perform its obligations under the Series 2006A Bonds, and the Legal Documents to which the Agency is a party, and engage in the transactions contemplated by the Agency in the Indenture and in the Final Offering Circular; when delivered to and paid for by the Underwriters at the Closing in accordance with the provisions of this Contract of Purchase, the Series 2006A Bonds will have been duly authorized, executed, issued and delivered pursuant to and for the purposes set forth in the Act and will constitute valid and binding obligations of the Agency, in conformity with, and entitled to the benefit and security of, the Act and the Indenture; this Contract of Purchase and

the Legal Documents to which the Agency is a party, have been duly executed and delivered and are legal, valid and binding obligations of the Agency enforceable in accordance with their terms, subject to the effect of bankruptcy, insolvency, reorganization, moratorium, fraudulent conveyance and other similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public agencies in the State of California.

(b) No Conflict. The execution and delivery by the Agency of the Legal Documents to which the Agency is a party and the Series 2006A Bonds, and compliance by the Agency with the provisions thereof, will not in any material respect conflict with, or constitute a breach of or default under any material agreement or other instrument to which the Agency is a party, the Agency's duties under the Legal Documents to which the Agency is a party, or any law, administrative regulation, court decree, resolution, by-laws or other agreement to which the Agency is subject or by which it or any of its property is bound.

(c) No Consents Required. After due inquiry, except as may be required under blue sky or other securities laws of any state, or with respect to any permits or approval heretofore received which are in full force and effect or the requirement for which is otherwise disclosed in the Final Offering Circular, there is no consent, approval, authorization or other order of, or filing or registration with, or certification by, any governmental authority, board, authority or commission or other regulatory authority having jurisdiction over the Agency, required for the valid execution, delivery or performance by the Agency of the Legal Documents to which the Agency is a party or the consummation by the Agency of the other transactions contemplated by the Final Offering Circular or the Legal Documents to which the Agency is a party. "Governmental Authority" shall mean any legislative or regulatory body or regulatory or governmental official, department, commission, board, bureau, agency, instrumentality, body or public benefit corporation.

(d) No Litigation. There is no action, suit, proceeding or investigation at law or in equity before or by any court or Governmental Authority or body pending against the Agency or to the knowledge of the Agency, threatened against the Agency to restrain or enjoin the delivery of the Series 2006A Bonds or in any way questioning or affecting (A) the proceedings under which the Series 2006A Bonds are to be issued, (B) the validity of any provision of the Series 2006A Bonds, the Legal Documents to which the Agency is a party or this Contract of Purchase, the pledge or assignment by the Agency effected under the Indenture, (C) the legal existence of the Agency or the title of its officers to their respective offices, or, except as otherwise disclosed in the Final Offering Circular, which would have a material adverse effect on the enforceability of the Master Settlement Agreement (the "MSA"), the Memorandum of Understanding (the "MOU"), the Agreement Regarding Interpretation of Memorandum of Understanding (the "ARIMOU") or the payment of Annual Payments and Strategic Contribution Payments (the "TSRs") thereunder and delivery thereof to the Agency for pledge under the Indenture, or in any way contesting or affecting the validity of the Legal Documents to which the Agency is a party, or the Series 2006A Bonds, or contesting the powers of the Agency to enter into or perform its obligations under any of the foregoing or in which a final adverse decision would declare any provision of the Legal Documents or the Series 2006A Bonds to be invalid or unenforceable in whole or in material part.

(e) Offering Circular Correct and Complete. The information (excluding the statements and information under the captions "APPENDIX F – Book-Entry Only System," "CIGARETTE CONSUMPTION REPORT," ["THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS,"] and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and any information provided in writing by the Underwriters for inclusion in the Final Offering Circular) contained in the Final Offering Circular was as of the date thereof, and will be as of the Closing, true and correct in all material respects and such information did not as of the date thereof and will not as of the Closing, contain any untrue or misleading statement of a material fact or omit to state any material fact necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading.

(f) Blue Sky Cooperation. The Agency agrees to cooperate with the Underwriters in endeavoring to qualify the Series 2006A Bonds for offering and sale under the securities or blue sky laws of such jurisdictions of the United States as the Underwriters may request; *provided, however*, that the Agency shall not be required to execute a special or general consent to service of process in any jurisdiction in which it is not now so subject or to qualify to do business in any jurisdiction where it is not now so qualified.

(g) Due Approval of Offering Circular Distribution. By official action of the Agency prior to or concurrently with the execution hereof, the Agency has duly approved the distribution of the Preliminary Offering Circular and the Final Offering Circular and has duly authorized and approved the execution and delivery of, and the performance by the Agency of the obligations on its part contained in, the Legal Documents to which the Agency is a party and the consummation by it of all other transactions contemplated by the Final Offering Circular and the Legal Documents to which the Agency is a party.

(h) No Breach or Default. Except as described in the Final Offering Circular, the Agency is not in breach of or in default under any applicable law or administrative regulation of the State of California or the United States or any applicable judgment or decree or any loan agreement, indenture, bond, note, resolution, agreement or other instrument to which the Agency is a party or is otherwise subject which breach or default would have a material and adverse impact on the Agency's ability to perform its obligations under the Legal Documents to which the Agency is a party, and no event has occurred and is continuing which, with the passage of time or the giving of notice, or both, would constitute a default or an event of default under any such instrument.

(i) Agreement to Notify Underwriters Regarding Offering Circular. At any time from the date hereof to and including twenty-five (25) days after the Closing, the Agency will advise the Underwriters promptly of any proposal to amend or supplement the Final Offering Circular and will not effect any such amendment or supplement without the consent of the Underwriters. At any time from the date hereof to and including twenty-five (25) days after the Closing, the Agency will advise the Underwriters promptly of the institution of any proceedings known to it seeking to prohibit or otherwise affect the use of the Final Offering Circular in connection with the offering, sale or distribution of the Series 2006A Bonds.

(j) Agreement to Amend Offering Circular. If at any time from the date hereof to and including twenty-five (25) days after the Closing in the reasonable opinion of the Underwriters, the Final Offering Circular as then amended or supplemented includes an untrue statement of a material fact, or omits to state any material fact necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading, the Agency will cooperate with the Underwriters in the preparation of an amendment or supplement to the Final Offering Circular; provided that all expenses thereby incurred (including printing expenses) will be paid for by the Agency.

(k) Amendments to Offering Circular Correct and Complete. Any information supplied by the Agency for inclusion in any amendment or supplement to the Final Offering Circular will not contain any untrue or misleading statement of a material fact relating to the Agency or omit to state any material fact relating to the Agency necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading, except that no representation and warranty is made concerning statements and information under the captions "APPENDIX F – Book-Entry Only System," "CIGARETTE CONSUMPTION REPORT," ["THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS,"] and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and any information provided by the Underwriters for inclusion in the Final Offering Circular.

(l) No Default. The Agency represents that it is not, and has not been at any time, in material default as to principal or interest with respect to any material obligation issued or guaranteed by it.

(m) Agreement to Preserve Tax Exemption. The Agency covenants that it will not take any action which would cause interest on the Series 2006A Bonds to be subject to federal income taxation or California personal income taxes (other than to the extent interest on the Series 2006A Bonds will be subject to federal income taxation as described under the caption "TAX MATTERS" in the Final Offering Circular) and that it will take such action as may be necessary to preserve the tax-exempt status of the Series 2006A Bonds.

(n) Use of Proceeds of Series 2006A Bonds. The proceeds of the sale of the Series 2006A Bonds shall be applied as provided in the Indenture and as described in the Final Offering Circular under the caption "USE OF PROCEEDS."

(o) Lien on Collateral. As of the date hereof, there are no liens or encumbrances on the items to be pledged pursuant to the Indenture, and the Agency has not entered into any contract or arrangement of any kind which might give rise to any such lien or encumbrance. As of the Closing, the Indenture will create in favor of the Indenture Trustee a perfected first lien and security interest in, all of the Issuer's right, title and interest, whether now owned or hereafter acquired, in, to and under the Collateral (as defined in the Indenture), subject in all cases to the provisions of the Indenture permitting the application thereof for the purposes and on the terms and conditions set forth therein.

(p) Certificates delivered by Agency. Any certificate signed by any official or other representative of the Agency delivered to the Underwriters pursuant to this Contract of Purchase shall be deemed a representation and warranty by the Agency to each of the Underwriters as to the truth of the statements therein made.

(q) Continuing Disclosure. As of the date hereof, the Agency has never failed to comply with the requirements of any continuing disclosure undertaking entered into pursuant to Rule 15c2-12 to provide annual financial information and notices of certain material events.

6. Conditions to the Obligations of the Underwriters. The Underwriters' obligations under this Contract of Purchase are and shall be subject to the receipt of the Corporation Letter of Representations and the County Certificate. The Underwriters have entered into this Contract of Purchase in reliance upon the representations, warranties and agreements of the Agency contained herein, the representations, warranties and agreement of the Corporation contained in the Corporation Letter of Representations, the certifications of the County contained in the County Certificate, the representations, warranties and agreements to be contained in the documents and instruments to be delivered at the Closing, the performance by the Agency of its obligations hereunder, and the opinions of Bond Counsel, counsel to the Indenture Trustee, counsel to the Agency, counsel to the Corporation, County Counsel, Disclosure Counsel and counsel to the Underwriters described hereafter. Accordingly, the Underwriters' obligations under this Contract of Purchase to purchase, to accept delivery of and to pay for the Series 2006A Bonds shall be conditioned upon and subject to (i) the performance by the Agency, and

the Indenture Trustee of their obligations to be performed hereunder and under such documents and instruments as shall reasonably be requested by the Underwriters or its counsel at or prior to the Closing, (ii) the accuracy in all material respects, in the reasonable judgment of the Underwriters, of the representations and warranties of the Agency herein and as of the time of the Closing, and (iii) shall also be subject to the following additional conditions:

(a) Bring-down of Representations. The representations, warranties and agreements of the Agency contained herein, of the Corporation contained in the Corporation Letter of Representations and of the County contained in the County Certificate shall be true, complete and correct on the date hereof and on and as of the Closing, and the statements made in all certificates and other documents delivered to the Underwriters at the Closing pursuant hereto shall be accurate in all material respects at the Closing; and the Agency shall be in compliance with each of the agreements made by it in this Contract of Purchase (unless such agreements are waived by the Underwriters).

(b) Authorization, Execution and Delivery of Documents. At the Closing, the Legal Documents, the Series 2006A Bonds and the Final Offering Circular shall have been duly authorized, executed and delivered by the respective parties thereto in substantially the forms heretofore submitted to the Underwriters, with only such changes as shall have been agreed to in writing by the Underwriters, and said agreements and resolutions shall not have been amended, modified or supplemented, except as may have been agreed to in writing by the Underwriters, and each shall be in full force and effect; and the Agency, the Corporation and the County shall perform or shall have performed all of their respective obligations, if any, required under or specified in the Legal Documents to be performed at or prior to the Closing.

(c) No Litigation. Except as disclosed in the Final Offering Circular or in a schedule delivered to the Underwriters at the Closing, no decision, ruling or finding shall have been entered by any court or Governmental Authority since the date of this Contract of Purchase (and not reversed on appeal or otherwise set aside) which has any of the effects described in Section 5(d) hereof or in paragraph (d) of either the Corporation Letter of Representations or the County Certificate.

(d) No Amendment of Final Offering Circular. At the Closing, the Final Offering Circular shall not have been amended, modified or supplemented, except as may have been agreed to in writing by the Underwriters.

(e) Marketability Adversely Affected. In the judgment of the Underwriters, between the date hereof and the Closing, the marketability of the Series 2006A Bonds at the initial offering prices set forth in the Final Offering Circular shall not have been materially adversely affected by reason of any of the following:

(1) Federal Legislation, Judicial Decisions or Rulings. (i) Legislation shall have been enacted by the House of Representatives or the Senate of the Congress of the United States, or be recommended to the Congress for passage (by press release, report, other form of notice or otherwise) by the President of the

United States, the Treasury Department of the United States, the Internal Revenue Service, or by the Chairman or ranking minority member of the United States Senate Committee on Finance, or the United States House of Representatives Committee on Ways and Means, or the Conference Committee of both Houses of Congress, or legislation shall have been proposed for consideration by any such Committee or its Chairman or ranking minority member, or legislation shall have been favorably reported for passage to either House of the Congress by any Committee of such House subsequent to the date hereof; or (ii) a decision shall have been rendered by the United States Tax Court or by a court established under Article III of the Constitution of the United States; or (iii) an order, ruling or regulation shall have been issued or proposed by or on behalf of the Treasury Department of the United States, or the Internal Revenue Service, or any other agency of the United States; or (iv) a release or official statement shall have been issued by the President of the United States, or by the Treasury Department of the United States, or by the Internal Revenue Service, the effect of which in any case described in clauses (i), (ii), (iii) or (iv) would be to impose, directly or indirectly, federal income taxation upon or otherwise affect, directly or indirectly, the tax consequences of the interest received on obligations of the general character of the Series 2006A Bonds, or on the Series 2006A Bonds, or upon income or loan payments received by entities of the general character of the Agency;

(2) State Legislation, Judicial Decisions or Rulings. (i) Legislation shall have been enacted by the either house of the State of California Legislature, or be recommended to the Legislature of the State of California for passage (by press release, report, other form of notice or otherwise) by the Governor of the State of California or the State of California Franchise Tax Board, or legislation shall have been proposed for consideration by any committee in the Legislature of the State of California, or legislation shall have been favorably reported for passage to either house or committee of such house subsequent to the date hereof; or (ii) a decision shall have been rendered by the State of California Supreme Court; or (iii) an order, ruling or regulation shall have been issued or proposed by or on behalf of the Franchise Tax Board of the State of California; or (iv) a release or official statement shall have been issued by the Governor of the State of California or the Franchise Tax Board of the State of California, the effect of which in any case described in clauses (i), (ii), (iii) or (iv) would be to impose, directly or indirectly, state income taxation upon or otherwise affect, directly or indirectly, the tax consequences of the interest received on obligations of the general character of the Series 2006A Bonds, or on the Series 2006A Bonds, or upon income or loan payments received by entities of the general character of the Agency;

(3) War. A war or conflict involving the United States shall have been declared, commenced or escalated, or any other national emergency relating to the effective operation of government shall have occurred;

(4) Banking Moratorium. A general banking moratorium shall have

been declared by authorities of the United States or the State of California or the general suspension of trading on any national securities exchange;

(5) Securities Exchange Restrictions. The imposition by the New York Stock Exchange or other national securities exchange, or any governmental authority, of any material restrictions not now in force with respect to the Series 2006A Bonds or obligations of the general character of the Series 2006A Bonds, or the material increase of any such restrictions now in force, including those relating to the extension of credit by, or the charge to the net capital requirements of, Underwriters;

(6) Regarding Federal Securities Laws. Any action shall have been taken by the Securities and Exchange Commission or by a court, or legislation shall have been enacted by the House of Representatives or the Senate of the Congress of the United States or recommended to the Congress for passage by the President of the United States or favorably reported, subsequent to the date hereof, for passage to either House of the Congress by any Committee of such House, which would require registration of any security under the Securities Act or the Exchange Act, or qualification of any indenture under the Trust Indenture Act, in connection with the public offering of the Series 2006A Bonds, or any action shall have been taken by any court or by any governmental authority suspending the use of the Preliminary Offering Circular or the Final Offering Circular or any amendment or supplement thereto, or any proceeding for that purpose shall have been initiated or threatened in any court or by any such authority;

(7) Final Offering Circular Untrue or Incomplete. Any event occurring, or information becoming known which, in the reasonable judgment of the Underwriters, makes untrue any material statement or information contained in the Final Offering Circular, or has the effect that the Final Offering Circular contains any untrue statement of a material fact or omits to state a material fact required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading;

(8) Certain Amendments to the Final Offering Circular. An event occurs prior to the Closing which, in the reasonable judgment of the Underwriters, requires or has required a supplement or amendment to the Final Offering Circular; or

(9) Action by Rating Agencies. Any rating of the Series 2006A Bonds shall fail to be the same as the rating for such Series 2006A Bonds as set forth in the Final Offering Circular.

(f) At or prior to the Closing, unless otherwise agreed to by the Underwriters, the Underwriters shall have received the following documents, in each case satisfactory in form and substance to it and its counsel:

(1) Agency Resolution. A certified copy of a resolution of the Agency duly authorizing and approving the issuance, offering and sale of the Series 2006A Bonds, the distribution of the Preliminary Offering Circular and the Final Offering Circular in connection therewith, the execution and delivery of this Contract of Purchase and all other Legal Documents to which the Agency is a party and all related actions, and such resolution shall be in full force and effect as of the Closing;

(2) Approving Opinion of Bond Counsel. The approving opinion, dated the date of the Closing, of Sidley Austin Brown & Wood LLP, Bond Counsel, in substantially the form included as Appendix D to the Final Offering Circular, together with a letter, dated the date of the Closing, addressed to the Representative to the effect that said opinion may be relied upon by such addressee to the same extent as if such opinion was addressed to such addressee;

(3) Opinions of Bond Counsel. The opinions of Bond Counsel, dated the Closing, in form and substance satisfactory to the Representative, addressed to the Rating Agencies, as to the enforceability of the MSA, true sale under the Sale Agreement and non-consolidation of the Corporation and non-consolidation of the Agency and as to the status of the MSA as an executory contract under the United States Bankruptcy Code, together with a letter, dated the date of the Closing, addressed to the Representative to the effect that such opinions may be relied upon by such addressee to the same extent as if such opinion were addressed to such addressee;

(4) Supplementary Opinion of Bond Counsel. A supplementary opinion of Bond Counsel, in form and substance satisfactory to the Underwriters, addressed to the Agency and the Representative, dated the date of the Closing, to the effect that:

(i) Specified Sections of the Final Offering Circular Correct and Complete - the statements contained in the Final Offering Circular under the captions "THE SERIES 2006A BONDS", "SECURITY FOR THE SERIES 2006A BONDS, "TAX MATTERS" and "CONTINUING DISCLOSURE UNDERTAKING," and in Appendices D and E in the Final Offering Circular, insofar as such statements expressly summarize certain portions of the Indenture, Sale Agreement and the final bond opinion concerning certain federal and state tax matters relating to the Series 2006A Bonds, are accurate in all material respects; and

(ii) Securities Registration Exemption - the Series 2006A Bonds are not subject to the registration requirements of the Securities Act of 1933, as amended, and the Indenture is exempt from qualification under the Trust Indenture Act of 1939, as amended.

(5) Opinion of Counsel to the Agency. An opinion of general counsel to the Agency, dated the Closing, in form and substance satisfactory to the Underwriters, addressed to the Agency, the Indenture Trustee and the Underwriters to the effect that:

(i) Due Organization and Existence - the Agency is duly created and established as a joint exercise of powers authority pursuant to the Act and the Constitution of the State of California;

(ii) Due Adoption - the Agency Resolution authorizing and approving the execution and delivery of this Contract of Purchase and the Legal Documents to which the Agency is a party and approving the Final Offering Circular, the Contract of Purchase and the Series 2006A Bonds was duly adopted at a meeting of the governing body of the Agency, which was called and held pursuant to law and with all public notice required by law and at which a quorum was present and acting throughout, and such resolution is in full force and effect as of the Closing;

(iii) No Litigation – except as disclosed in the Final Offering Circular, to the best of such counsel's knowledge and belief, there is no action, suit, proceeding or investigation at law or in equity before or by any court, public board or body against or affecting the Agency, pending or threatened, wherein an unfavorable decision, ruling or finding would have a materially adverse effect upon the transactions contemplated by the Final Offering Circular, the Series 2006A Bonds, the Legal Documents to which the Agency is a party or this Contract of Purchase;

(iv) No Conflict - the execution and delivery of the Legal Documents to which the Agency is a party, the adoption of the Agency Resolution and compliance with the provisions of all of them, do not and will not conflict with or constitute a breach of or default under any material agreement or other instrument known to such counsel to which the Agency is a party, or to the best of such counsel's knowledge, after reasonable inquiry, any court order, consent decree, statute, rule, regulation or any other law to which the Agency presently is subject;

(v) Due Authorization, Execution and Delivery; Legal, Valid and Binding Agreements - the Legal Documents to which the Agency is a party have been duly authorized, executed and delivered by the Agency, and, assuming due authorization, execution and delivery by the other parties thereto constitute legal, valid and binding agreements of the

Agency enforceable in accordance with their respective terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public agencies in the State of California; and

(vi) No Consents Required – Final Offering Circular, Legal Documents - no authorization, approval, consent, or other order of the State of California or any other Governmental Authority or authority within the State of California other than has been obtained is required for the valid authorization, execution and delivery of the Legal Documents to which the Agency is a party and the approval of the Final Offering Circular.

(6) Opinion of Counsel to the Corporation. An opinion of counsel to the Corporation, dated the Closing, in form and substance satisfactory to the Underwriters, addressed to the Corporation, the Indenture Trustee and the Underwriters, to the effect that:

(i) Due Organization and Existence - the Corporation is a nonprofit public benefit corporation duly organized, validly existing and in good standing under the laws of the State of California;

(ii) Due Adoption - the Corporation Resolution authorizing and approving the execution and delivery of the Corporation Letter of Representations, the Sale Agreement and the Legal Documents to which the Corporation is a party was duly adopted at a meeting of the governing body of the Corporation, which was called and held pursuant to law and with all public notice required by law and at which a quorum was present and acting throughout, and such resolution is in full force and effect as of the Closing;

(iii) No Litigation – except as disclosed in the Final Offering Circular, to the best of such counsel's knowledge and belief, there is no action, suit, proceeding or investigation at law or in equity before or by any court, public board or body against or affecting the Corporation, pending or threatened, wherein an unfavorable decision, ruling or finding would have a materially adverse effect upon the transactions contemplated by the Final Offering Circular, the Series 2006A Bonds, the Legal Documents to which the Corporation is a party or this Contract of Purchase;

(iv) No Conflict - the execution and delivery of the Corporation Letter of Representations, the Sale Agreement and the Legal Documents to which the Corporation is a party, the adoption of the Corporation

Resolution and compliance with the provisions of all of them, do not and will not conflict with or constitute a breach of or default under any material agreement or other instrument known to such counsel to which the Corporation is a party, or to the best of such counsel's knowledge, after reasonable inquiry, any court order, consent decree, statute, rule, regulation or any other law to which the Corporation presently is subject;

(v) Due Authorization, Execution and Delivery; Legal, Valid and Binding Agreements - the Sale Agreement and the Legal Documents to which the Corporation is a party have been duly authorized, executed and delivered by the Corporation, and, assuming due authorization, execution and delivery by the other parties thereto constitute legal, valid and binding agreements of the Corporation enforceable in accordance with their respective terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public entities in the State of California; and

(vi) No Consents Required –Legal Documents - no authorization, approval, consent, or other order of the State of California or any other Governmental Authority or authority within the State of California other than has been obtained is required for the valid authorization, execution and delivery of the Sale Agreement and the Legal Documents to which the Corporation is a party.

(7) Opinion of County Counsel. An opinion of County Counsel, dated the Closing, in form and substance satisfactory to the Underwriters, addressed to the County, the Agency, the Corporation, the Indenture Trustee and the Underwriters, to the effect that:

(i) Due Organization and Existence - the County is a political subdivision of the State of California duly organized and validly existing under the Constitution and the laws of the State of California;

(ii) Due Adoption - the resolution of the County authorizing and approving the execution and delivery of the Sale Agreement (the "County Resolution") was duly adopted at a meeting of the governing body of the County, which was called and held pursuant to law and with all public notice required by law and at which a quorum was present and acting throughout, and such resolution is in full force and effect as of the Closing;

(iii) No Litigation – except as disclosed in the Final Offering Circular, to the best of such counsel's knowledge and belief, there is no

action, suit, proceeding or investigation at law or in equity before or by any court, public board or body against or affecting the County, pending or threatened, wherein an unfavorable decision, ruling or finding would have a materially adverse effect upon the transactions contemplated by the Sale Agreement or which would have a material adverse effect on the enforceability of the MSA or the payment of Sold County Tobacco Assets thereunder;

(iv) No Conflict - the execution and delivery of the Sale Agreement, the adoption of the County Resolution and compliance with the provisions of all of them, do not and will not conflict with or constitute a breach of or default under any material agreement or other instrument known to such counsel to which the County is a party, or to the best of such counsel's knowledge, after reasonable inquiry, any court order, consent decree, statute, rule, regulation or any other law to which the County presently is subject;

(v) Due Authorization, Execution and Delivery; Legal, Valid and Binding Agreements - the Sale Agreement has been duly authorized, executed and delivered by the County and the County has sold the Sold County Tobacco Assets to the Corporation in accordance with the state and local laws of California, and, assuming due authorization, execution and delivery by the other parties thereto constitute legal, valid and binding agreements of the County enforceable in accordance with their respective terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public agencies in the State of California; and

(vi) No Consents Required – Sale Agreement - no authorization, approval, consent, or other order of the State of California or any other Governmental Authority or authority within the State of California other than the County Board of Supervisors was required for the valid authorization, execution and delivery of the Sale Agreement by the County.

(8) Opinion of Indenture Trustee's Counsel. The opinion of counsel to the Indenture Trustee, dated the Closing, addressed to the Underwriters, to the effect that:

(i) Due Organization and Existence - the Indenture Trustee has been duly organized and is validly existing in good standing as a national banking association under the laws of the United States of America with full power and authority to undertake the trust of the Indenture;

(ii) Corporate Action - the Indenture Trustee has duly authorized, executed and delivered the Series 2006A Bonds and the Legal Documents to which the Indenture Trustee is a party, and by all proper corporate action has authorized the acceptance of the duties and obligations of the Indenture Trustee under the Indenture and has authorized in its capacity as Indenture Trustee the execution and delivery of the Series 2006A Bonds; and

(iii) Due Authorization, Execution and Delivery - assuming due authorization, execution and delivery by the other parties to the Legal Documents, the Legal Documents to which the Indenture Trustee is a party are the valid, legal and binding agreements of the Indenture Trustee, enforceable in accordance with their terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity.

(9) Opinion of Underwriters' Counsel. The opinion of Nixon Peabody LLP, counsel for the Underwriters, dated the Closing and addressed to the Underwriters, satisfactory in form and substance to the Underwriters.

(10) Opinion of Disclosure Counsel. The opinion of Hawkins Delafield & Wood LLP, Los Angeles, California, Disclosure Counsel to the County, dated the Closing and addressed to the Underwriters, satisfactory in form and substance to the Underwriters, in substantially the form attached as Exhibit C

(11) Final Offering Circular. Two (2) copies of the executed Final Offering Circular.

(12) Indenture Trustee Resolution. Two (2) certified copies of the general resolution of the Indenture Trustee authorizing the execution and delivery of certain documents by certain officers of the Indenture Trustee, which resolution authorizes the execution and delivery of the Series 2006A Bonds and the Indenture.

(13) Indenture Trustee's Representations, Warranties and Agreements. A certificate of the Indenture Trustee dated as of the date of the Closing to the effect that:

(i) Due Organization and Existence - the Indenture Trustee is duly organized and existing as national banking association in good standing under the laws of the United States of America having the full power and authority to enter into and perform its duties under the Legal Documents to which the Indenture Trustee is a party and to execute and deliver the Series 2006A Bonds to the Underwriters pursuant to the terms of the

Indenture;

(ii) Due Authorization; Valid and Binding Obligations - the Indenture Trustee is duly authorized to enter into the Legal Documents to which it is a party;

(iii) No Conflict - the execution and delivery by the Indenture Trustee of the Legal Documents to which the Indenture Trustee is a party, and compliance with the terms thereof will not, in any material respect, conflict with, or result in a violation or breach of, or constitute a default under, any loan agreement, indenture, bond, note, resolution or any other agreement or instrument to which the Indenture Trustee is a party or by which it is bound, or any law or any rule, regulation, order or decree of any court or Governmental Authority or body having jurisdiction over the Indenture Trustee or any of its activities or properties, or (except with respect to the lien of the Indenture) result in the creation or imposition of any lien, charge or other security interest or encumbrance of any nature whatsoever upon any of the property or assets of the Indenture Trustee;

(iv) Consents - exclusive of federal or state securities laws and regulations, other than routine filings required to be made with governmental agencies in order to preserve the Indenture Trustee's authority to perform a trust business (all of which routine filing, to the best of the Indenture Trustee's knowledge, have been made), no consent, approval, authorization or other action by any governmental or regulatory authority having jurisdiction over the Indenture Trustee is or will be required for the execution and delivery by the Indenture Trustee of the Legal Documents to which the Indenture Trustee is a party or the execution and delivery of the Series 2006A Bonds; and

(v) No Litigation - there is no litigation pending or threatened against or affecting the Indenture Trustee to restrain or enjoin the Indenture Trustee's participation in, or in any way contesting the powers of the Indenture Trustee with respect to the transactions contemplated by the Series 2006A Bonds and the Indenture.

(14) Agency Resolution(s). Copies of resolution(s) adopted by the Agency and certified by the Secretary of the governing body of the Agency authorizing the execution and delivery of the Legal Documents to which the Agency is a party.

(15) Corporation Resolution(s). Copies of resolution(s) adopted by the Board of Directors of the Corporation authorizing the execution and delivery of the Legal Documents to which the Corporation is a party.

(16) County Resolution. Copies of resolution adopted by the Board of

Supervisors of the County and certified by the Clerk of the Board of Supervisors authorizing the execution and delivery of the Sale Agreement.

(17) Agency Bring-Down and Permit Certificate. A certificate of an authorized officer of the Agency, dated the Closing, confirming as of such date the representations and warranties of the Agency contained in this Contract of Purchase.

(18) Corporation Bring-Down Certificate. A certificate of an authorized officer of the Corporation, dated the Closing, confirming as of such date the representations and warranties of the Corporation contained in its Letter of Representations.

(19) County Bring-Down Certificate. A certificate of an authorized representative of the County, dated the Closing, confirming as of such date the certifications of the County contained in the County Certificate.

(20) Tax Certificate of County. A Tax Certificate of the County in form and substance acceptable to Bond Counsel.

(21) Tax Certificate of Agency. A Tax Certificate of the Agency in form and substance acceptable to Bond Counsel.

(22) Tax Certificate of Corporation. A Tax Certificate of the Corporation in form and substance acceptable to Bond Counsel.

(23) Instructions to State of California Attorney General. A certified copy of the letter delivered to the State of California Attorney General providing instructions as to the disposition of the County's share of the TSRs in accordance with the Sale Agreement.

(24) Ratings. Evidence that the Series 2006A Bonds have been rated "_____" by [Moody's Investors Service, Inc.] and "___" by [Fitch, Inc.].

(25) Joint Exercise of Powers Agreement of the Agency. A certified copy of the Joint Exercise of Powers Agreement, as amended, of the Agency.

(26) Notice of Filing of Joint Exercise of Powers Agreement with the State. Certified copies of the notice of filing of the Joint Exercise of Powers Agreement with the State.

(27) Articles and Bylaws of the Corporation. Copies of each of the Articles of Incorporation and Bylaws of the Corporation.

(28) Letter of Determination of Non-Profit Status of the Corporation. A certified copy of the letter of determination from the State of California that the Corporation is an organization described in Section 501(c)(3) of the Internal

Revenue Code of 1986 (the "Code") or corresponding provisions of prior law and is exempt from taxation under California law and is not a private foundation within the meaning of Section 509(a) of the Code;

(29) Good Standing Certificate of the Corporation. Good Standing Certificate of the Secretary of State of the State of California, with respect to the Corporation.

(30) DTC Letter. A copy of the Letter of Representations to DTC, in form and substance satisfactory to the Underwriters.

(31) Accounting Letter. A letter from [_____] to the Representative and the Agency, dated the Closing, concerning certain information of an accounting, financial or statistical nature set forth in the Final Offering Circular and any supplement thereto.

(32) Global Insight Inc. Certificate. A certificate or letter, dated the Closing, of Global Insight Inc. to the effect that Global Insight Inc. consents to the inclusion of the Global Insight Inc. reports in the Preliminary Offering Circular and the Final Offering Circular and to the references to Global Insight Inc. under the headings "Summary Statement—Cigarette Consumption", "–Cigarette Consumption Report" and "–Population Information" and "CIGARETTE CONSUMPTION REPORT" and ["THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS"] and that the information in the Preliminary Offering Circular and Final Offering Circular under each such heading is accurate.

(33) Legal Documents. Fully executed counterparts or certified copies of the Legal Documents, which may be included in a complete record of proceedings of the Bonds.

(34) Miscellaneous. Such additional legal opinions, certificates, proceedings, instruments and other documents as Bond Counsel and counsel for the Underwriters may reasonably request to evidence compliance with legal requirements, the truth and accuracy, as of the time of Closing, of the representations and warranties contained herein, in the Final Offering Circular and in the Letter of Representations and the due performance or satisfaction by the Indenture Trustee, the Corporation, the Agency and the County at or prior to such time of all agreements, if any, then to be performed and all conditions then to be satisfied.

(g) All matters relating to this Contract of Purchase, the Series 2006A Bonds and the sale thereof, the Final Offering Circular, the Legal Documents and the consummation of the transactions contemplated by this Contract of Purchase shall have been approved by the Underwriters and counsel for the Underwriters, such approval not to be unreasonably withheld.

If the conditions to the Underwriters' obligations contained in this Contract of Purchase are not satisfied or if the Underwriters' obligations shall be terminated for any reason permitted by this Contract of Purchase, this Contract of Purchase shall terminate and neither the Underwriters nor the Agency shall have any further obligations hereunder except that the respective obligations of the Agency and the Underwriters set forth in Paragraph 7 hereof (relating to expenses) shall continue in full force and effect.

7. Expenses. (a) If the sale of the Series 2006A Bonds provided for herein is not consummated because of any refusal, inability or failure on the part of the Agency or the Corporation to perform any agreement herein or comply with any provision hereof other than by reason of a default by any of the Underwriters, the Agency agrees to reimburse the Underwriters, through the Representatives, on demand, for all out-of-pocket expenses (including reasonable fees and disbursements of Underwriters' Counsel) that shall have been incurred by them in connection with the proposed purchase and sale of the Series 2006A Bonds.

(b) Upon issuance of the Series 2006A Bonds, the Agency agrees that all costs and expenses incurred in connection with the transactions contemplated by this Contract of Purchase, the Indenture, the Loan Agreement and the Sale Agreement shall be paid by the Agency from the net proceeds of the sale of the Bonds, including (i) the printing and delivery to the Underwriters of the Preliminary Offering Circular and any supplements thereto; (ii) the preparation, issuance and delivery of the Series 2006A Bonds to the Underwriters; (iv) the printing and delivery to the Underwriters of copies of the Final Offering Circular and any supplements thereto; (vi) any fees and expenses charged by rating agencies for the rating of the Series 2006A Bonds; (viii) financial advisory fees; (ix) the fees of Global Insight Inc.; (xi) the fees of Accountants and the Indenture Trustee; (xii) the fees and expenses of the Agency; (xiii) the expenses of the Corporation; and (xiv) the fees and expenses of Bond Counsel and Hawkins Delafield & Wood LLP, Disclosure Counsel. Such costs and expenses shall be paid by the Agency on the Closing if request for payment has been received on or prior to the Closing.

(c) The Underwriters shall pay from the Underwriters' discount received referenced in Section 1: (a) all advertising expenses in connection with the public offering of the Series 2006A Bonds; (b) the fees and expenses of counsel to the Underwriters, including their fees in connection with the qualification of the Series 2006A Bonds for sale under the Blue Sky or other securities laws and regulations of various jurisdictions; (c) California Debt and Investment Advisory Commission fees; (d) Representative's out-of-pocket expenses incurred in connection with the financing including: air travel and hotel in connection with the pricing of the Series 2006A Bonds, investor meetings, rating agency trip, bond closing, meals and transportation for County, Representative and other working group personnel during the rating agency investor meeting, pricing and bond closing trips, expenses related to attending working group meetings such as parking, meals and transportation and any other miscellaneous closing costs; and (e) all other expenses incurred by it in connection with its public offering and distribution of the Series 2006A Bonds.

8. Indemnification by the Agency.

(a) To the extent permitted by law, the Agency agrees to indemnify and hold harmless the Underwriters, the directors, officers, employees and agents of each Underwriter and each person who controls any Underwriter within the meaning of either the Securities Act or the Exchange Act (collectively, the "Indemnified Persons," and individually, an "Indemnified Person") from and against any losses, claims, damages or liabilities, joint or several, to which any Indemnified Person may become subject under the Securities Act, the Exchange Act or other federal or state statutory law or regulation, at common law or otherwise, insofar as such losses, claims, damages or liabilities (or actions in respect thereof) arise out of, or are based upon, any untrue statement or alleged untrue statement of a material fact contained in the Preliminary Offering Circular or the Final Offering Circular (excluding the statements and information under the captions "APPENDIX F – Book-Entry Only System," "CIGARETTE CONSUMPTION REPORT," ["THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS,"] and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and any information provided by the Underwriters for inclusion in the Final Offering Circular), or in any amendment thereof or supplement thereto, or in any other document with respect to the offering of the Series 2006A Bonds that has been publicly disseminated by the Agency in printed or electronic form, or arise out of, or are based upon, the omission or alleged omission to state therein a material fact necessary to make the statements therein not misleading, and will reimburse each Indemnified Person, as incurred, for any legal or other expenses reasonably incurred by such Indemnified Person in investigating, defending or preparing to defend any such loss, claim, damage, liability or action; provided, however, that the Agency shall not be liable in any such case to the extent that any such loss, claim, damage or liability arises out of, or is based upon, any untrue statement or alleged untrue statement or omission or alleged omission made in the Final Offering Circular, in reliance upon and in conformity with written information furnished to the Agency by or on behalf of any Indemnified Person specifically for inclusion therein; and provided further, however, that the indemnity with respect to the Final Offering Circular shall not inure to the benefit of the Underwriters on account of any loss, expense, liability or claim arising from the sale of the Series 2006A Bonds by the Underwriters to any person if a copy of the Final Offering Circular (as amended or supplemented, or as proposed by the Agency to be amended or supplemented, if the Agency shall have furnished, or in the case of such proposed amendment or supplement, if the Agency shall have furnished, to the Underwriters at least one full business day prior to confirmation of such sale by the Underwriters an amended Final Offering Circular or amendments or supplements to the Final Offering Circular relating to the untrue statement or alleged untrue statement or omission or alleged omission for which indemnity is sought, as the case may be) shall not have been sent or given to such person at or prior to the confirmation of the sale of such Series 2006A Bonds to such person. This indemnity agreement will be in addition to any liability which the Agency may otherwise have.

(b) Promptly after receipt by an Indemnified Person under paragraph (a) of this Section of notice of the commencement of any action, such Indemnified Person shall, if a claim in respect thereof is to be made against the Agency under such paragraph, notify the Agency in writing of the commencement thereof, but the failure so to notify the Agency (i) will not relieve it from liability under paragraph (a) above unless and to the extent it did not otherwise learn of such action and such failure results in the forfeiture by the Agency of substantial rights and

defenses and (ii) will not, in any event, relieve the Agency from any obligations to any Indemnified Person other than the indemnification obligation provided in paragraph (a) above. In case any such action shall be brought against any Indemnified Person, and such Indemnified Person shall notify the Agency of the commencement thereof, the Agency shall be entitled to participate in and, to the extent that it wishes, to assume the defense of, with counsel satisfactory to such Indemnified Person, and after notice from the Agency to such Indemnified Person of its election so to assume the defense thereof, the Agency shall not be liable to such Indemnified Person under paragraph (a) of this Section for any legal or other expenses subsequently incurred by such Indemnified Person in connection with the defense thereof other than reasonable costs of any investigation; provided, however, that the Agency shall not, in connection with any one such action or separate but substantially similar or related actions arising out of the same general allegations or circumstances, be liable for the fees and expenses of more than one separate firm of attorneys at any point in time for the Indemnified Persons. Notwithstanding the Agency's election to appoint counsel to represent the Indemnified Person in an action, the Indemnified Person shall have the right to employ separate counsel (including local counsel), and the Agency shall bear the reasonable fees, costs and expenses of such separate counsel if (i) the use of counsel chosen by the Agency to represent the Indemnified Person would present such counsel with a conflict of interest, (ii) the actual or potential defendants in, or targets of, any such action include both the Agency and the Indemnified Person and the Indemnified Person shall have reasonably concluded that there may be legal defenses available to it and/or other Indemnified Persons which are different from or additional to those available to the Agency, (iii) the Agency shall not have employed counsel satisfactory to the Indemnified Person to represent the Indemnified Person within a reasonable time after notice of the institution of such action, or (iv) the Agency shall authorize the Indemnified Person to employ separate counsel at the expense of the Agency.

The Agency will not, without the prior written consent of the Indemnified Persons, settle or compromise or consent to the entry of any judgment with respect to any pending or threatened claim, action, suit or proceeding in respect of which indemnification or contribution may be sought hereunder (whether or not the Indemnified Persons are actual or potential parties to such claim or action) unless such settlement, compromise or consent includes an unconditional release of each Indemnified Person from all liability arising out of such claim, action, suit or proceeding.

(c) In the event that the indemnity provided in paragraph (a) of this Section 8 is unavailable to or insufficient to hold harmless an Indemnified Person for any reason, the Agency and the Underwriters severally agree to contribute to the aggregate losses, claims, damages and liabilities (including legal or other expenses reasonably incurred in connection with investigating or defending same) (collectively "Losses") to which the Agency and one or more of the Underwriters may be subject in such proportion as is appropriate to reflect the relative benefits received the Agency on the one hand and by the Underwriters on the other from the offering of the Series 2006A Bonds; provided, however, that in no case shall the Underwriters be responsible for any amount in excess of the underwriting discount applicable to the Series 2006A Bonds. If the allocation provided by the immediately preceding sentence is unavailable for any reason, the Agency and the Underwriters severally shall contribute in such proportion as is appropriate to reflect not only such relative benefits but also relative fault of the Agency on the

one hand and of the Underwriters on the other in connection with the statements or omissions which resulted in such Losses as well as any other relevant equitable considerations; provided, however, that in no case shall the Underwriters be responsible for any amount in excess of the underwriting discount applicable to the Series 2006A Bonds. Benefits received by the Agency shall be deemed to be equal to the total net proceeds from the offering (before deducting expenses) received by the Agency, and benefits received by the Underwriters shall be deemed to be equal to the total underwriting discount. Relative fault shall be determined by reference to, among other things, whether any untrue or any alleged untrue statement of a material fact or the omission or alleged omission to state a material fact relates to information provided by the Agency on the one hand or the Underwriters on the other, the intent of the parties and their relative knowledge, access to information and opportunity to correct or prevent such untrue statement or omission. The Agency and the Underwriters agree that it would not be just and equitable if contribution were determined by *pro rata* allocation or any other method of allocation which does not take account of the equitable considerations referred to above. Notwithstanding the provisions of this paragraph (c), no person guilty of fraudulent misrepresentation (within the meaning of Section 11(f) of the Securities Act) shall be entitled to contribution from any person who was not guilty of such fraudulent misrepresentation. For purposes of this Section 10, each person who controls an Underwriter within the meaning of either the Securities Act or the Exchange Act and each director, officer, employee and agent of an Underwriter shall have the same rights to contribution as such Underwriter, and each person who controls the Agency within the meaning of either the Securities Act or the Exchange Act and each director of the Agency shall have the same rights to contribution as the Agency, subject in each case to the applicable terms and conditions of this paragraph (c).

(d) The Underwriters agree to indemnify and hold harmless the Agency and its officers and employees to the same extent as the indemnity from the Agency to the Indemnified Persons described in paragraph (a) of this Section but only with respect to information furnished in writing by the Underwriters or on their behalf, which consists of the information furnished for the inside and outside of the cover of the Final Offering Circular and under the caption "Underwriting" as set forth in the Final Offering Circular. In case any action shall be brought against the Agency in respect of which indemnity may be sought against the Underwriters, the Underwriters shall have the rights and duties given to the Agency and the Agency shall have the rights and duties given to the Underwriters by paragraph (b) of this Section and the term "Indemnified Person" shall include the Agency and its officers and employees.

9. Notices.

(a) Indenture Trustee. Any notice or other communication to be given to the Indenture Trustee under this Contract of Purchase may be given by delivering the same in writing to [The Bank of New York Trust Company, N.A., Attention: Corporate Trust Department.]

(b) Underwriters. Any such notice or other communication to be given to the Underwriters may be given by delivering the same to Citigroup Global Markets Inc. Attention: _____.

(c) Agency. Any notice or communication to be given the Agency under this Contract of Purchase may be given by delivering the same to the The California County Tobacco Securitization Agency, 1221 Oak Street, Suite 536, Oakland, CA 94612 Attention: President

(d) Corporation. Any notice or communication to be given the Corporation under this Contract of Purchase may be given by delivering the same to it at _____ Street, Los Angeles, California 9_____ Attention: _____.

All notices or communications hereunder by any party shall be given and served upon each other party.

10. Force and Effect. All representations, warranties and agreements of the Agency, the Corporation, the County or the Indenture Trustee pursuant to this Contract of Purchase or the Corporation's Letter of Representations or the County's Certificate as the case may be, shall remain operative and in full force and effect regardless of (i) any investigation made by or on behalf of the Underwriters; (ii) delivery of and payment for the Series 2006A Bonds pursuant to this Contract of Purchase; or (iii) termination of this Contract of Purchase but only to the extent provided by the last paragraph of Paragraph 8 hereof, regarding preconditions of Closing; provided, the Underwriters certify that as of the date hereof and with respect to the information contained in the Final Offering Circular, (a) the representatives of the Agency, the Corporation and the County have responded to the satisfaction of the Underwriters to all of the Underwriters' requests for information, (b) the Underwriters have received from representatives of the Agency, the Corporation and the County the information that the Underwriters have requested, and (c) there are no pending and unanswered requests by the Underwriters for information from the Agency, the Corporation and the County.

11. Counterparts. This Contract of Purchase may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

12. Governing Law. This Contract of Purchase shall be governed by the laws of the State of California.

13. Entire Agreement. This Contract of Purchase when accepted by you in writing as heretofore specified shall constitute the entire agreement between us and is made solely for the benefit of the Agency and the Underwriters (including the successors or assigns thereof). No

other person shall acquire or have any right hereunder or by virtue hereof, except as set forth herein.

14. Headings. The headings of the paragraphs of this Contract of Purchase are inserted for convenience only and shall not be deemed to be a part hereof.

15. Unenforceable Provisions. If any provision of this Contract of Purchase shall be held or deemed to be or shall, in fact, be invalid, inoperative or unenforceable as applied in any particular case in any jurisdiction or jurisdictions, or in all jurisdictions because it conflicts with any provisions of any constitution, statute, rule of public policy, or any other reason, such circumstances shall not have the effect of rendering the provision in question invalid, inoperable or unenforceable in any other case or circumstance, or of rendering any other provision or provisions of this Contract of Purchase invalid, inoperative or unenforceable to any extent whatsoever.

16. Effectiveness. This Contract of Purchase shall become effective upon the execution of the acceptance hereof by the Authorized Officer (as defined in the Agency Resolution) or his or her designee and shall be valid and enforceable at the time of such acceptance and acknowledgment.

Very truly yours,

CITIGROUP GLOBAL MARKETS INC.
as Representative of the Underwriters

By:_____
Authorized Representative

Accepted:

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY

By: _____
Authorized Representative

EXHIBIT A

LETTER OF REPRESENTATIONS OF THE

LOS ANGELES COUNTY SECURITIZATION CORPORATION

January ___, 2006

Citigroup Global Markets Inc..,
as Representative of the Underwriters

Ladies and Gentlemen:

The California County Tobacco Securitization Agency (the "Agency") proposes to cause the issuance and delivery of $_____ aggregate principal amount of the Agency's Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A Bonds. The "Series 2006A Bonds" consist of the "Series 2006A Convertible Bonds" and the "Series 2006A Capital Appreciation Bonds." The Series 2006A Bonds are dated, mature, bear or accrete interest and shall have such other terms as are set forth in the Indenture hereinafter referred to.

The Series 2006A Bonds will be issued and secured under and pursuant to an Indenture dated as of _____ 1, 2006, as supplemented in the case of each series by a Series Supplement, dated as of _____1, 2006 (as supplemented, the "Indenture"), by and between the Agency and _____as indenture trustee (the "Indenture Trustee"). The Series 2006A Bonds are being issued for the purpose of funding the loan from the Agency to the Corporation pursuant to a Secured Loan Agreement, dated as of _____ 1, 2006 (the "Loan Agreement"), by and between the Agency and the Corporation. The County of Los Angeles (the "County") sold its right, title and interest of the County to be paid certain payments (such payments as more fully defined in the Final Offering Circular, the "Sold County Tobacco Assets"), pursuant to a Sale Agreement, dated as of _____1, 2006, between the County and the Corporation (the " Sale Agreement").

The Series 2006A Bonds are to be sold by the Agency pursuant to the Contract of Purchase between the Agency and Citigroup Global Markets Inc., on behalf of itself and the other Underwriters (the "Underwriters") dated January ___, 2006 (the "Contract of Purchase").

The execution and delivery of the Indenture, the Loan Agreement, the Sale Agreement, the Contract of Purchase, and the Series 2006A Bonds have been authorized by resolutions of the Corporation (the "Corporation Resolution"), and the Series 2006A Bonds shall be as described in, and shall be secured under and pursuant to the Indenture. The Series 2006A Bonds shall be payable and shall be subject to redemption as provided in the Indenture.

The Loan Agreement, the Sale Agreement, and this Letter of Representations of the Corporation (the "Corporation Letter of Representations") are referred to collectively herein as the "Legal Documents." Capitalized terms not otherwise defined herein shall have the meanings as defined in the Indenture.

This Letter of Representations may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

In order to facilitate your entering into the Contract of Purchase and to induce you to purchase the Series 2006A Bonds as contemplated therein, the Corporation hereby represents, warrants and agrees with you as follows:

(a) Due Organization and Authority; Legal, Valid and Binding Obligations. The Corporation is a nonprofit public benefit corporation duly organized and validly existing pursuant to the laws of the State of California and has all necessary power and authority to adopt the Corporation Resolution and enter into and perform its duties under the Legal Documents to which the Corporation is a party, the Corporation Resolution has been adopted and has not been rescinded, and the Legal Documents to which the Corporation is a party, when executed and delivered by the respective parties thereto, will constitute legal, valid and binding obligations of the Corporation in accordance with their respective terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public agencies in the State of California.

(b) No Conflict. The execution and delivery by the Corporation of the Legal Documents to which the Corporation is a party, the adoption of the Corporation Resolution, and compliance by the Corporation with the provisions of all of them, do not and will not conflict with or constitute a breach of or default under any material agreement or other instrument to which the Corporation is a party, or any court order, consent decree, statute, rule, regulation or any other law to which the Corporation presently is subject.

(c) No Consents Required. After due inquiry, except as may be required under blue sky or other securities laws of any state, or with respect to any permits or approval heretofore received which are in full force and effect or the requirement for which is otherwise disclosed in the Final Offering Circular, there is no consent, approval, authorization or other order of, or filing with, or certification by, any governmental authority, board, authority or commission or other regulatory authority having jurisdiction over the Corporation, required for the valid execution, delivery or performance by the Corporation of the Legal Documents to which the Corporation is a party or the consummation by the Corporation of the

other transactions contemplated by the Final Offering Circular or the Legal Documents to which the Corporation is a party.

(d) No Litigation. Except as disclosed in the Final Offering Circular, there is no action, suit, proceeding or investigation at law or in equity before or by any court or Governmental Authority or body pending against the Corporation, or to the knowledge of the Corporation, threatened against the Corporation to restrain or enjoin the delivery of the Series 2006A Bonds or in any way questioning or affecting (A) the proceedings under which the Series 2006A Bonds are to be issued, (B) the validity of any provision of any of the Legal Documents to which the Corporation is a party, (C) the legal existence of the Corporation or the title of its officers to their respective offices, or in any way contesting or affecting the validity of the Legal Documents to which the Corporation is a party, or the Series 2006A Bonds, or contesting the powers of the Corporation to enter into or perform its obligations under any of the foregoing or in which a final adverse decision would declare any provision of the Legal Documents or the Series 2006A Bonds to be invalid or unenforceable in whole or in material part.

(e) No Breach or Default. The Corporation is not in breach of or in default under any applicable law or administrative regulation of the State of California or the United States or any applicable judgment or decree or any loan agreement, indenture, bond, note, resolution, agreement or other instrument to which the Corporation is a party or is otherwise subject which breach or default would have a material and adverse impact on the Corporation's ability to perform its obligations under the Legal Documents to which the Corporation is a party, and no event has occurred and is continuing which, with the passage of time or the giving of notice, or both, would constitute a default or an event of default under any such instrument.

(f) Agreement to Preserve Tax Exemption. The Corporation covenants that it will not take any action which would cause interest on the Series 2006A Bonds to be subject to federal income taxation or California personal income taxes (other than to the extent the Series 2006A Bonds will be subject to federal income taxation as described under the caption "TAX MATTERS" in the Final Offering Circular) and that it will take such action as may be necessary to preserve the tax-exempt status of the Series 2006A Bonds.

Very truly yours,

LOS ANGELES COUNTY
SECURITIZATION CORPORATION

By:_____
Authorized Representative

Accepted and confirmed as of the date above written
CITIGROUP GLOBAL MARKETS INC., as Representative

By: _____
Authorized Representative

EXHIBIT B

CERTIFICATE OF THE
COUNTY OF LOS ANGELES

The California County Tobacco Securitization Agency (the "Agency") proposes to cause the issuance and delivery of $_____ aggregate principal amount of the Agency's Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A Bonds. The "Series 2006A Bonds" consist of the "Series 2006A Convertible Bonds" and the "Series 2006A Capital Appreciation Bonds." The Series 2006A Bonds are dated, mature, bear or accrete interest and shall have such other terms as are set forth in the Indenture hereinafter referred to.

The Series 2006A Bonds will be issued and secured under and pursuant to an Indenture dated as of _____ 1, 2006, as supplemented in the case of each series by a Series Supplement, dated as of _____1, 2006 (as supplemented, the "Indenture"), by and between the Agency and _____as indenture trustee (the "Indenture Trustee"). The Series 2006A Bonds are being issued for the purpose of funding the loan from the Agency to the Corporation pursuant to a Secured Loan Agreement, dated as of _____ 1, 2006 (the "Loan Agreement"), by and between the Agency and the Corporation. The County of Los Angeles (the "County") sold its right, title and interest of the County to be paid certain payments (such payments as more fully defined in the Final Offering Circular, the "Sold County Tobacco Assets"), pursuant to a Sale Agreement, dated as of _____1, 2006, between the County and the Corporation (the " Sale Agreement").

The Series 2006A Bonds are to be sold by the Agency pursuant to the Contract of Purchase between the Agency and Citigroup Global Markets Inc., on behalf of itself and the other Underwriters (the "Underwriters") dated January ___, 2006 (the "Contract of Purchase").

This Certificate may be executed by the parties hereto in separate counterparts, each of which when so executed and delivered shall be an original, but all such counterparts shall together constitute but one and the same instrument.

Capitalized terms not otherwise defined herein shall be as defined in the Indenture.

In order to facilitate your entering into the Contract of Purchase and to induce you to purchase the Series 2006A Bonds as contemplated therein, the County hereby certifies as follows:

(a) Due Organization and Agency; Legal, Valid and Binding Obligations. The County is a political subdivision of the State of California duly organized and operating pursuant to the Constitution and laws of the State of California and has all necessary power and authority to adopt the County Resolution and enter into and perform its duties under the Sale Agreement, the County Resolution

has been adopted and has not been rescinded and the Sale Agreement constitutes the valid and binding obligation of the County enforceable against the County in accordance with its terms, subject to the effect of bankruptcy, reorganization, moratorium, fraudulent conveyance and similar laws relating to or affecting creditors' rights generally or the application of equitable principles in any proceeding, whether at law or in equity and by the limitations on legal remedies imposed on actions against public agencies in the State of California.

(b) No Conflict. The execution and delivery by the County of the Sale Agreement, the adoption of the County Resolution by the County, and compliance by the County with the provisions of all of them, do not and will not conflict with or constitute a breach of or default under any material agreement or other instrument to which the County is a party, or any court order, consent decree, statute, rule, regulation or any other law to which the County presently is subject.

(c) No Consents Required. After due inquiry, except as may be required under blue sky or other securities laws of any state, or with respect to any permits or approval heretofore received which are in full force and effect or the requirement for which is otherwise disclosed in the Final Offering Circular, there is no consent, approval, authorization or other order of, or filing with, or certification by, any governmental authority, board, authority or commission or other regulatory authority having jurisdiction over the County, required for the valid execution, delivery or performance by the County of the Sale Agreement or the consummation by the County of the other transactions contemplated by the Sale Agreement.

(d) No Litigation. Except as disclosed in the Final Offering Circular, there is no action, suit, proceeding or investigation at law or in equity before or by any court or Governmental Authority or body pending against the County, or to the knowledge of the County, threatened against the County which would have a material adverse effect on the enforceability of the MSA or the payment of Sold County Tobacco Assets thereunder, or in any way contesting or affecting the validity of the Sale Agreement, the County Resolution or the transactions relating to the Sale Agreement or the legal existence of the County or the title of its officers to their respective offices, or in any way contesting or affecting the validity of the Sale Agreement or in which a final adverse decision would declare any provision of the Sale Agreement to be invalid or unenforceable in whole or in material part.

(e) No Breach or Default. The County is not in breach of or in default under any applicable law or administrative regulation of the State of California or the United States or any applicable judgment or decree or any loan agreement, indenture, bond, note, resolution, agreement or other instrument to which the County is a party or is otherwise subject which breach or default would have a

material and adverse impact on the County's ability to perform its obligations under the Sale Agreement, and no event has occurred and is continuing which, with the passage of time or the giving of notice, or both, would constitute such a default or event of default under any such instrument.

Dated: January ___, 2006

COUNTY OF LOS ANGELES

By:_____
Authorized Representative

Accepted and confirmed as of the date above written

CITIGROUP GLOBAL MARKETS INC.
as Representative of the Underwriters

By: _____
Authorized Representative

EXHIBIT C

FORM OF DISCLOSURE COUNSEL OPINION

January ___, 2006

County of Los Angeles, California

The California County Tobacco Securitization Agency

Los Angeles County Securitization Corporation

Citigroup Global Markets Inc., as Representative of the Underwriters

Ladies and Gentlemen:

In connection with the issuance by The California County Tobacco Securitization Agency (the "Agency") of its "Series 2006A Bonds" consisting of its "Series 2006A Convertible Bonds" and the "Series 2006A Capital Appreciation Bonds" in the aggregate principal amount of $_____ (collectively, the "Bonds") which are being delivered to Citigroup Global Markets Inc., as representative (the "Representative") of the Underwriters (the "Underwriters") today pursuant to the Contract of Purchase dated January ___, 2006 (the "Contract of Purchase") by and between you and the Agency, we, as Disclosure Counsel, have examined and relied upon the following:

(a) a Resolution of the Agency, adopted on January ___, 2006, authorizing the issuance of the Bonds and the approval of certain documents in connection with the issuance of the Bonds;

(b) a Resolution of the Los Angeles County Securitization Corporation, a non-profit public benefit corporation (the "Corporation"), adopted on _____, authorizing the approval of certain documents in connection with the issuance of the Bonds;

(c) a Resolution of the County of Los Angeles (the "County"), adopted on _____, authorizing the Sale Agreement, dated as of _____ (the " Sale Agreement"), between the County and the Corporation;

(d) the Indenture, dated as of _____ 1, 2006, between the Agency and _____as indenture trustee (the "Indenture Trustee") with respect to the Bonds, as supplemented in the case of each series by a Series Supplement with respect to the Bonds, dated as of _____ 1, 2006 (collectively, the "Indenture");

(e) the Secured Loan Agreement, dated as of _____ 1, 2006, between the Corporation and the Agency (the "Loan Agreement");

(f) the Sale Agreement;

(g) an executed copy of the Final Offering Circular; and

(h) an executed copy of the Contract of Purchase and the certificates and opinions of counsel delivered pursuant to the Contract of Purchase.

In addition, we have examined and relied on originals or copies, certified or otherwise identified to our satisfaction, of such other documents, instruments or corporate records, and have made such investigation of law, as we have considered necessary or appropriate for the purpose of this opinion.

In accordance with our understanding with the Agency, we rendered legal advice and assistance to Agency in the course of its investigation pertaining to, and its participation in preparation of, the Final Offering Circular and the issuance and sale of the Bonds. Rendering such assistance involved, among other things, examinations, inquiries and discussions concerning various legal and related subjects, and reviews of and reports on certain documents and proceedings. We also participated in personal and telephone conferences with your representatives and with representatives of the Agency, the Corporation, the County, Bond Counsel, Counsel to the Agency, Counsel to the Corporation, Los Angeles County Counsel, Global Insight, Inc.. the Underwriters, Underwriters' counsel and others during which the contents of the Final Offering Circular and related matters were discussed and reviewed, and conducted such other due diligence as we considered necessary in rendering the opinion set forth below.

The limitations inherent in the independent verification of factual matters and the character of determinations involved in the preparation of the Final Offering Circular are such, however, that we have necessarily assumed the accuracy, completeness and fairness of and take no responsibility for any of the statements made in the Final Offering Circular. We have also assumed but have not independently verified that the signatures on all documents and certificates that we examined were genuine.

On the basis of the information developed in the course of the performance of the services referred to above, considered in light of our understanding of the applicable law and experience we have gained through our practice thereunder, we are of the opinion, that:

(a) it is not necessary, in connection with the offer or sale of the Bonds, to register the Bonds under the Securities Act of 1933, as amended, or to qualify the Indenture under the Trust Indenture Act of 1939, as amended;

(b) without having undertaken to determine independently the accuracy or completeness of the statements contained in the Final Offering Circular, but on the basis of our participation in conferences and our examination of certain documents as described herein, no information has come to our attention which would lead us to believe that the Final Offering

Circular as of its date and as of the Closing contained or contains any untrue statement of a material fact or omitted or omits to state any material fact necessary to make the statements therein, in light of the circumstances under which they were made, not misleading (except for any financial, statistical or economic data or forecasts, numbers, charts, tables, graphs, estimates, projections, assumptions or expressions of opinion contained in the Final Offering Circular and the information under the headings "CIGARETTE CONSUMPTION REPORT," "THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS," and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and in Appendices A, B and F, as to which we express no opinion or view). In addition, based on our participation in the above-mentioned conferences, and in reliance thereon and on the records, documents, certificates and opinions herein mentioned (as set forth above), we advise you that, during the course of our representation of the Agency on this matter, no information came to our attention which caused us to believe that the statements included in the Offering Circular under the heading "TOBACCO INDUSTRY" as of its date and as of the date hereof (except for any financial, statistical or economic data or forecasts, numbers, charts, tables, graphs, estimates, projections, assumptions or expressions of opinion, as to which we express no opinion or view) was not and is not correct in any material respect; and

(c) the statements contained in the Final Offering Circular under the captions "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT," "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU, AND THE CALIFORNIA ESCROW AGREEMENT" are accurate in all material respects.

This letter is solely for the benefit of the addressees and it is not to be used, circulated, quoted, or otherwise referred to for any purpose other than the offering of the securities covered by the Final Offering Circular and may not be relied upon without our express written permission, except that references may be made to it in any list of closing documents pertaining to the delivery of the Bonds.

Very truly yours,

EXHIBIT D

MATURITY SCHEDULE

$000,000,000

THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
Tobacco Settlement Asset-Backed Bonds
(Los Angeles County Securitization Corporation)
Series 2006A

MATURITY SCHEDULES, INTEREST RATES AND YIELDS

$_____ Series 2006A Capital Appreciation Bonds
Due ____ 1, 20__, Yield ____%

Initial Principal Amount	Accreted Value at [Maturity]	Initial Amount per $5,000 Accreted Value at [Maturity]	[Accretion Interest Rate]
	$	$	$

$_____ Series 2006A Convertible Bonds
Due ____ 1, 20__, Yield ____%
Accretion Period Ends: _____1, 20__

Initial Principal Amount	Accreted Value at [Conversion Date]]	Initial Amount per $5,000 Accreted Value at [Conversion Date]	[Accretion Interest Rate]
	$	$	$

This Preliminary Offering Circular and the information contained herein are subject to completion or amendment without notice. Under no circumstances shall this Preliminary Offering Circular constitute an offer to sell or the solicitation of an offer to buy, nor shall there be any sale of the securities in any jurisdiction in which such offer, solicitation or sale would be unlawful prior to registration or qualification under the securities laws of such jurisdiction

HD&W – 12/29/05 Draft

PRELIMINARY OFFERING CIRCULAR DATED JANUARY [18], 2006

New Issue – Book-Entry Only **Ratings: See "RATINGS" herein.**

*In the opinion of Sidley Austin Brown & Wood LLP, Bond Counsel, based upon existing law and assuming compliance with certain covenants in the documents pertaining to the Series 2006A Bonds and the requirements of the Internal Revenue Code of 1986, as amended (the "**Code**"), interest on the Series 2006A Bonds is not includable in the gross income of the holders of the Series 2006A Bonds for federal income tax purposes. In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Such interest, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability. In the opinion of Bond Counsel, interest on the Series 2006A Bonds is exempt from personal income taxes imposed by the State of California. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006A Bonds. See "TAX MATTERS" herein.*

$000,000,000*
THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
Tobacco Settlement Asset-Backed Bonds
(Los Angeles County Securitization Corporation)
Series 2006A

Dated: Date of Delivery **Due: As shown on the inside cover**

The California County Tobacco Securitization Agency (the "**Agency**") is a public entity created pursuant to a Joint Exercise of Powers Agreement, dated as of November 15, 2000, as amended, by and among the County of Los Angeles, California (the "**County**") and eight other counties in the State of California (each, a "**Member**"). The Agency is a separate entity from the County and its debts, liabilities and obligations do not constitute debts, liabilities or obligations of the County or its other Members. See "THE AGENCY" herein.

The Agency's Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A (the "**Series 2006A Bonds**"), consisting of the Capital Appreciation Bonds (the "**Capital Appreciation Bonds**") and the Convertible Bonds (the "**Convertible Bonds**"), are to be issued pursuant to an Indenture, as supplemented by a Series 2006A Supplement, each dated as of _____ 1, 2006 (the "**Indenture**"), between the Agency and _____, as indenture trustee (the "**Indenture Trustee**"). The proceeds of the Series 2006A Bonds will be loaned by the Agency to the Los Angeles County Securitization Corporation (the "**Corporation**"), a nonprofit public benefit corporation organized under the laws of the State, pursuant to a Secured Loan Agreement, dated as of _____ 1, 2006, between the Agency and the Corporation. The Corporation will apply the loan proceeds to (i) purchase the Sold County Tobacco Assets (herein defined), (ii) fund the Debt Service Reserve Account for the Series 2006A Bonds, (iii) fund the Operating Account for the Series 2006A Bonds, and (iv) pay the costs of issuance incurred in connection with the issuance of the Series 2006A Bonds.

The Series 2006A Bonds are primarily secured by a portion of tobacco settlement revenues ("**TSRs**") required to be paid to the State of California (the "**State**") under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers (the "**PMs**"), 46 states and six other U.S. jurisdictions, in November 1998 in settlement of certain cigarette smoking-related litigation and made payable to the County pursuant to agreements with the State and other parties (all of such payments to the County, as more fully described herein, are referred to as "**County Tobacco Assets**"). The portion of the County Tobacco Assets to be purchased with a portion of the proceeds of the Series 2006A Bonds is referred to herein as the "**Sold County Tobacco Assets**". See "SECURITY FOR THE SERIES 2006A BONDS" herein.

The amount of Sold County Tobacco Assets received is dependent on many factors, including future cigarette consumption and the financial capability of the PMs as well as litigation affecting the MSA, related state legislation and state enforcement thereof and the tobacco industry. See "RISK FACTORS" herein.

Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River*, in which the Attorney General of the State is a defendant, and *Freedom Holdings*, both discussed in "RISK FACTORS" herein), that are pending in the United States District Court for the Southern District of New York. The court in the *Grand River* and *Freedom Holdings* actions is considering plaintiffs' allegations of an illegal output cartel under the federal antitrust laws and, in the *Grand River* case, plaintiffs' allegations of violations under the Commerce Clause of the United States Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of TSRs available to the Agency to pay principal or Accreted Value (collectively, the "**Principal**") of and interest on the Series 2006A Bonds and make Turbo Redemptions (herein defined), and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

The Series 2006A Bonds are limited obligations of the Agency, payable from and secured solely by Revenues (herein defined) and the other Collateral (herein defined) pledged under the Indenture. The Bondholders have no recourse to other assets of the Agency, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Agency. If, notwithstanding the limitation on recourse described in the preceding sentence, any Bondholders are deemed to have an interest in any asset of the Agency pledged to the payment of other debt obligations of the Agency, the Bondholders' interest in such asset shall be subordinate to the claims and rights of the holders of such other debt obligations and the Indenture will constitute a subordination agreement for purposes of Section 510(a) of the U.S. Bankruptcy Code.

The Series 2006A Bonds do not constitute a charge against the general credit of the Agency or any of its Members, including the County, and under no circumstances shall the Agency or any Member, including the County, be obligated to pay the Principal of, redemption premiums, if any, or interest on the Series 2006A Bonds, except from the Collateral pledged therefor

* Preliminary, subject to change.

under the Indenture. Neither the State, nor any public agency of the State (other than the Agency), nor any Member of the Agency, including the County, is pledged to the payment of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds. The Series 2006A Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Agency) or any Member of the Agency, including the County. The County is under no obligation to make payments of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds in the event that Revenues are insufficient for the payment thereof.

The Capital Appreciation Bonds shall accrue interest from their date of delivery, which interest shall be compounded on the first June 1 or December 1 (each a "**Distribution Date**"), and thereafter semiannually on the Distribution Dates until their respective maturity dates. Prior to the Conversion Date, the Convertible Bonds shall accrue interest from their date of delivery, which interest shall be compounded on the first Distribution Date and thereafter semiannually on the Distribution Dates in each year. After the applicable Conversion Date, such Convertible Bonds shall become Current Interest Bonds with interest thereon payable on each Distribution Date following such Conversion Date. See "THE SERIES 2006A BONDS – General" herein.

The Series 2006A Bonds are subject to optional redemption, mandatory redemption from amounts on deposit in the Turbo Redemption Account, and mandatory prepayment from amounts on deposit in the Lump Sum Prepayment Account as described herein. The Series 2006A Bonds are also subject to extraordinary prepayment upon an Event of Default under the Indenture as described herein. See "THE SERIES 2006A BONDS" herein.

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

The cover page contains information for quick reference only. It is not a summary of this issue. Investors must read the entire Offering Circular to obtain information essential to making an informed investment decision.

Citigroup

Bear, Stearns & Co. Inc. **UBS Financial Services**

The Series 2006A Bonds are offered when, as and if issued and accepted by the Underwriters, subject to the approval of legality by Sidley Austin Brown & Wood LLP, San Francisco, California, as Bond Counsel. Certain legal matters with respect to the Agency, the Corporation and the County will be passed upon by County Counsel and Bond Counsel. Certain legal matters will be passed upon for the Agency by Hawkins Delafield & Wood LLP, Los Angeles, California, as Disclosure Counsel to the Agency, and for the Underwriters by their counsel, Nixon Peabody LLP. It is expected that the Series 2006A Bonds will be available for delivery in book-entry form only through DTC in New York, New York on or about February [1], 2006.

Date: _____, 2006

$000,000,000*
THE CALIFORNIA COUNTY TOBACCO SECURITIZATION AGENCY
Tobacco Settlement Asset-Backed Bonds
(Los Angeles County Securitization Corporation)
Series 2006A

MATURITY SCHEDULES, INTEREST RATES AND YIELDS*

$_____ Series 2006A Capital Appreciation Bonds
Due June 1, 20__, Yield ____%
Projected Final Turbo Redemption Date: June 1, 20__,†
Projected Weighted Average Life: ___ years†
CUSIP No. _____‡

Initial Principal Amount	Accreted Value at [Maturity]	Initial Amount per $5,000 Accreted Value at [Maturity]	[Accretion Interest Rate]
$	$	$	%

$_____ Series 2006A Convertible Bonds
Due June 1, 20__, Yield ____%
Projected Final Turbo Redemption Date: June 1, 20__,†
Projected Weighted Average Life: ___ years†
Accretion Period Ends: _____1, 20__
CUSIP No. _____‡

Initial Principal Amount	Accreted Value at [Conversion Date]	Initial Amount per $5,000 Accreted Value at [Conversion Date]	[Accretion Interest Rate]
$	$	$	%

* Preliminary, subject to change.

† Assumes Turbo Redemption payments are made in accordance with the Global Insight Base Case Forecast and Structuring Assumptions described in this Offering Circular. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. No assurance can be given that these structuring assumptions will be realized.

‡ Copyright 2006, American Bankers Association. CUSIP data herein are provided by Standard & Poor's, CUSIP Service Bureau, a division of The McGraw-Hill Companies, Inc. The CUSIP numbers listed above are being provided solely for the convenience of Bondholders only at the time of issuance of the Series 2006A Bonds and the Agency, the Corporation, the County and the Underwriters do not make any representation with respect to such numbers or undertake any responsibility for their accuracy now or at any time in the future. The CUSIP number for a specific maturity is subject to being changed after the issuance of the Series 2006A Bonds as a result of various subsequent actions including, but not limited to, a refunding in whole or in part of such maturity or as a result of the procurement of secondary market portfolio insurance or other similar enhancement by investors that is applicable to all or a portion of certain maturities of the Series 2006A Bonds.

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

NO DEALER, BROKER, SALESPERSON OR OTHER PERSON IS AUTHORIZED IN CONNECTION WITH ANY OFFERING MADE HEREBY TO GIVE ANY INFORMATION OR MAKE ANY REPRESENTATION OTHER THAN AS CONTAINED HEREIN, AND, IF GIVEN OR MADE, SUCH INFORMATION OR REPRESENTATION MUST NOT BE RELIED UPON AS HAVING BEEN AUTHORIZED BY THE AGENCY, THE CORPORATION, THE COUNTY OR THE UNDERWRITERS. THIS OFFERING CIRCULAR DOES NOT CONSTITUTE AN OFFER TO SELL, OR A SOLICITATION OF AN OFFER TO BUY, ANY OF THE SECURITIES OFFERED HEREBY BY ANY PERSON IN ANY JURISDICTION IN WHICH IT IS UNLAWFUL FOR SUCH PERSON TO MAKE SUCH AN OFFER OR SOLICITATION.

THERE CAN BE NO ASSURANCE THAT A SECONDARY MARKET FOR THE SERIES 2006A BONDS WILL DEVELOP, OR IF ONE DEVELOPS, THAT IT WILL PROVIDE BONDHOLDERS WITH LIQUIDITY OR THAT IT WILL CONTINUE FOR THE LIFE OF THE SERIES 2006A BONDS.

This Offering Circular contains information furnished by the Agency, the Corporation, the County, Global Insight and other sources, all of which are believed to be reliable. Information concerning the tobacco industry and participants therein has been obtained from certain publicly available information provided by certain participants and certain other sources (see **"**CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY**"**). The participants in such industry have not provided any information to the Agency, the Corporation or the County for use in connection with this offering. In certain cases, tobacco industry information provided herein (such as market share data) may be derived from sources which are inconsistent or in conflict with each other. The Agency, the Corporation and the County have no independent knowledge of any facts indicating that the information under the caption **"**CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY**"** herein is inaccurate in any material respect, but have not independently verified this information and cannot and do not warrant the accuracy or completeness of this information. The information contained under **"**CIGARETTE CONSUMPTION REPORT**"** attached as Appendix A hereto and under **"**THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS**"** herein have been included in reliance upon Global Insight and the Statement Department of Finance, respectively, as experts in econometric forecasting and have not been independently verified for accuracy or appropriateness of assumptions, although the Agency, the Corporation and the County have no independent knowledge that the information is not materially accurate and complete.

The information and expressions of opinion contained herein are subject to change without notice and neither the delivery of this Offering Circular nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Agency, the Corporation or the County or the matters covered by the report of Global Insight included as Appendix A to, or under the caption **"**CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY**"** in this Offering Circular, since the date hereof or that the information contained herein is correct as of any date subsequent to the date hereof. Such information and expressions of opinion are made for the purpose of providing information to prospective investors and are not to be used for any other purpose or relied on by any other party. With respect to certain matters relating to the Series 2006A Bonds, the Agency has undertaken to provide updates to investors through certain information repositories. See **"**CONTINUING DISCLOSURE UNDERTAKING**"** herein.

This Offering Circular contains forecasts, projections and estimates that are based on current expectations or assumptions. In light of the important factors that may materially affect the amount of Revenues (see **"**RISK FACTORS,**"** **"**LEGAL CONSIDERATIONS,**"** **"**SUMMARY OF THE MASTER SETTLEMENT AGREEMENT,**"** **"**THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT,**"** **"**CIGARETTE CONSUMPTION REPORT**"** and **"**THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS**"** herein), the inclusion in this Offering Circular of such forecasts, projections and estimates should not be regarded as a representation by the Agency, the Corporation, the County, Global Insight or the Underwriters that the results of such forecasts, projections and estimates will occur. Such forecasts, projections and estimates are not intended as representations of fact or guarantees of results.

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

statement contained herein to reflect any changes in the Agency's, the Corporation's or the County's expectations with regard thereto or any change in events, conditions or circumstances on which any such statement is based.

THE SERIES 2006A BONDS HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION, ANY STATE SECURITIES COMMISSION OR ANY OTHER REGULATORY AUTHORITY, NOR HAS ANY OF THE FOREGOING PASSED UPON THE ACCURACY OR THE ADEQUACY OF THIS OFFERING CIRCULAR. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

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

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SUMMARY STATEMENT

This Summary Statement is subject in all respects to more complete information contained in this Offering Circular and should not be considered a complete statement of the facts material to making an investment decision. The offering of the Series 2006A Bonds to potential investors is made only by means of the entire Offering Circular. Capitalized terms used in this Summary Statement and not otherwise defined shall have the meanings given such terms in the Indenture or Sale Agreement, as applicable. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – Definition" attached hereto.

Overview ..... The California County Tobacco Securitization Agency (the "**Agency**") is issuing its Tobacco Settlement Asset-Backed Bonds (Los Angeles County Securitization Corporation) Series 2006A (the "**Series 2006A Bonds**"), consisting of the Capital Appreciation Bonds (the "**Capital Appreciation Bonds**") and the Convertible Bonds (the "**Convertible Bonds**"), to fund the Agency's loan to the Los Angeles County Securitization Corporation, a California nonprofit public benefit corporation (the "**Corporation**"), pursuant to a Secured Loan Agreement, dated as of _____ 1, 2006 (the "**Loan Agreement**"), between the Agency and the Corporation. The Series 2006A Bonds will be issued pursuant to an Indenture, as supplemented by a Series Supplement, each dated as of _____ 1, 2006 (collectively, the "**Indenture**"), between the Agency and The _____, as indenture trustee (the "**Indenture Trustee**"). The Corporation will use the proceeds of the loan from the Agency to acquire the Sold County Tobacco Assets (herein defined) pursuant to the Sale Agreement (herein defined) as further described herein.

The Series 2006A Bonds are primarily secured by a portion of tobacco settlement revenues ("**TSRs**") required to be paid to the State of California (the "**State**") under the Master Settlement Agreement (the "**MSA**") entered into by participating cigarette manufacturers, 46 states and six other U.S. jurisdictions, in November 1998 in settlement of certain cigarette smoking-related litigation and made payable to the County of Los Angeles, California (the "**County**") pursuant to agreements with the State and other parties. See "SECURITY FOR THE SERIES 2006A BONDS" herein. The County will sell to the Corporation 25.9% its right, title and interest in, to and under the MSA and the Memorandum of Understanding (the "**MOU**"), as agreed to by the State and the Participating Jurisdictions (described below), as provided in the Agreement Regarding Interpretation of Memorandum of Understanding (the "**ARIMOU**") and the Decree (as defined herein), including the County's Annual Payments and Strategic Contribution Payments (all such payments to the County are collectively referred to as the "**County Tobacco Assets**") pursuant to a Sale Agreement dated as of ____ 1, 2006, between the County and the Corporation (the "**Sale Agreement**"). The portion of the County Tobacco Assets to be sold pursuant to the Sale Agreement is referred to herein as the "**Sold County Tobacco Assets**" and the remainder of the County Tobacco Assets is referred to herein as the "**Unsold County Tobacco Assets**". The Corporation will finance the purchase the Sold County Tobacco Assets by means of a loan from the Agency of a portion of the proceeds of the Series 2006A Bonds.

The Bondholders will have no interest in or to the Unsold County Tobacco Assets. The right of the Bondholders to receive payments on their Series 2006A Bonds from the Sold County Tobacco Assets

pledged thereto is equal to and on a parity with, and is not inferior or superior to, the right of the County to receive the Unsold County Tobacco Assets. The Revenues (herein defined) derived from the Sold County Tobacco Assets will be deposited with the Indenture Trustee commencing ____, 2006; however, neither scheduled debt service nor Turbo Redemption payments will be due and payable with respect to the Series 2006A Bonds until _____. See "SECURITY FOR THE SERIES 2006A BONDS" herein.

The Agency ..... The Agency is a public entity created by a Joint Exercise of Powers Agreement, dated as of November 15, 2000, as amended, among the County and the Counties of Merced, Kern, Stanislaus, Marin, Placer, Fresno, Alameda and Sonoma (each, a "**Member**"). The Agency is a separate entity from its Members, and its debts, liabilities and obligations do not constitute debts, liabilities and obligations of the Members.

The Corporation..... The Corporation is a special purpose nonprofit public benefit corporation organized under the California Nonprofit Public Benefit Corporation Law.

The County ..... The County of Los Angeles is a political subdivision in the State of California and is a separate entity from the Agency and the Corporation.

Securities Offered..... The Series 2006A Bonds consist of the Capital Appreciation Bonds and the Convertible Bonds. It is expected that the Series 2006A Bonds will be delivered in book-entry form through the facilities of The Depository Trust Company, New York, New York ("**DTC**"), on or about February [1], 2006 (the "**Closing Date**")*. Beneficial owners of the Series 2006A Bonds will not receive physical delivery of bond certificates. See Appendix F – "BOOK-ENTRY ONLY SYSTEM" attached hereto. The Capital Appreciation Bonds will be issued in the initial principal amounts and with the Accreted Values at maturity set forth on the inside cover to this Offering Circular, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Maturity Date thereof. The Convertible Bonds will be issued in the initial principal amounts and with the Accreted Values at the Conversion Date thereof as set forth on the inside cover to this Offering Circular, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Conversion Date thereof.

Collateral ..... The Series 2006A Bonds will be secured by the Agency's rights under the Loan Agreement, including the right to receive Loan Payments, certain moneys and investments held under the Indenture, the Sold County Tobacco Assets and such other assets and property described in the Indenture (as further described herein, the "**Collateral**").

Pursuant to the Loan Agreement, the Corporation has pledged and assigned to the Agency and granted a security interest in all right, title and interest of the Corporation in, to and under the following property, whether now owned or hereafter acquired: (a) the Sold County Tobacco Assets purchased from the County, (b) to the extent permitted by law (as to which no representation is made by the Corporation), corresponding

* Preliminary, subject to change.

present or future rights, if any, of the Corporation to enforce or cause the enforcement of payment of purchased Sold County Tobacco Assets pursuant to the MOU and the ARIMOU, (c) corresponding rights of the Corporation under the Sale Agreement, and (d) all proceeds of any and all of the foregoing (collectively, the "**Corporation Tobacco Assets**").

The Bondholders will have no interest in or to the Unsold County Tobacco Assets. The right of the Bondholders to receive payments on their Series 2006A Bonds from the Sold County Tobacco Assets pledged thereto is equal to and on a parity with, and is not inferior or superior to, the right of the County to receive the Unsold County Tobacco Assets. The Revenues derived from the Sold County Tobacco Assets will be deposited with the Indenture Trustee commencing ____, 2006; however, neither scheduled debt service nor Turbo Redemption payments will be due and payable with respect to the Series 2006A Bonds until _____. See "SECURITY FOR THE SERIES 2006A BONDS" herein.

Master Settlement Agreement ..... The MSA was entered into on November 23, 1998 among the attorneys general of the 46 states (including the State), Puerto Rico, Guam, U.S. Virgin Islands, the District of Columbia, American Samoa and the Commonwealth of the Northern Mariana Islands (collectively, the "**Settling States**") and the then four largest United States tobacco manufacturers: Philip Morris Incorporated ("**Philip Morris**"), R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**"), Brown & Williamson Tobacco Corporation ("**B&W**") and Lorillard Tobacco Company ("**Lorillard**") (collectively, the "**Original Participating Manufacturers**" or "**OPMs**"). On January 5, 2004, Reynolds American Inc. ("**Reynolds American**") was incorporated as a holding company to facilitate the combination of the U.S. assets, liabilities and operations of B&W with those of Reynolds Tobacco. References herein to the Original Participating Manufacturers or OPMs means, for the period prior to June 30, 2004, collectively, Philip Morris, Reynolds Tobacco, B&W and Lorillard and for the period on and after June 30, 2004, collectively, Philip Morris, Reynolds American and Lorillard. The MSA resolved cigarette smoking-related litigation between the Settling States and the OPMs and released the OPMs from past and present smoking-related claims by the Settling States, and provides for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the Settling States (including Initial Payments, Annual Payments and Strategic Contribution Fund Payments, each as defined herein), and the imposition of certain tobacco advertising and marketing restrictions, among other things.

The County, the Corporation and the Agency are not parties to the MSA.

The MSA is an industry-wide settlement of litigation between the Settling States and the Participating Manufacturers (as such term is defined below). The MSA permits tobacco companies other than the OPMs to become parties to the MSA. Tobacco companies other than OPMs that become parties to the MSA are referred to herein as "**Subsequent Participating Manufacturers**" or "**SPMs**," and the SPMs, together with the OPMs, are referred to herein as the "**Participating Manufacturers**" or "**PMs**". Tobacco companies that do not become parties to the MSA are referred to herein as "**Non-**

Participating Manufacturers" or "**NPMs**".

California Consent Decree, the MOU, the ARIMOU and the California Escrow Agreement .....

On December 9, 1998, the Consent Decree and Final Judgment was entered in the Superior Court of the State of California for San Diego County (the "**Decree**"), which governs the class action portion of the State's lawsuit against the tobacco companies. The Decree, which is final and non-appealable, settled the class action litigation brought by the State against the OPMs and resulted in the achievement of California State-Specific Finality under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – State-Specific Finality and Final Approval" herein.

Prior to the entering of the Decree, the plaintiffs of certain pending cases agreed, among other things, to coordinate their pending cases and to allocate certain portions of the recovery among the State, its 58 counties, the Cities of San Jose, Los Angeles and San Diego and the City and County of San Francisco (collectively, the "Participating Jurisdictions") (the City and County of San Francisco is allocated a share both as a county and as one of the four cities). This agreement was memorialized in the MOU by and among counsel representing the State and a number of the Participating Jurisdictions. Upon satisfying certain conditions set forth in the MOU and the ARIMOU, the Participating Jurisdictions are deemed to be "eligible" to receive a share of the Initial Payments, Annual Payments and Strategic Contribution Payments to which the State is entitled under the MSA (the "TSRs"). All of the Participating Jurisdictions under the MOU and the ARIMOU, including the County, have satisfied the conditions of the MOU and the ARIMOU and are eligible to receive their portion of the Initial Payments, Annual Payments and Strategic Contribution Payments TSRs to which the State is entitled under the MSA.

Under the MOU, 45% of the State's allocation of TSRs under the MSA is allocated to the Participating Jurisdictions that represent the 58 counties and 5% to the four cities that are Participating Jurisdictions (1.25% each), with the remaining 50% being retained by the State. The 45% share of the TSRs allocated to the Participating Jurisdictions that are counties is allocated among the counties based on population, on a per capita basis as reported in the 1990 Official United States Decennial Census, as adjusted by the 2000 Official United States Decennial Census. Pursuant to the proportional allocable share provided in the MOU and the ARIMOU, the County is currently entitled to receive 12.6468665% of the total statewide share of the TSRs (based on adjustments made to reflect the 2000 Official United States Decennial Census.) This percentage is subject to adjustments for population changes every ten years based on the United States Decennial Census as described herein. The TSRs are subject to several adjustments as described herein. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT" and "THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS" herein.

To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU

among the State and the Participating Jurisdictions, the parties entered into the ARIMOU.

Under the MSA, the State's portion of the TSRs is deposited into the California State-Specific Account held by Citibank N.A., as the escrow agent appointed pursuant to the MSA (the "**MSA Escrow Agent**"). Pursuant to the terms of the MOU, the ARIMOU and an Escrow Agreement dated April 12, 2000, as amended by the first amendment to escrow agreement, dated July 19, 2001 (the "**California Escrow Agreement**"), between the State and Citibank, N.A., as California Escrow Agent (the "**California Escrow Agent**"), the State has instructed the MSA Escrow Agent to transfer (upon receipt thereof) all amounts in the California State-Specific Account to the California Escrow Agent. The California Escrow Agent is required to deposit the State's 50% share of the TSRs in an account for the benefit of the State, and the remaining 50% of the TSRs into separate sub-accounts within an account held for the benefit of the Participating Jurisdictions (the "**California Local Government Escrow Account**"). In connection with the Series 2006A Bonds, the California Escrow Agent will be irrevocably instructed to disburse the Sold County Tobacco Assets from the California Local Government Escrow Account directly to the Indenture Trustee. The MOU provides that the distribution of tobacco-related recoveries is not subject to alteration by legislative, judicial or executive action at any level, and if an alteration were to occur and survive legal challenge, any modification would be borne proportionally by the State and the Participating Jurisdictions. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT" herein.

Litigation Regarding MSA and Related Statutes ..... Numerous lawsuits have been filed challenging the MSA and related statutes, including two cases (*Grand River* and *Freedom Holdings*, discussed in "RISK FACTORS" herein), that are pending in the United States District Court for the Southern District of New York. The plaintiffs in both cases seek, *inter alia*, a determination that state statutes enacted pursuant to the MSA conflict with and are preempted by the federal antitrust laws. The plaintiffs in the *Grand River* case also seek a determination that state statutes enacted pursuant to the MSA violate the Commerce Clause of the United States Constitution. A determination that the MSA or state legislation enacted pursuant to the MSA is void or unenforceable would have a materially adverse effect on the payments by PMs under the MSA and the amount or the timing of receipt of TSRs available to the Agency to pay principal or Accreted Value (collectively, the "**Principal**") of and interest on the Series 2006A Bonds and redeem the Series 2006A Bonds prior to their state maturity dates, and could result in the complete loss of a Bondholder's investment. See "RISK FACTORS" and "LEGAL CONSIDERATIONS" herein.

Payments Pursuant to the MSA ..... Under the MSA, the OPMs are required to make the following payments to the Settling States: (i) five initial payments, all of which have been paid (the "**Initial Payments**"), (ii) annual payments (the "**Annual Payments**"), which are required to be made annually on each April 15, having commenced April 15, 2000 and continuing in perpetuity in the base amounts set forth below (subject to adjustment as described herein):

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

and (iii) ten annual payments in the amount of $861 million (the "**Strategic Contribution Payments**"), each of which is subject to adjustment and required to be made on each April 15, commencing April 15, 2008 and ending April 15, 2017.

Final Approval of the MSA occurred on November 12, 1999. Upon Final Approval, the MSA Escrow Agent distributed the up-front Initial Payment, and since then has distributed the subsequent Initial Payments and the Annual Payments due on or before April 15, 2005 to the Settling States that achieved State-Specific Finality. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Annual Payments" herein.

Under the MSA, the State is entitled to 12.7639554% of the Annual Payments and 5.1730408% of the Strategic Contribution Payments made by PMs under the MSA and distributed through the National Escrow Agreement, entered into on December 23, 1998, among the Settling States, the OPMs and the MSA Escrow Agent. By operation of the MOU and the ARIMOU, however, the State has allocated 50% of such payments to the Participating Jurisdictions, including the County, and retained only the remaining 50%.

Under the MSA, each OPM is required to pay an allocable portion of each Annual Payment and each Strategic Contribution Payment based on its respective market share of the United States cigarette market during the preceding calendar year, in each case, subject to certain adjustments as described herein. Each SPM has Annual Payment and Strategic Contribution Payment obligations under the MSA (separate from the payment obligations of the OPMs) according to its market share, but only if its market share exceeds the higher of its 1998 market share or 125% of its 1997 market share. The payment obligations under the MSA follow tobacco product brands if they are transferred by any of the PMs. Payments by the PMs under the MSA are required to be made to the MSA Escrow Agent, which is required pursuant to the instructions of the MSA Escrow Agreement to remit an allocable share of such payments to the parties entitled thereto.

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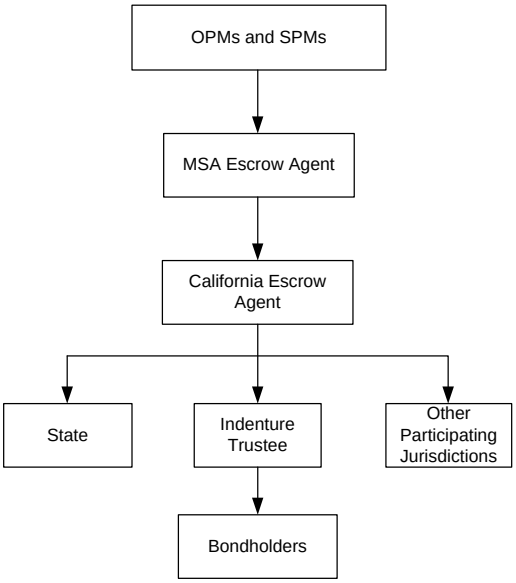
* As described herein, the base amounts of Annual Payments are subject to various adjustments which have resulted in reduced Annual Payments in certain prior years. See "RISK FACTORS – Decline in Cigarette Consumption Materially Beyond Forecasted Levels May Adversely Affect Payments," "– Other Potential Payment Decreases Under the Terms of the MSA," and "SUMMARY OF MASTER SETTLEMENT AGREEMENT – Annual Payments" herein.

Under the MSA, the Annual Payments and the Strategic Contribution Payments due are subject to numerous adjustments, some of which are material. Such adjustments include, among others, reductions for decreased domestic cigarette shipments, reductions to account for those states that settle or have settled their claims against the PMs independently of the MSA, and increases related to inflation in an amount of not less than 3% per year in the case of the Annual Payments and Strategic Contribution Payments. The portion of the TSRs that constitute Sold County Tobacco Assets is further subject to reductions or increases to account for changes in the relative population of the County. See "RISK FACTORS – Potential Payment Adjustments for Population Changes Under the MOU and the ARIMOU" herein.

Flow of TSR Payments..... Upon the sale of the Sold County Tobacco Assets to the Corporation, the Sold County Tobacco Assets will constitute Corporation Tobacco Assets and the California Escrow Agent will be irrevocably instructed by the County to disburse the Sold County Tobacco Assets from the California Local Government Escrow Account directly to the Indenture Trustee for the Series 2006A Bonds. The Revenues derived from the Sold County Tobacco Assets will be deposited with the Indenture Trustee commencing ____, 2006; however, neither scheduled debt service nor Turbo Redemption payments will be due and payable with respect to the Series 2006A Bonds until _____.

The following diagram depicts the flow of Sold County Tobacco Assets to the Indenture Trustee upon the issuance of the Series 2006A Bonds. See "THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT – Flow of Funds and California Escrow Agreement" herein.



Industry Overview ..... The three OPMs, Philip Morris, Reynolds American and Lorillard, are the largest manufacturers of cigarettes in the United States (based on

2004 market share). According to Loews Corporation, the parent of Lorillard, the OPMs accounted for approximately 85%* of the United States domestic cigarette market in 2004 based on shipments. The market for cigarettes is highly competitive, and is characterized by brand recognition and loyalty. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" herein.

Cigarette Consumption ..... As described in the Cigarette Consumption Report referred to below, domestic cigarette consumption grew dramatically in the 20th century, reaching a peak of 640 billion cigarettes in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004. A number of factors affect consumption, including, but not limited to, pricing, industry advertising, expenditures, health warnings, restrictions on smoking in public places, nicotine dependence, youth consumption, general population trends and disposable income. See "CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "CIGARETTE CONSUMPTION REPORT" attached hereto.

Cigarette Consumption Report ..... Global Insight Inc. ("**Global Insight**"), an international econometric and consulting firm, has been retained on behalf of the Agency to forecast cigarette consumption in the United States from 2004 through 2045. Global Insight's report, entitled "A Forecast of U.S. Cigarette Consumption (2004-2045) for the Los Angeles County Securitization Corporation" dated December 21, 2005 (the "**Cigarette Consumption Report**"), is attached hereto as Appendix A and should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions contained therein. The Cigarette Consumption Report is subject to certain disclaimers and qualifications as described therein.

Global Insight considered the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effects of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation and health warnings. Global Insight found the following variables to be effective in building an empirical model of adult per capita cigarette consumption: real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places and the trend over time in individual behavior and preferences. Using data from 1965 to 2003 and an analysis of the variables, Global Insight constructed an empirical model of adult per capita cigarette consumption ("**CPC**") for the United States. Using standard multivariate regression analysis to determine the

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* Market share information for the OPMs based on domestic industry shipments or sales may be materially different from Relative Market Share for purposes of the MSA and the respective obligations of the OPMs to contribute to Annual Payments and Strategic Contribution Fund Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Annual Payments" and " – Strategic Contribution Fund Payments" herein. Additionally, aggregate market share information as reported by the Loews Corporation is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of their filings with the SEC. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" and "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" herein. The aggregate market share information used in the Collection Methodology and Assumptions may differ materially from the market share information used by MSA Auditor in calculating adjustments to Annual Payments and Strategic Contribution Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" herein.

relationship between such variables and CPC along with Global Insight's standard adult population growth statistics and adjustments for non-adult smoking, Global Insight projected adult cigarette consumption through 2045.

While the Cigarette Consumption Report is based on United States cigarette consumption, MSA Payments are computed based in part on shipments in or to the fifty United States, the District of Columbia and Puerto Rico. The Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the United States may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time. See "CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "CIGARETTE CONSUMPTION REPORT" attached hereto. The projections and forecasts regarding future cigarette consumption included in the Global Insight Cigarette Consumption Report are estimates which have been prepared on the basis of certain assumptions and hypotheses. No representation or warranty of any kind is or can be made with respect to the accuracy or completeness of, and no representation or warranty should be inferred from, these projections and forecasts.

Population Information..... [To Come]

Use of Proceeds ..... The proceeds of the Series 2006A Bonds will be loaned by the Agency to the Corporation pursuant to a Loan Agreement. The Corporation will apply the loan proceeds to (i) purchase the Sold County Tobacco Assets, (ii) fund the Debt Service Reserve Account for the Series 2006A Bonds, (iii) fund the Operating Account for the Series 2006A Bonds, and (iv) pay the costs of issuance incurred in connection with the issuance of the Series 2006A Bonds.

Interest ..... Interest on the Capital Appreciation Bonds accrues from their date of delivery, which interest shall be compounded on the first June 1 or December 1 (each a "**Distribution Date**"), and thereafter semiannually on the Distribution Dates until their respective maturity dates. See Appendix G – "Table of Accreted Values" attached hereto. Interest on the Convertible Bonds accrues from their date of delivery, which interest will be compounded on the first Distribution Date and thereafter semiannually on the Distribution Dates in each year. After the applicable Conversion Date, such Convertible Bonds will become Current Interest Bonds (the "**Current Interest Bonds**") with interest thereon payable on each Distribution Date following such Conversion Date. See Appendix G – "Table of Accreted Values" attached hereto. Interest shall be calculated on the basis of a year of 360 days and twelve 30-day months.

Principal..... The Principal of a Series 2006A Bond must be paid on the stated maturity date thereof (each, a "Maturity Date"). The ratings of the Series 2006A Bonds only address each Rating Agency's assessment of the ability of the Agency to pay interest when due and to pay Principal of the Series 2006A Bonds on their respective Maturity Dates and do not address payment at any earlier time, whether from Turbo Redemptions (herein defined) or otherwise. See "RATINGS" herein. A failure by the Agency to pay the Principal of a Series 2006A Bond when due will constitute an Event of Default under the Indenture.

Turbo Redemption.....	The Series 2006A Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity dates from amounts on deposit in the Turbo Redemption Account on each June 1 and December 1, commencing _____ 1, 20__, at the redemption price of 100% of the Accreted Value thereof to the date fixed for redemption without premium, with respect to the Capital Appreciation Bonds, and 100% of the Accreted Value thereof together with interest accrued after the Conversion Date to the date fixed for redemption without premium, with respect to the Convertible Bonds ("**Turbo Redemption**"). The Series 2006A Bonds are subject to Turbo Redemption in order of maturity. See "THE SERIES 2006A BONDS – Turbo Redemption" herein.
Actual Payments of Principal	Due to a number of factors, including actual shipments of cigarettes in the United States and the actual level of payments received by the Settling States under the MSA, the amount available to pay Principal on the Series 2006A Bonds may fluctuate from year to year. As a result, Revenues received by the Agency from the Corporation under the Loan Agreement may be insufficient to pay Principal or sufficient to pay Principal but insufficient for Turbo Redemptions. In either event, the Agency will have no obligation to make Turbo Redemptions. A failure by the Agency to pay the Principal of a Series 2006A Bond on its applicable Maturity Date will constitute an Event of Default under the Indenture.
Optional Redemption.....	The Capital Appreciation Bonds maturing on or prior to June 1, 20__ are not subject to optional redemption. The Capital Appreciation Bonds maturing on and after June 1, 20__ are subject to optional redemption, in whole or in part, on any date on or after June 1, 20__, at a redemption price of 100% of the Accreted Value thereof to the date fixed for redemption. The Convertible Bonds maturing on or prior to June 1, 20__ are not subject to optional redemption. The Convertible Bonds maturing on and after June 1, 20__ are subject to optional redemption, in whole or in part, on any date on or after June 1, 20__, at a redemption price of 100% of the Principal thereof together with accrued interest after the Conversion Date to the date fixed for redemption.
Extraordinary Prepayment.....	If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the Principal amount thereof without premium. "**Pro Rata**" means, for an allocation of available amounts to any payment of interest or principal to be made under the Indenture, the application of a fraction to such available amounts (a) the numerator of which is equal to the amount due to the respective Holders to whom such payment is owing, and (b) the denominator of which is equal to the total amount due to all Holders to whom such payment is owing.
Lump Sum Prepayment	The Series 2006A Bonds are subject to mandatory prepayment, in whole or in part prior to their stated maturity dates from amounts on deposit in the Lump Sum Prepayment Account on any date, at the prepayment price of 100% of the Accreted Value thereof to the date fixed for prepayment without premium, with respect to the Capital Appreciation

Bonds, and 100% of the Accreted Value together with interest accrued after the Conversion Date to the date fixed for prepayment without premium, with respect to the Convertible Bonds. Any prepayment of Series 2006A Bonds from amounts in the Lump Sum Prepayment Account pursuant to the Indenture will be Pro Rata without regard to their order of maturity.

Bond Structuring Assumptions and Methodology ..... The Series 2006A Bonds were structured on the basis of forecasts, which themselves are based on assumptions, as described herein. Among these are a forecast of United States cigarette consumption contained in the Cigarette Consumption Report, and a forecast of future population in the County based on certain population information and the application of certain adjustments and offsets to payments to be made by the PMs pursuant to the MSA, and a forecast of the Accounts and all earnings on amounts on deposit in the Accounts established under the Indenture. In addition, such forecasts were used to project amounts expected to be available for redemption of the Turbo Term Bonds from Turbo Redemptions and the resulting expected average life of the Turbo Term Bonds.

No assurance can be given, however, that events will occur in accordance with such assumptions and forecasts. Any deviations from such assumptions and forecasts could materially and adversely affect the payment of the Series 2006A Bonds. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

Debt Service Reserve Account ..... A reserve account (the "**Debt Service Reserve Account**") will be established and held by the Indenture Trustee and funded from the proceeds of the Series 2006A Bonds in an amount equal to $_____ (the "**Debt Service Reserve Requirement**"). The Agency is required to maintain a balance in the Debt Service Reserve Account, to the extent of available funds, equal to the Debt Service Reserve Requirement.

Amounts on deposit in the Debt Service Reserve Account will be available to pay Principal of and interest on the Series 2006A Bonds to the extent that Revenues are insufficient for such purpose. "**Revenues**" means the Sold County Tobacco Assets and all fees, charges, payments, proceeds, collections, investment earnings and other income and receipts paid or payable to the Agency or the Indenture Trustee for the account of the Agency or the Bondholders. Amounts in the Debt Service Reserve Account shall not be available to make Turbo Redemption payments on the Series 2006A Bonds unless such amounts, together with all available Revenues, are sufficient to retire all Bonds Outstanding under the Indenture, in which event such amounts shall be transferred to the Turbo Redemption Account. Unless an Event of Default has occurred, amounts withdrawn from the Debt Service Reserve Account will be replenished from Revenues as described herein. See "SECURITY FOR THE SERIES 2006A BONDS – Flow of Funds" herein.

Flow of Revenues ..... Revenues are to be promptly (and in no event later than two Business Days after their receipt) deposited by the Indenture Trustee in the Collection Account created under the Indenture. As soon as possible following each deposit of Revenues to the Collection Account, the Indenture Trustee is to transfer Revenues on deposit in the Collection Account as provided under the Indenture. See "SECURITY FOR THE

SERIES 2006A BONDS – Flow of Funds" for a detailed description of the accounts created under the Indenture and the uses of moneys therein.

Events of Default..... The occurrence of any of the following events will constitute an "**Event of Default**" under the Indenture:

(i) failure to pay when due interest on any payment date or the Principal on the applicable Maturity Date of any Bonds or failure to pay when due interest on and the principal of any Bonds in accordance with any notice of redemption or prepayment;

(ii) failure of the Agency to observe or perform any other provision of the Indenture which is not remedied within 60 days after notice thereof has been given to the Agency by the Indenture Trustee or to the Agency and the Indenture Trustee by the Bondholders of at least 25% in principal amount of the Series 2006A Bonds then Outstanding;

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

(iv) an event of default has occurred and is continuing under the Loan Agreement, which events consist of (a) failure by the Corporation to pay, or cause to be paid, to the Indenture Trustee for deposit in the Collection Account established under the Indenture the portion of the TSRs relating to the Sold County Tobacco Assets as required pursuant to the Loan Agreement, (b) failure by the Corporation to observe or perform any other covenant, obligation, condition or agreement contained in the Loan Agreement and such failure shall continue for thirty (30) days from the date of written notice from the Agency or the Indenture Trustee of such failure, (c) any representation, warranty, certificate, information or other statement (financial or otherwise) made or furnished by or on behalf of the Corporation to the Agency in or in connection with the Loan Agreement shall be false, incorrect, incomplete or misleading in any material respect when made or furnished, (d) the Corporation shall (1) apply for or consent to the appointment of a receiver, trustee, liquidator or custodian of itself or of all or a substantial part of its property, (2) be unable, or admit in writing its inability, to pay its debts generally as they mature, (3) make a general assignment for the benefit of its or any of its creditors, (4) be dissolved or liquidated in full or in part, (5) become insolvent (as such term may be defined or interpreted under any applicable statute), (6) commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or consent to any such relief or to the appointment of or taking possession of its property by any official in an involuntary case or other proceeding commenced against it, or (7) take any action for the purpose of effecting any of the foregoing, (e) proceedings for the appointment of a receiver, trustee, liquidator or custodian of the Corporation or of all or a substantial part of the property thereof, or an involuntary case or other proceedings seeking liquidation, reorganization or other relief with respect to the Corporation or the debts thereof under any bankruptcy, insolvency or other similar law now or hereafter in effect shall be commenced and an order for relief entered or such proceeding shall not

be dismissed or discharged within sixty (60) days of commencement, (f) the Loan Agreement or any material term thereof shall cease to be, or be asserted by the Corporation not to be, a legal, valid and binding obligation of the Corporation enforceable in accordance with its terms, and (g) the instructions to the Attorney General of the State regarding disbursing the Corporation Tobacco Assets to the Indenture Trustee as provided in the Loan Agreement shall be revoked or cease to be complied with.

See "SECURITY FOR THE SERIES 2006A BONDS – Events of Default; Remedies" herein for a discussion of the remedies available to the Indenture Trustee upon the occurrence of an Event of Default.

Covenants ..... The County, the Corporation and the Agency have made certain covenants for the benefit of the Bondholders. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Indenture" for a summary of the covenants made by the Agency, Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Loan Agreement" for a summary of covenants made by the Corporation, and Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Sale Agreement" for a summary of the covenants made by the County.

Continuing Disclosure ..... Pursuant to the Indenture, the Agency has agreed to provide, or cause to be provided, to each nationally recognized municipal securities information repository and any State information repository for purposes of Rule 15c2-12(b)(5) (the "**Rule**") adopted by the U.S. Securities and Exchange Commission (each, a "**Repository**") certain annual financial information and operating data and, in a timely manner, notice of certain material events. See "CONTINUING DISCLOSURE UNDERTAKING" herein.

Ratings..... The ratings for the Series 2006A Bonds address only the ability of the Agency to pay the Principal and interest when due as set forth on the inside cover page of this Offering Circular. Neither projections of Turbo Redemption payments of the Series 2006A Bonds nor any principal payment amounts used for structuring purposes, other than amounts due on the Maturity Dates for the Series 2006A Bonds, have been rated by the Rating Agencies. A rating is not a recommendation to buy, sell or hold securities, and such rating is subject to revision or withdrawal at any time. See "RATINGS" herein.

Legal Considerations ..... Reference is made to "LEGAL CONSIDERATIONS" herein for a description of certain legal issues relevant to an investment in the Series 2006A Bonds.

Tax Matters..... In the opinion of Bond Counsel, based upon existing law and assuming compliance with certain covenants in the documents pertaining to the Series 2006A Bonds and the requirements of the Internal Revenue Code of 1986, as amended (the "**Code**"), interest on the Series 2006A Bonds is not includable in the gross income of the holders of the Series 2006A Bonds for federal income tax purposes. In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the federal alternative minimum taxable income of individuals and corporations. Such interest, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a

corporation's alternative minimum tax liability. In the opinion of Bond Counsel, interest on the Series 2006A Bonds is exempt from personal income taxes imposed by the State of California. Bond Counsel expresses no opinion regarding any other tax consequences related to the ownership or disposition of, or the accrual or receipt of interest on, the Series 2006A Bonds. See "TAX MATTERS" herein.

Risk Factors ..... Reference is made to "RISK FACTORS" herein for a description of certain considerations relevant to an investment in the Series 2006A Bonds.

Availability of Documents..... Included herein are brief summaries of certain documents and reports, which summaries do not purport to be complete or definitive, and reference is made to such documents and reports for full and complete statements of the contents thereof. Copies of the Indenture, the Loan Agreement and the Sale Agreement may be obtained upon request from the Indenture Trustee at: _____, _____, Attention: Corporate Trust Services. Any statements in this Offering Circular involving matters of opinion, whether or not expressly so stated, are intended as such and not as representations of fact. This Offering Circular is not to be construed as a contract or agreement among the Agency, the Corporation, the County and the purchasers or Bondholders.

RISK FACTORS

The Series 2006A Bonds differ from many other tax-exempt securities in a number of respects. Prospective investors should carefully consider the factors set forth below regarding an investment in the Series 2006A Bonds as well as other information contained in this Offering Circular. The following discussion of risks is not meant to be a complete list of the risks associated with the purchase of the Series 2006A Bonds and does not necessarily reflect the relative importance of the various risks. Potential purchasers of the Series 2006A Bonds are advised to consider the following factors, among others, and to review the other information in this Offering Circular in evaluating the Series 2006A Bonds. Any one or more of the risks discussed, and others, could lead to a decrease in the market value and/or the liquidity of the Series 2006A Bonds. There can be no assurance that other risk factors will not become material in the future.

Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation

General Overview. Certain smokers, consumer groups, cigarette importers, cigarette wholesalers, cigarette distributors, cigarette manufacturers, Native American tribes, taxpayers, taxpayers' groups and other parties have instituted lawsuits against various PMs, certain of the Settling States and other public entities challenging the MSA and/or the Qualifying Statutes and related legislation. One or more of the lawsuits, several of which remain pending, allege, among other things, that the MSA and/or the Qualifying Statutes and related legislation are void or unenforceable under the Commerce Clause and certain other provisions of the United States Constitution and the federal antitrust laws, as described below under "*—Grand River, Freedom Holdings and Related Cases*" in this subsection. In addition, some of the lawsuits allege that the MSA and/or related state legislation are void or unenforceable under the federal civil rights laws, state constitutions, consumer protection laws and unfair competition laws. Certain of these lawsuits seek, and, if ultimately successful, could result in, a determination that the MSA and/or the Qualifying Statutes and related legislation is void or unenforceable. Certain of the lawsuits further seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA. In addition, class action lawsuits have been filed in several federal and state courts, and one such lawsuit remains pending, alleging that under the federal Medicaid law, any amount of tobacco settlement funds that the Settling States receive in excess of what they paid through the Medicaid program to treat tobacco-related diseases should be paid directly to Medicaid recipients. To date, challenges to the MSA or related state legislation have not been ultimately successful, although two challenges in a federal district court in the Second Circuit have survived appellate review of motions to dismiss and have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related statutes. In these cases, certain decisions by the United States Court of Appeals for the Second Circuit have created heightened uncertainty as a result of that court's interpretation of federal antitrust immunity and Commerce Clause doctrines as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts, which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes do not violate the Commerce Clause of the United States Constitution and are protected from antitrust challenges based on established antitrust immunity doctrines. In addition, appeals are still possible in certain other cases. See "*—Grand River, Freedom Holdings and Related Cases*" in this subsection. The MSA and related state legislation may also continue to be challenged in the future. A determination that the MSA or related state legislation is void or unenforceable would have a material adverse effect on the payments by the PMs under the MSA and the amount or the timing of receipt of TSRs available to the Agency to make Turbo Redemptions and pay Principal of and interest on the Series 2006A Bonds and could result in the complete loss of a Bondholder's investment. See "LEGAL CONSIDERATIONS" herein.

Qualifying Statute and Related Legislation. Under the MSA's NPM Adjustment, downward adjustments may be made to the Annual Payments and Strategic Contribution Payments payable by a PM if the PM experiences a loss of market share in the United States to NPMs as a result of the PM's participation in the MSA. See "− Other Potential Payment Decreases Under the Terms of the MSA−*NPM Adjustment*" herein and "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT−MSA Provisions Relating to Model/Qualifying Statutes" herein. A Settling State may avoid the effect of this adjustment by adopting and diligently enforcing a Qualifying Statute, as hereinafter described. The State has adopted the Model Statute, which by definition is a Qualifying Statute under the MSA. The Model Statute, in its original form, required an NPM to make escrow deposits approximately in the

amount that the NPM would have had to pay had it been a PM and further authorized the NPM to obtain from the applicable Settling State the release of the amount by which the escrow deposit in that state exceeded that state's allocable share of the total payments that the NPM would have made as a PM. Legislation has been enacted in at least 44 of the Settling States, including the State, amending the Qualifying Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under the statute to the excess above the total payment that the NPM would have paid had it been a PM (each an "**Allocable Share Release Amendment**"). A majority of the PMs, including all OPMs, have indicated in writing that the State's Model Statute, as amended, will continue to constitute a Qualifying Statute within the meaning of the MSA In addition, 44 Settling States (including the State) have passed, and various states are considering, legislation (often termed "**Complementary Legislation**") to further ensure that NPMs are making required escrow payments under the states' respective Qualifying Statutes. Pursuant to the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold directly or indirectly in the State is required to certify annually that it is either (a) a PM and is in full compliance with the terms of the MSA or (b) an NPM and is in full compliance with the State's Qualifying Statute. The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the United States Constitution and/or state constitutions and are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are also possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Pending challenges to the Qualifying Statutes and related legislation are described below under "*—Grand River, Freedom Holdings and Related Cases*" and "*Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation*" in this subsection.

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

A determination that an Allocable Share Release Amendment is unenforceable would not constitute a breach of the MSA but could permit NPMs to exploit differences among states, target sales in states without Allocable Share Release Amendments, and thereby potentially increase their market share at the expense of the PMs. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — MSA Provisions Relating to Model/Qualifying Statutes" herein.

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

Grand River, Freedom Holdings and Related Cases. Among the pending challenges to the MSA and/or related state legislation are two lawsuits referred to herein as *Grand River* and *Freedom Holdings*, both of which are pending in the United States District Court for the Southern District of New York. The *Grand River* case is pending against the attorneys general of 31 states, including the State, and alleges, among other things, that (a) the MSA creates an unlawful output cartel under federal antitrust law and state legislation enacted pursuant to the MSA mandates or authorizes such cartel and are thus preempted by federal law and that (b) the MSA and related statutes are invalid or unenforceable under the Commerce Clause and other provisions of the U.S. Constitution. The plaintiffs in *Grand River* seek to enjoin the enforcement of the Qualifying Statutes and Complementary Legislation by the Grand River Challenged States (defined below), including the State. The *Freedom Holdings* case is pending against the attorney general and the commissioner of taxation and finance of the State of New York and alleges, among other things, that the MSA creates an unlawful output cartel under federal antitrust law and New York state legislation enacted pursuant to the MSA mandates or authorizes such cartel and are thus preempted by federal law. The plaintiffs in *Freedom Holdings* seek to enjoin the enforcement of New York's Qualifying Statute and Complementary Legislation. These suits have survived appellate review of motions to dismiss for failure to state a claim upon which relief can be granted and are in the discovery phase of litigation in preparation for the

development of a factual record to support possible findings of fact that may be used by the court in its decision as to the pending claims. To date, these are the only cases challenging the MSA or related legislation that have proceeded to a stage of litigation where the ultimate outcome may be determined by, among other things, findings of fact based on extrinsic evidence as to the operation and impact of the MSA and the related state legislation.

On July 1, 2002, *Grand River Enterprises Six Nations Ltd. v. Pryor* was filed in the United States District Court of the Southern District of New York by certain NPMs against current and former attorneys general of 31 states (the "**Grand River Challenged States**"). The plaintiffs seek to enjoin the enforcement of the Grand River Challenged States' Qualifying Statutes and Complementary Legislation, alleging that such Qualifying Statutes and Complementary Legislation violate the plaintiffs' constitutional rights under the Commerce Clause and other provisions of the U.S. Constitution and also that such Qualifying Statutes and Complementary Legislation conflict with and are therefore preempted by the federal antitrust laws. In September 2003, the District Court held that it lacked personal jurisdiction over the non-New York attorneys general and dismissed the plaintiffs' complaint against them. In addition, the District Court dismissed the plaintiffs' complaint against the New York Attorney General, finding that the plaintiffs had failed to state a claim. After the Second Circuit's decision in *Freedom Holdings* (discussed below), however, the District Court granted the plaintiffs' motion in *Grand River* to reinstate, against the New York Attorney General only, that portion of the complaint alleging that New York's Qualifying Statute and New York's Complementary Legislation conflict with antitrust laws and are preempted by federal law.

The plaintiffs appealed the dismissal of their other claims to the Second Circuit. On September 28, 2005, the Second Circuit reinstated the Commerce Clause challenge and reinstated the non-New York attorneys general, including the attorney general of the State, as defendants, finding that a federal court in New York could exercise personal jurisdiction over them, and affirmed the dismissal of certain remaining claims, including the claim that the Qualifying Statute and related legislation violated the Indian Commerce Clause of the U.S. Constitution. The case was remanded to the District Court and remains pending. On October 12, 2005, the defendants, including the California Attorney General, filed a petition with the Second Circuit for rehearing with regard to the Second Circuit's ruling on the issue of personal jurisdiction. The plaintiffs have filed a petition with the Second Circuit for rehearing on the Indian Commerce Clause ruling.

With regard to the Commerce Clause challenge, the Second Circuit noted that because it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit held that although each state's Qualifying Statute and Complementary Legislation apply to cigarette sales within that State, the plaintiffs sufficiently stated a possible claim that these statutes together create a national or "interstate" regulatory policy and thereby exert "extraterritorial control" over out-of-state transactions in contravention of the Commerce Clause. To date, *Grand River* is the only case in which a Commerce Clause challenge to the MSA and related statutes has survived a motion to dismiss. An adverse ruling on Commerce Clause grounds could potentially lead to invalidation of the MSA and the Qualifying Statutes in their entirety and result in the complete loss of a Bondholder's outstanding investment.

With regard to the reinstatement of the non-New York defendants, the Second Circuit explained that where an out-of-state defendant has "transacted business" in the state and there is "substantial nexus" between that transaction and the litigation in question, the federal courts in the state can obtain jurisdiction over the defendants. The Second Circuit concluded that by negotiating the MSA in New York, the attorneys general "transacted business" for the purpose of conferring jurisdiction in federal courts in New York. The Court also held that there was "substantial nexus" between the MSA negotiations and the lawsuit, because although the challenged statutes are discrete acts of each state, they were integral to the operation of the MSA and were negotiated as such. As a defendant in the action, the Attorney General of the State could be bound by a decision in this case, and could, for example, be enjoined from enforcing the State's Qualifying Statute and Complementary Legislation and possibly the MSA. In addition, a ruling in the *Grand River* case invalidating the Qualifying Statute and Complementary Legislation would conflict with the current law in the Ninth Circuit, in that district courts in the Ninth Circuit have upheld California's Qualifying Statute and Complementary Legislation. Such a conflict may result in significant uncertainty regarding the validity and enforceability of the MSA and/or related legislation in California and could result in the complete loss of a Bondholder's investment.

Grand River remains pending in the Southern District and the court has ordered the parties to proceed with discovery with respect to the antitrust and Commerce Clause claims. A final decision in this case by the District Court would be subject to appeal as of right to the Second Circuit. However, any decision by the Second Circuit in

this case would not be subject to appeal as of right to the United States Supreme Court. No assurance can be given that the Supreme Court would choose to hear and determine any appeal relating to the personal jurisdiction of the District Court over the non-New York attorneys general (including the attorney general of the State) in this case or any appeal relating to the validity or enforceability of MSA and related/or legislation in this or any other case. Even if appealed, a decision adverse to the defendants in *Grand River* could, unless stayed pending appeal at the discretion of the court, result in the complete cessation of the TSRs available to make payments on the Series 2006A Bonds during the pendency of the appeal.

On April 16, 2002, in *Freedom Holdings, Inc. v. Spitzer*, certain cigarette importers filed an action against the Attorney General and the Commissioner of Taxation and Finance of the State of New York (the "**New York State Defendants**"), challenging New York's Complementary Legislation, alleging in their initial complaint that New York's Complementary Legislation enforces a market-sharing and price-fixing cartel, and allows the OPMs to charge supra-competitive prices for their cigarettes. Plaintiffs also alleged that New York's Complementary Legislation violates the Commerce Clause of the U.S. Constitution and establishes an output cartel in violation of federal antitrust law. The initial complaint also alleged that the legislation is selectively enforced in violation of the Equal Protection Clause of the U.S. Constitution. The Southern District dismissed the action on May 14, 2002.

In its decision, the Southern District applied two United States Supreme Court doctrines known as the "state action" immunity doctrine (based on a Supreme Court case known as "**Parker**") and the First Amendment based immunity doctrine (based on two Supreme Court cases known collectively as *Noerr-Pennington* ("**NP**")). The applicability of the *Parker* immunity doctrine requires two levels of analysis. Where a state confers authority on private parties to engage in conduct that would otherwise be per se violative of antitrust laws, cases subsequent to *Parker* (most notably a United States Supreme Court case known as "**MidCal**") have required both a clear articulation of state policy and active supervision by the state of the otherwise anticompetitive conduct for *Parker* immunity to apply. When a state is acting unilaterally, in its capacity as the sovereign, however, no *MidCal* analysis is required and *Parker* immunity applies directly. The Southern District held, among other things, that New York's Complementary Legislation was protected from antitrust challenge by both direct *Parker* immunity and *NP* immunity.

The plaintiffs appealed and on January 6, 2004, the Second Circuit partially reversed the decision of the Southern District. In its reversal, the Second Circuit in *Freedom Holdings* noted, because it was reviewing a motion to dismiss, that it was required to accept as true the material facts alleged in the complaint and to draw all reasonable inferences in the plaintiffs' favor. The Second Circuit affirmed the Southern District's dismissal of that portion of the complaint that alleged a Commerce Clause violation. The Second Circuit reversed the dismissal of the plaintiffs' Equal Protection claim, based on allegations that the Complementary Legislation is not applied to the sale of cigarettes by wholesalers or importers located on Native American Reservations located in New York, but allowed the plaintiffs to amend their complaint to correct deficiencies in the pleadings. The Second Circuit held, however, that the plaintiffs had alleged facts sufficient to state a claim that New York's Complementary Legislation conflicts with federal antitrust law, and that based on the facts alleged, the legislation was not protected from an antitrust challenge based on either of the *Parker* or *NP* immunity doctrines. The Second Circuit determined, on the record before it, that a *MidCal* analysis was required and, on that record and solely for the purpose of reviewing the Southern District's dismissal of the complaint, found insufficient active supervision and insufficient articulation of state policy to support a conclusion that there was antitrust immunity under *Parker* and *MidCal*. On March 25, 2004, the Second Circuit denied the New York State Defendants' petition for a rehearing.

In April 2004, the plaintiffs in *Freedom Holdings* filed an amended complaint, which was supplemented in November 2004, and the plaintiffs now seek (1) a declaratory judgment that the operation of the MSA, New York's Qualifying Statute and New York's Complementary Legislation implements an illegal *per se* output cartel in violation of the federal antitrust laws and is thus preempted by federal antitrust law and (2) an injunction permanently enjoining the enforcement of New York's Qualifying Statute and New York's Complementary Legislation. The amended complaint does not seek an injunction enjoining the enforcement or administration of the MSA. The amended complaint is limited only to claims under the federal antitrust laws and does not allege that the MSA, New York's Qualifying Statute or New York's Complementary Legislation violate the Commerce Clause or the Equal Protection Clause of the United States Constitution.

On September 14, 2004, the Southern District denied the plaintiffs' motion for a preliminary injunction enjoining New York, during the pendency of the action, from enforcing the MSA, New York's Qualifying Statute

and New York's Complementary Legislation. The Southern District held that, based on the evidence presented by the parties, the plaintiffs had failed to establish a likelihood of success on the merits of their claims (1) that New York's Qualifying Statute and New York's Complementary Legislation authorized or mandated a per se violation of the federal antitrust laws or (2) that the MSA, New York's Qualifying Statute and New York's Complementary Legislation would not be entitled to *Parker* antitrust immunity under a *MidCal* analysis. The Southern District also determined that the plaintiffs had failed to make a showing of irreparable harm sufficient to justify preliminary injunctive relief. The Southern District, however, granted the plaintiffs' motion to enjoin New York from enforcing its Allocable Share Release Amendment, holding that the plaintiffs had established a likelihood of success on their claim that New York's Allocable Share Release Amendment conflicts with the federal antitrust laws and that its enforcement would cause plaintiffs and other NPMs irreparable harm. The plaintiffs appealed the Southern District's denial of their motion for a preliminary injunction as to New York's Qualifying Statute and New York's Complementary Legislation. The plaintiffs did not appeal the denial of their motion for a preliminary injunction to enjoin the enforcement of the MSA and supplemented their amended complaint to state that they do not seek a permanent injunction to enjoin the enforcement of the MSA. The New York State Defendants did not appeal the granting of the plaintiffs' motion to enjoin enforcement of New York's Allocable Share Release Amendment. On May 18, 2005, the Second Circuit affirmed the Southern District's denial of the plaintiffs' request for a preliminary injunction. The Second Circuit held that the plaintiffs failed to satisfy the irreparable harm requirement for a preliminary injunction. The Second Circuit made no determination as to the likelihood of the plaintiffs' ultimate success on the merits. On July 20, 2005, the plaintiffs filed a motion for partial summary judgment requesting the court to declare that the Allocable Share Release Legislation is a per se violation of and preempted by the Sherman Act and to permanently enjoin New York from enforcing the Allocable Share Release Legislation against the plaintiffs. The motion was denied without prejudice on October 28, 2005. *Freedom Holdings* remains pending and the Southern District has ordered the parties to proceed with discovery with respect to the antitrust claims.

[Heightened Uncertainty;] Possibility of Conflict Among Federal Courts. Certain decisions by the United States Court of Appeals for the Second Circuit in *Freedom Holdings* have created heightened uncertainty as a result of the court's interpretation of federal antitrust law immunity doctrines, as applied to the MSA and related statutes, which interpretation appears to conflict with interpretations by other courts which have rejected challenges to the MSA and related statutes. Prior decisions rejecting such challenges have concluded that the MSA and related statutes are protected from an antitrust challenge based on the *Parker* or *NP* doctrines.

An adverse decision by the Second Circuit in *Grand River* regarding the enforceability of the MSA and/or related statutes under federal antitrust law or the Commerce Clause of the U.S. Constitution could be controlling law not only within the Second Circuit but also in each of the Grand River Challenged States, including the State, unless the Second Circuit ruling with regard to the Southern District's jurisdiction over the non-New York defendants is reviewed and reversed by the Second Circuit (upon rehearing en banc) or by the U.S. Supreme Court. Such review by the Second Circuit or the U.S. Supreme Court is not available as of right. No assurance can be given that the Second Circuit or the U.S. Supreme Court would choose to undertake such a review.

In addition, an adverse decision by the Second Circuit in *Freedom Holdings* regarding the enforceability of the MSA and/or related statutes under federal antitrust law would be controlling law only within the Second Circuit from which no appeal as of right to the United States Supreme Court would exist. If, however, the Second Circuit were to make a final determination in *Freedom Holdings* that the MSA constitutes a per se federal antitrust violation, not immunized by the *NP* or *Parker* doctrines, or that New York's Qualifying Statute and Complementary Legislation authorize or mandate such a per se violation, such determination could be considered to be in conflict with decisions rendered by other federal courts, including federal courts in California, which have come to different conclusions on these issues. The existence of a conflict as to the rulings of different federal courts on these issues, especially between Circuit Courts of Appeals, is one factor that the Supreme Court may take into account when deciding whether to exercise its discretion in agreeing to hear an appeal. No assurance can be given that the Supreme Court would choose to hear and determine any appeal relating to the substantive merits of *Freedom Holdings*. Any decision by the United States Supreme Court on the substantive merits of *Freedom Holdings* would be binding everywhere in the United States, including in California.

Ninth Circuit Cases. On March 28, 2005, the District Court for the Northern District of California in the California case, *Sanders v. Lockyer*, dismissed an antitrust challenge to the MSA and California's Qualifying Statute and Complementary Legislation brought by a class of California consumers against the State of California and the

OPMs. The District Court, expressly unpersuaded by *Freedom Holdings*, found the MSA to be the sovereign act of the State and further found California's Qualifying Statute and Complementary Legislation to be direct legislative activity entitled to *Parker* immunity without the need for any additional *MidCal* analysis. The District Court also found the MSA and California's Qualifying Statute and Complementary Legislation to be entitled to *NP* immunity. The plaintiffs have appealed the dismissal to the Ninth Circuit Court of Appeals. The plaintiff's opening appellate brief was filed on August 19, 2005, and the defendant's brief was filed on October 20, 2005.

On August 13, 1999, in *PTI, Inc v. Philip Morris Inc.*, certain cigarette importers and cigarette distributors filed an action in the United States District Court for the Central District of California against the PMs and all of the state officials involved in the negotiation of the MSA and those charged with the enforcement of the Qualifying Statute and Complementary Legislation as enacted by the respective states (collectively, the "**State Defendants**"). The plaintiffs therein sought to enjoin the passage or enforcement, as the case may be, of the Qualifying Statute and Complementary Legislation. The complaint alleged, among other things, that the passage, implementation and/or enforcement of the Qualifying Statute would be preempted by federal antitrust laws and violate certain provisions of the federal constitution, including the Interstate Compact Clause, the prohibition on Bills of Attainder, the Commerce Clause, the Import-Export Clause, the Supremacy Clause, the First Amendment, the Equal Protection Clause, and the Due Process Clause. On May 25, 2000, the District Court found that jurisdiction did not exist over the non-California State Defendants, and dismissed with prejudice all federal antitrust and constitutional claims against the PMs and the California State Defendants based on the merits. Like the *Sanders* Court, the *PTI* Court found antitrust immunity under both the *NP* and *Parker* doctrines. With respect to the Commerce Clause challenge, the Court found that neither the Qualifying Statute nor the Complementary Legislation was discriminatory on its face and applied equally to in-state, out-of-state and foreign manufacturers. In addition, the Court found that the alleged burden imposed on interstate commerce by the Qualifying Statute did not clearly exceed the putative local benefits of discouraging cigarette consumption.

Other Litigation Challenging the MSA, Qualifying Statutes and Related Legislation. In addition to *Freedom Holdings* and *Grand River*, other cases remain pending in federal courts that challenge the MSA, the Qualifying Statute, the Complementary Legislation and/or the Allocable Share Release Amendment in California (see the previous discussion of *Sanders v. Lockyer*), Louisiana, Oklahoma, Kansas, Kentucky, Tennessee and Arkansas. Most of these cases, as briefly described below, by way of example only, and not as an exclusive or complete list, raise essentially the same issues as those raised in *Freedom Holdings* or *Grand River*.

Two cases are currently pending in Louisiana that challenge the MSA, Qualifying Statutes and related legislation. In *Xcaliber International Limited, LLC v. Ieyoub*, certain NPMs have challenged the state's Allocable Share Release Amendment on both federal and state constitutional grounds. This action was dismissed by the District Court in February 2005 and the plaintiffs have appealed the dismissal to the Fifth Circuit Court of Appeals. In *Coker v. Foti*, filed in August 2005, certain NPMs and cigarette distributors brought an action in a federal district court in Louisiana, seeking, among other relief, (i) a declaration that the MSA and Louisiana's Qualifying Statute and Complementary Legislation are invalid under the Interstate Compact Clause of the United States Constitution and that Louisiana's Qualifying Statute and Complementary Legislation are preempted by the federal antitrust laws; and (ii) an injunction barring the enforcement of the MSA and Louisiana's Qualifying Statute and Complementary Legislation. On November 2, 2005 the State defendants filed a motion to dismiss the complaint.

In the Oklahoma case, *Xcaliber International Limited, LLC v. Edmondson*, certain NPMs have challenged Oklahoma's enforcement of its Allocable Share Release Amendment under federal antitrust laws. On May 20, 2005, the District Court granted summary judgment in favor of defendant, holding that the Oklahoma Allocable Share Release Amendment constituted unilateral state action that is directly protected from preemption by the *Parker* immunity doctrine. The plaintiffs have requested that the District Court reconsider its summary judgment order and appealed the order to the United States Court of Appeals for the Tenth Circuit. On August 31, 2005, the District Court denied the motion to reconsider. On October 28, 2005, the Tenth Circuit referred the case for mediation conferencing.

In the Kentucky case, *Tritent International Corp. v. Commonwealth of Kentucky*, the plaintiffs seek a declaratory judgment that Kentucky's Qualifying Statute and Complementary Legislation conflict with federal antitrust laws and certain provision of the U.S. Constitution. On September 8, 2005, the district court granted Kentucky's motion to dismiss the complaint and on October 24, 2005, the District Court denied the plaintiffs' subsequent motion for reconsideration.

Similarly, in the Tennessee case, *S&M Brands, Inc. v. Summers*, the plaintiffs seek a declaratory judgment that Tennessee Qualifying Statute (including the Allocable Share Release Amendment) and Complementary Legislation also conflict with federal antitrust laws and certain provisions of the U.S. Constitution. On June 1, 2005, the Sixth Circuit affirmed the District Court's denial of plaintiffs' motion for a preliminary injunction with respect to the enforcement of Tennessee's Allocable Share Release Amendment. On October 6, 2005, the District Court granted Tennessee's motion to dismiss the complaint except that portion of the complaint that alleges that the state's retroactive enforcement of the state's Allocable Share Release Provision violates plaintiff's constitutional rights, which issue was not raised by the state in its motion and was therefor not addressed by the court. The issue of the retroactive enforcement of the state's Allocable Share Release Provision is the subject of a motion made by the plaintiffs which is currently pending before the district court. In its opinion, the District Court expressly rejected the Second Circuit's reasoning in sustaining antitrust challenges in the *Freedom Holdings* case and the Third Circuit's rationale for denying state action immunity in the *Bedell* and *Mariana* cases. Instead, *S&M Brands* followed the *Sanders* and *PTI* line of cases and held that Qualifying Statute and Complementary Legislation are direct state action, entitled to *Parker* immunity without the need for *MidCal* analysis.

Two cases are currently pending in Arkansas. In the first case filed, *Grand River Enterprises Six Nations Ltd. v. Beebe*, the plaintiffs seek to enjoin preliminarily and permanently Arkansas' enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in *Freedom Holdings*. Arkansas' motion to dismiss the complaint remains pending in the District Court. In the second case, *International Tobacco Partners Ltd. v. Beebe*, the plaintiffs seek a declaratory judgment that the MSA and Arkansas' Qualifying Statute, Complementary Legislation and Allocable Share Release Amendment are preempted by federal antitrust laws and certain provisions of the U.S. Constitution. Arkansas' motion to dismiss the complaint remains pending with the District Court. The District Court has, however, as against the plaintiffs only, preliminarily enjoined the enforcement of Arkansas' Allocable Share Release Amendment. On August 8, 2005, the court ordered Arkansas to reimburse certain amounts it withheld pursuant to the Allocable Share Release Amendment to International Tobacco.

Two cases are currently pending in Kansas. In the first case filed, *Xcaliber International Limited, LLC v. Kline*, the plaintiffs seek to enjoin preliminarily and permanently Kansas' enforcement of its Allocable Share Release Amendment as preempted by the federal antitrust laws, expressly based on the same facts that were before the District Court in the *Freedom Holdings* case in New York The complaint challenges only the Allocable Share Amendment but purports to reserve the right to challenge the Kansas Qualifying Statute in its entirety. The plaintiff's motion for preliminary injunction and Kansas' motion to dismiss the complaint remain pending in the District Court. In the second case, *International Tobacco Partners Ltd. v. Kline*, the plaintiffs seek a declaratory judgment that the Allocable Share Release Amendment is preempted by federal antitrust laws and certain provisions of the U.S. Constitution and preliminary and permanent injunctions against the enforcement of the Allocable Share Release Amendment. Although the complaint asserts that the MSA and Kansas' Qualifying Statute are also preempted by federal antitrust laws and certain provisions of the U.S. Constitution, it does not specifically seek to enjoin the enforcement thereof.

The plaintiffs in Freedom Holdings filed a motion with the federal Judicial Panel on Multidistrict Litigation (the "**MDL Panel**") requesting that the Tennessee, Kentucky and Oklahoma cases described above, together with *Grand River*, be transferred to the Southern District of New York for coordinated and consolidated pretrial proceedings with *Freedom Holdings*. On June 16, 2005, the MDL Panel denied this motion. The MDL Panel's denial of this motion is not subject to appeal.

If there is an adverse ruling in one or more of the cases discussed above, it could have a material adverse effect on the amount of TSRs available to the Agency to make Turbo Redemptions and pay Principal of and interest on the Series 2006A Bonds and could result in the complete loss of a Bondholder's investment. For a description of the opinions of Bond Counsel addressing such matters, see "LEGAL CONSIDERATIONS − MSA Enforceability" and "LEGAL CONSIDERATIONS – Qualifying Statute Constitutionality" herein.

Litigation Seeking Monetary Relief from Tobacco Industry Participants

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and

by non-smokers alleging harm from environmental tobacco smoke ("**ETS**"), also known as "secondhand smoke." Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of September 30, 2005, there were 13 cases on appeal in which verdicts were returned against Philip Morris, including a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. On December 15, 2005, however, the Illinois Supreme Court reversed the judgment against Philip Morris and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the United States. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. It is possible that the plaintiffs will seek further appeals and/or rehearings. No assurance can be given that that such appeals and/or rehearings will not be granted or that they will not be decided in the plaintiffs' favor.

The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins, (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act.

The ultimate outcome of these and any other pending or future lawsuits is uncertain. Verdicts of substantial magnitude that are enforceable as to one or more PMs, if they occur, could encourage commencement of additional litigation, or could negatively affect perceptions of potential triers of fact with respect to the tobacco industry, possibly to the detriment of pending litigation. An unfavorable outcome or settlement or one or more adverse judgments could result in a decision by the affected PMs to substantially increase cigarette prices, thereby reducing cigarette consumption beyond what is forecast in the Cigarette Consumption Report. In addition, the financial condition of any or all of the PM defendants could be materially and adversely affected by the ultimate outcome of pending litigation, including bonding and litigation costs or a verdict or verdicts awarding substantial compensatory or punitive damages. Depending upon the magnitude of any such negative financial impact (and irrespective of whether the PM is thereby rendered insolvent), an adverse outcome in one or more of the lawsuits could substantially impair the affected PM's ability to make payments under the MSA and have a material adverse effect on the amount of TSRs available to the Agency to make Turbo Redemptions and pay Principal and interest on the Series 2006A Bonds. See "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY − Civil Litigation" and "LEGAL CONSIDERATIONS" herein.

Decline in Cigarette Consumption Materially Beyond Forecasted Levels May Adversely Affect Payments

Smoking Trends. As discussed in the Cigarette Consumption Report, cigarette consumption in the United States has declined since its peak in 1981 of 640 billion cigarettes to an estimated 393 billion cigarettes in 2004. Adult per capita cigarette consumption (total consumption divided by the number of people 18 years and older) has been declining since 1964. The Cigarette Consumption Report forecasts a continued decline in total cigarette consumption at an average annual rate of 1.78% to 188 billion cigarettes in 2045 under its Base Case Forecast (as defined herein), which represents a decline in per capita consumption at an average rate of 2.54% per year. These consumption declines are based on historical trends which may not be indicative of future trends, as well as other factors which may vary significantly from those assumed or forecasted by Global Insight.

According to the Cigarette Consumption Report, the pharmaceutical industry is seeking approval from the U.S. Food and Drug Administration (the "**FDA**") for two new smoking cessation products possibly more effective than those now in existence such as gum and patch nicotine replacement products, and other smoking cessation products such as NicoBloc or Zyban: Varenicline, a Pfizer product, is a smoking cessation pill containing a product that binds to brain nicotine receptors and is intended to satisfy nicotine cravings without being pleasurable or addictive, and Acomplia, a Sanofi-Synthelabo product, is mainly a weight reduction pill, but also contributes to smoking cessation. Two companies are also seeking FDA approval for vaccines to prevent and treat nicotine addiction. One of these companies, Cytos Biotechnology AG, announced on May 14, 2005 that it had successfully completed Phase II testing of a virus-based vaccine, which is genetically engineered to cause an immune system response from nicotine. The company now plans to begin Phase III trials. One NPM has also introduced a cigarette with reportedly little or no nicotine. Future FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels. Such new products or similar products, if successful, or such FDA regulation, if enacted, could have a material adverse effect on cigarette consumption.

A decline in the overall consumption of cigarettes beyond the levels forecasted in the Cigarette Consumption Report could have a material adverse effect on the payments by PMs under the MSA and the amounts of TSRs available to the Agency to make Turbo Redemptions and pay Principal of and interest on the Series 2006A Bonds.

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the FDA, amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. Philip Morris has indicated its strong support for this legislation. FDA regulation could also include regulation of nicotine content in cigarettes to non-addictive levels.

Cigarettes are also currently subject to substantial excise taxes in the United States. The federal excise tax per pack of 20 cigarettes is $0.39 as of November 2005. All states, the District of Columbia and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.46 per pack in Rhode Island. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City. According to the Cigarette Consumption Report, excise tax increases were enacted in 20 states and in New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) in 2005. The population-weighted average state excise tax as of December 21, 2005 was $0.913 per pack.

According to the Cigarette Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in nine states and a few large cities. California imposed comprehensive statewide smoking bans in 1998 and banned smoking in its prisons effective July 1, 2005. Delaware banned smoking in all indoor public areas in 2002. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Also in 2003, Connecticut, Maine, and Florida passed laws which ban smoking in restaurants and bars. Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. Since then Georgia, Massachusetts, Montana, Rhode Island, and Vermont have established similar bans. Voters in Washington State passed a ballot initiative on November 8, 2005 which will ban smoking in all public places effective January 2006. The restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. On December 7, 2005 Chicago passed a smoking ban which also applies within 15 feet of entrances to restaurants and other public places. It goes into effect in January 2006, with an exemption for bars until July 2008. The State of New Jersey and the District of Columbia have also been considering comprehensive bans. The American Nonsmokers' Rights Foundation documents clean indoor air ordinances by local governments throughout the U.S. As of October 4, 2005, there were 2,057 municipalities with indoor smoking restrictions.

The attorneys general of the Settling States recently obtained agreements from Philip Morris, Reynolds Tobacco and B&W that they will remove product advertisements from various magazines that are circulated in schools for educational purposes.

No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes. Excise tax increases and other legislative or regulatory measures could severely increase the cost of cigarettes, limit or prohibit the sale of cigarettes, make cigarettes less appealing to smokers or reduce the addictive qualities of cigarettes. As a result of these types of initiatives and other measures, the overall consumption of cigarettes nationwide may decrease materially more than forecasted in the Cigarette Consumption Report and thereby have a material adverse effect on the amounts available to pay Principal of and interest on the Series 2006A Bonds. See "CERTAIN INFORMATION RELATED TO THE TOBACCO INDUSTRY – Regulatory Issues" herein.

Other Potential Payment Decreases Under the Terms of the MSA

Adjustments to MSA Payments. The MSA provides that the amounts payable by the PMs are subject to numerous adjustments, offsets and recalculations, some of which are material. Such adjustments, offsets and recalculations, could reduce the TSRs available to the Agency below the respective amounts required to pay Principal of and interest on the Series 2006A Bonds. [The State has advised the Agency that both the Settling States and the PMs are disputing or have disputed the calculations of the Initial Payments for 2000, 2001, 2002 and 2003 and Annual Payments for 2000, 2001, 2002 and 2003.] No assurance can be given as to the magnitude of such recalculation, if any. Any recalculation could trigger the Offset for Miscalculated or Disputed Payments. For additional information regarding the MSA and the payment adjustments, see "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT" herein.

The assumptions used to project Revenues (the source of the payments on the Series 2006A Bonds) are based on the premise that certain adjustments will occur as set forth under "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. Actual adjustments could be materially different from what has been assumed and described herein.

Growth of NPM Market Share and Other Factors. The assumptions used to project Revenues and structure the Series 2006A Bonds contemplate declining consumption of cigarettes in the United States combined with a static relative market share of 6.2%* for the NPMs. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. Should the forecasted decline in consumption occur, but be accompanied by a material

* The aggregate market share of NPMs utilized in the Cash Flow Assumptions may differ materially from the market share information utilized by the MSA Auditor when calculating the NPM adjustments.

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

The Model Statute in its original form had required each NPM to make escrow deposits approximately in the amount that the NPM would have had to pay had it been a PM, but entitled the NPM to a release, from each Settling State in which the NPM had made an escrow deposit, of the amount by which the escrow deposit exceeds that Settling State's allocable share of the total payments that the NPM would have been required to make had it been a PM. At least 44 Settling States, including the State, have enacted, and other states are considering, legislation that amends this provision in their Model/Qualifying Statutes, by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain to the excess above the total payment that the NPM would have paid had it been a PM (so called "**Allocable Share Release Legislation**"). The National Association of Attorneys General ("**NAAG**") has endorsed these legislative efforts. A majority of the PMs, including all OPMs, have indicated their agreement in writing that in the event a Settling State enacts legislation substantially in the form of the Allocable Share Release Legislation, such Settling State's previously enacted Model Statute or Qualifying Statute will continue to constitute a Model Statute or Qualifying Statute within the meaning of the MSA. Following a challenge by NPMs, the United States District Court for the Southern District of New York in September 2004 enjoined New York from enforcing its Allocable Share Release Legislation. NPMs are also currently challenging Allocable Share Release Legislation in the State and in Arkansas, Kansas, Kentucky, Louisiana, Oklahoma and Tennessee. It is possible that NPMs will challenge such legislation in other states. See " – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein. To the extent either (i) that other states do not enact or enforce Allocable Share Release Legislation or (ii) that a state's Allocable Share Release Legislation is invalidated, NPMs could concentrate sales in such states to take advantage of the absence of Allocable Share Release Legislation by limiting the amount of its escrow payment obligations to only a fraction of the payment it would have been required to make had it been a PM. Because the price of cigarettes affects consumption, NPM cost advantage is one of the factors that has resulted and could continue to result in increases in market share for the NPMs.

A significant loss of market share by PMs to NPMs could have a material adverse effect on the payments by PMs under the MSA and the amounts of TSRs available to pay Principal of and interest on the Series 2006A Bonds. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" and "CIGARETTE CONSUMPTION REPORT" herein.

NPM Adjustment. The NPM Adjustment is based upon market share increases, measured by domestic sales of cigarettes by NPMs, and is designed to reduce the payments of the PMs under the MSA to compensate the PMs for losses in market share to NPMs during a calendar year as a result of the MSA. Three conditions must be met in order to trigger an NPM Adjustment for one or more Settling States: (1) the aggregate market share of the PMs in any year must fall more than 2% below the aggregate market share held by those same PMs in 1997, (2) a nationally recognized economic firm must determine that the disadvantages experienced as a result of the provisions of the MSA were a significant factor contributing to the market share loss for the year in question, and (3) the Settling States in question must be proven to not have diligently enforced their Model Statutes. The NPM Adjustment is applied to the subsequent year's Annual Payment and Strategic Contribution Payment due to those Settling States that have been proven to not diligently enforce their Model Statutes. The 1997 market share percentage for the PMs, less 2%, is defined in the MSA as the "**Base Aggregate Participating Manufacturer Market Share**". If the PMs' actual aggregate market share is between 0% and 16 ⅔% less than the Base Aggregate Participating Manufacturer Market Share, the amounts paid by the PMs would be decreased by three times the percentage decrease in the PMs' actual aggregate market share. If, however, the aggregate market share loss from the Base Aggregate Participating Manufacturer Market Share is greater than 16 ⅔%, the NPM Adjustment would be calculated as follows:

NPM Adjustment = 50% +
[50%/(Base Aggregate Participating Manufacturer Market Share – 16⅔%)]
x [market share loss – 16⅔%]

The Settling States and the PMs have selected The Brattle Group as the economic consultants that will be responsible for making the "significant factor" determination. Each of the three OPMs has also notified the Settling States by separate letter that, in connection with the market share loss for calendar year 2003, it intends to seek an NPM Adjustment should the economic consultants determine that the MSA was a significant factor contributing to the market share loss in 2003. The entire NPM Adjustment is to be applied against the subsequent year's payments due to only those Settling States that do not qualify for an exemption. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" herein.

The State has indicated that the 2005 Annual Payments by the OPMs were made without the diversion of any portion thereof into the Disputed Payments Account for the Settling States. According to the State, however, eleven SPMs did pay approximately $84 million of their 2005 Annual Payments into the Disputed Payments Account for the Settling States as a result of alleged disputes, including disputes related to NPM Adjustments. Of this $84 million, approximately $43 million has now been released to the Settling States. It is not known, however, to what extent such release of money represents final settlement of disputes. The States of Kentucky, Montana and Vermont have also indicated that they expect OPMs, alleging disputes related to the NPM Adjustment, to divert a portion of their future MSA payments into the Disputed Payments Account. Those three states, reporting that the PMs experienced a decline in market share of 6.2% in 2003, assumed an NPM Adjustment of 18.6% in projecting their fiscal 2006 and 2007 MSA payments for budgetary purposes. The State Attorney General has received no indication from the PMs whether or not they currently plan to pay or not pay future Annual Payments into the Disputed Payments Account or whether or not they expect to withhold payment. A Bondholder should assume that any PM alleging, in any given year, that (1) the aggregate market share of the PMs in such year fell more than 2% below its aggregate market in 1997, (2) disadvantages experienced as a result of the provisions of the MSA were significant factors contributing to such market share loss and (3) one or more of the Settling States did not diligently enforce the Qualifying Statute will claim the NPM Adjustment for such year and either make an appropriate deposit into the Disputed Payments Account or withhold payment. In connection with settlement of NPM Adjustment claims for the years 1999 through 2002, the OPMs and the Settling States agreed prospectively that OPMs claiming an NPM Adjustment for any year will not make such a Disputed Payments Account deposit or withholding unless and until the selected economic consultants, The Brattle Group, determine that the provisions of the MSA were significant factors contributing to the market share loss giving rise to the alleged NPM Adjustment. (The SPMs have not agreed to await such a determination.) Therefore, a Bondholder should assume that if the selected economic consultants make such a "significant factor" determination regarding a year for which one or more OPMs have claimed an NPM Adjustment, such OPMs will either make an appropriate deposit into the Disputed Payments Account or withhold payment reflecting the claimed NPM Adjustment.

In general, any Settling State that adopts, maintains and diligently enforces its Qualifying Statute is exempt from the NPM Adjustment. The State has adopted the Model Statute (which is a Qualifying Statute under the MSA). No provision of the MSA attempts to define what activities, if undertaken by a Settling State, would constitute diligent enforcement. Furthermore, it may be unclear which party bears the burden of proving or disproving whether a State has diligently enforced its Qualifying Statute. With regard to the question of whether any diligent enforcement dispute would be resolved in state courts or through arbitration, one New York state court has ruled that arbitration is not the proper forum for resolution of a diligent enforcement dispute. See *The State of New York v. Philip Morris Incorporated*. On August 3, 2005, however, a Connecticut state court ruled that issues relating to the calculation of an NPM Adjustment and whether a Settling State has diligently enforced its Qualifying Statute are subject to arbitration pursuant to the terms of the MSA. See *State of Connecticut v. Philip Morris, Inc*. The case involves a claim by certain SPMs that the MSA Auditor, selected by the parties to the MSA to determine payments under the MSA, miscalculated their annual payments for 2003 by refusing to reduce the amounts by applying the NPM Adjustment. In the decision, the court held that a challenge to the MSA Auditor's determination that the MSA forbids the application of the NPM Adjustment to payments owed by PMs for any year in which all Settling States had Qualifying Statutes in full force and effect is subject to arbitration. The MSA provides that the arbitration shall be governed by the United States Federal Arbitration Act. The decision of an arbitration panel under the Federal Arbitration Act may only be overturned under limited circumstances, including a showing of a manifest disregard of the law by the panel. The court's determination is contrary to the determination by the New

York State court that concluded that such issues were not subject to arbitration under the MSA. The Connecticut court's decision is subject to appeal by the State of Connecticut. In January 2002, for example, B&W disputed the recalculation of the Annual Payments due in 2000 and 2001, claiming that the MSA Auditor relied upon inappropriate data in calculating B&W's market share and that a larger NPM Adjustment should have been applied to the 2001 payment because a majority of the Settling States were not diligently enforcing their Qualifying Statutes in 2000. Although this dispute was resolved in April 2002, other disputes regarding the diligent enforcement of Qualifying Statutes by the Settling States may be expected in the future if the market share of the NPMs increases and results in a correspondingly large NPM Adjustment that, absent the protection of the Qualifying Statutes, could apply.

In February 2002, B&W sent a letter addressed to the Settling States requesting information relating to the enforcement of their applicable Qualifying Statute. In November 2003, six SPMs sent a letter to NAAG and the Attorneys General of the Settling States, which is intended to provide notice that such SPMs may initiate litigation or arbitration proceedings relating to the MSA. The MSA requires a party to provide at least 30 days' prior written notice to the other parties before initiating a proceeding to enforce the MSA or alleging breaches of the MSA. Among other things, such SPMs alleged that the NPM Adjustment is not working as designed to ensure that SPMs are not penalized by becoming signatories to the MSA. They also alleged that the Market Share Loss recorded by the MSA Auditor is significantly smaller than the Market Share Loss that actually exists and that the Model Statute has not been diligently enforced or that in states where it is diligently enforced, does not contain efficient and effective enforcement mechanisms. The SPMs specifically request in their letter to continue to discuss possible resolution of these issues with the other parties to the MSA. The letter does not specify what type of relief would be sought in any litigation or arbitration proceedings. In March, 2005, Philip Morris filed a Freedom of Information Act request with the State seeking information pertaining to the State's efforts to identify NPMs and to enforce its Qualifying Statute. The State believes that nearly identical requests were sent to substantially all of the other Settling States.

In addition, 44 Settling States, including the State, have passed, and various states are considering, legislation (often termed "Complementary Legislation") to further ensure that NPMs are making required escrow payments under the Qualifying Statutes. Under the State's Complementary Legislation, every tobacco product manufacturer whose cigarettes are sold, directly or indirectly, in the State is required to certify annually that it is either a PM or, if an NPM, that it is in full compliance with the State's Qualifying Statute. The Attorney General is required to maintain a directory listing all tobacco product manufacturers that have filed current and accurate certifications. No person may sell, offer or possess for sale in the State cigarettes of a tobacco product manufacturer not included in the then current directory. Any cigarettes that have been sold, offered for sale or possessed in the State in violation of the State's Complementary Legislation shall be deemed contraband and subject to confiscation and forfeiture. The State's Qualifying Statute and Complementary Legislation, along with similar legislation in thirty other states, have been challenged in New York State by a group of NPMs on various constitutional grounds, including claims based on preemption by the federal antitrust laws. See "− Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

All of the OPMs and other PMs have provided written assurances that the Settling States have no duty to enact Complementary Legislation, that the failure to enact such a legislation will not be used in determining whether a State has diligently enforced its Qualifying Statute pursuant to the terms of the MSA, and, that the diligent enforcement obligations under the MSA shall not apply to the Complementary Legislation. In addition, the written assurances contain an agreement that the Complementary Legislation shall not constitute an amendment to a Settling State's Qualifying Statute. However, a determination that a state's Complementary Legislation is invalid may make enforcement of its Qualifying Statute more difficult, which could lead to an increase in the market share of NPMs, resulting in a reduction of Annual Payments under the MSA. The State's Complementary Legislation has been challenged in a federal district court in New York by certain NPMs on constitutional grounds (including allegations that the Complementary Legislation is preempted by federal antitrust laws). See "− Litigation Challenging the MSA, Qualifying Statutes and Related Legislation − *Grand River, Freedom Holdings and Related Cases*" herein. In the view of the Office of the Attorney General of the State, the State has been and is diligently enforcing its Qualifying Statute. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – MSA Provisions Related to Model/Qualifying Statutes" and "THE INDENTURE – Non-Impairment Covenant" herein.

Should a PM be entitled to an NPM Adjustment in future years due to non-diligent enforcement of the Qualifying Statute by the State, the NPM Adjustment could materially reduce the flow of TSRs and have a material adverse effect on the amounts available to make Turbo Redemptions and pay Principal of and interest on the Series 2006A Bonds. See "Disputed or Recalculated Payments" below. The structuring assumptions for the Series 2006A Bonds do not include any NPM Adjustments. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

Disputed or Recalculated Payments and Disputes under the Terms of the MSA. Miscalculations or recalculations by the MSA Auditor or disputed calculations by any of the parties to the MSA, such as those described above under "NPM Adjustment", have resulted and could in the future result in offsets to, or delays in disbursements of, payments to the Settling States pending resolution of the disputed item in accordance with the provisions of the MSA. By way of example, on August 30, 2004, one of the SPMs announced that it had notified the Attorneys General of 46 states that it intends to initiate proceedings against the Attorneys General for violating the terms of the MSA. It alleges that the Attorneys General violated its rights and the MSA by extending unauthorized favorable financial terms to Miami-based Vibo Corporation d/b/a General Tobacco when, on August 19, 2004, the Attorneys General entered into an agreement with General Tobacco allowing it to become an SPM. General Tobacco imports discount cigarettes manufactured in Colombia, South America. In the notice sent to the Attorneys General, the SPM indicated that it will seek to enforce the terms of the MSA, void the General Tobacco Agreement and enjoin the Settling States and NAAG from listing General Tobacco as a PM on their websites. Based on these arguments, Liggett Group, Inc., Commonwealth Brands and other SPMs announced in August 2005 that they had filed suit against Kentucky seeking among other things, to void the General Tobacco Agreement or to provide the plaintiffs with similar treatment. Commonwealth Brands filed similar lawsuits in 2004 against Virginia, New York, Connecticut, New Mexico and Arkansas.

Disputes concerning payments and their calculations may be raised up to four years after the respective Payment Due Date (as defined in the MSA). The resolution of disputed payments may result in the application of an offset against subsequent Annual Payments or Strategic Contribution Payments. Both the diversion of disputed payments to the Disputed Payments Account and the application of offsets against future payments could materially impair the flow of TSRs available to the Agency to make Turbo Redemptions and pay Principal and interest on the Series 2006A Bonds. The structuring assumptions for the Series 2006A Bonds do not factor in an offset for miscalculated or disputed payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Offset for Miscalculated or Disputed Payments*" herein.

On June 3, 2005, the State filed an application in San Diego County Superior Court for an enforcement order against Bekenton USA, Inc. ("**Bekenton**"), to compel Bekenton to comply with its full payment obligations under the MSA. On June 29, 2005, Bekenton filed a motion to file a suit against the, alleging that the State breached the Most Favored Nation ("**MFN**") provisions of the MSA by allowing three other SPMs (Farmer's Tobacco Co., General Tobacco, and Premier Manufacturing Incorporated) to join the MSA under more favorable terms. In a tentative ruling dated November 1, 2005, the Superior Court granted Bekenton's motion to file suit based on this allegation. In its initial complaint, Bekenton had further alleged that (a) the State's agreements with Farmer's Tobacco, General Tobacco and Premier (the "**Three Agreements**"), which required them to make certain back payments (as required by the MSA) as a precondition to joining the MSA, permitted such back payments to be made on an extended time frame and (b) this time frame effectively "relieved" Farmer's Tobacco, General Tobacco and Premier of certain payment obligations as PMs. Bekenton claimed that it was entitled to a similar relief under another clause of the MFN (the "**Relief Clause**"), which requires that if any PM is relieved of a payment obligation, such relief becomes applicable to all of the PMs. In the November 1, 2005, tentative ruling, the Superior Court denied Bekenton's motion to file suit under the Relief Clause, ruling that (1) because the Three Agreements were preconditions to allowing Farmer's Tobacco, General Tobacco and Premier to become PMs, these companies were not "PMs" for purposes of the Relief Clause and (2) even if Farmer's Tobacco, General Tobacco and Premier are PMs for purposes of the Relief Clause, the payment schedules in the Three Agreements did not relieve them of any obligations. A final determination that the State entered into the Three Agreements in breach of the MFN could result in a reduction in the amount of TSRs owed by the PMs to the State.

Bekenton is involved in a similar dispute in Iowa. In that case, the State of Iowa sought to de-list Bekenton as a PM for failing to comply with the MSA payment provisions and to prohibit Bekenton from doing business in Iowa for failing to comply with the escrow payment provisions of the Iowa Qualifying Statute. On August 11, 2005

an Iowa state court, finding that the MSA itself provides procedures for the resolution of disputes regarding MSA payments and that such procedures should be followed in this case, enjoined Iowa from "de-listing" Bekenton, permitting Bekenton to continue selling cigarettes in Iowa.

"Nicotine-Free" Cigarettes. The MSA contemplates that the manufacturers of cigarettes will be either a PM or an NPM. The term "cigarette" is defined in the MSA to mean any product that contains tobacco and nicotine, is intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette and includes "roll-your-own" tobacco. Should a manufacturer develop a "nicotine-free" tobacco product (intended to be burned and is likely to be offered to, or purchased by, consumers as a cigarette), such manufacturer would not be a manufacturer for purposes of the MSA. Sales of such a product could cause a reduction in Annual Payments and Strategic Contribution Payments. In addition, if consumers used the product to quit smoking, it could reduce the size of the market. The capital costs required to establish a profitable cigarette manufacturing facility are relatively low and new cigarette manufacturers are less likely to be subject to frequent litigation than OPMs. Furthermore, the Qualifying Statutes would not cover a manufacturer of such "nicotine-free" products and such manufacturer would not be required to make escrow deposits in the same manner as the NPMs are so required. Vector Group has introduced QUEST, a tobacco product that is reportedly nicotine-free. One OPM has also introduced a similar product that reportedly contains little or no nicotine.

Potential Payment Adjustments for Population Changes Under the MOU and the ARIMOU

The MOU provides that the amounts of TSRs payable are subject to adjustments for population changes. The amount of the TSRs distributed to Participating Jurisdictions, including the County, pursuant to the MOU and the ARIMOU is allocated on a per capita basis, calculated using the then most current official United States Decennial Census figures, which are currently updated every ten years. Based on the 2000 Census, 28.1041478% of the residents of the State resided in the County. Pursuant to the MOU and the ARIMOU, the County is therefore entitled to an equivalent percentage of the TSRs allocable to the Participating Jurisdictions (after payments to cities that are Participating Jurisdictions). There can be no assurance that future United States Census reports will not conclude that the County represents a smaller relative percentage of the overall population of the State than in 2000, or that the TSRs payable to the County will not decline. Subsequent adjustments are expected to occur at subsequent ten-year intervals following each Census, and there can be no assurance that the percentage of TSRs payable to the County will not materially decline following such adjustments. In addition, there can be no assurance that the frequency of such Census reports will not change, or that the methodology utilized by the United States in performing the Census will not change, or that any such change in methodology would not result in a determination that the County represents a smaller relative percentage of the overall State population than reported in any prior Census.

Based upon the California Department of Finance (the "**Department of Finance**") population forecasts made in ____ and updated through ____ in ____, the County's share of total State population will be ___% in 2010, ___% in 2020, ___% in 2030 and ___% in 2040. County population will inevitably vary from the projections and forecasts in the Department of Finance population forecasts, and that the variations may be material and adverse. See "THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS" herein.

Other Risks Relating to the MSA and Related Statutes

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

Amendments, Waivers and Termination. As a settlement agreement between the PMs and the Settling States, the MSA is subject to amendment in accordance with its terms, and may be terminated upon consent of the parties thereto. Parties to the MSA, including the State, may waive the performance provisions of the MSA. The Agency is not a party to the MSA; accordingly, neither the Agency nor the Corporation has the right to challenge any such amendment, waiver or termination. While the economic interests of the State and the Bondholders are expected to be the same in many circumstances, no assurance can be given that such an amendment, waiver or

termination of the MSA would not have a material adverse effect on the Agency's ability to make payments to the Bondholders. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Amendments and Waivers" herein.

Reliance on State Enforcement of the MSA and State Impairment. The State may not convey and has not conveyed to the County, the Corporation, the Agency or the Bondholders any right to enforce the terms of the MSA. Pursuant to its terms, the MSA, as it relates to the State, can only be enforced by the State. Although the State is entitled under the MOU to 50% of the State's allocable share of each Annual Payment and Strategic Contribution Payment under the MSA, no assurance can be given that the State will enforce any particular provision of the MSA. Failure to do so may have a material adverse effect on the Bondholders. It is possible that the State could attempt to claim some or all of the TSRs for itself or otherwise interfere with the security for the Series 2006A Bonds. In that event, the Bondholders, the Indenture Trustee, the Agency, the Corporation or the County may assert claims based on contractual, fiduciary or constitutional rights, but no prediction can be made as to the disposition of such claims. See "LEGAL CONSIDERATIONS" herein.

Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of TSRs

The only source of payment for the Series 2006A Bonds (other than amounts in the Debt Service Reserve Account, with respect to the Series 2006A Bonds, and interest earnings) is the TSRs that are paid by the PMs. Therefore, if one or more PMs were to become a debtor in a case under Title 11 of the United States Code (the "**Bankruptcy Code**"), there could be delays in or reductions or elimination of payments on the Series 2006A Bonds, and Bondholders could incur losses on their investments. Philip Morris, by way of example, prior to the resolution of the dispute in the *Price* case in Illinois in the spring of 2003 over the size of the required appeal bond, had publicly stated that it would not have been possible for it to post the $12 billion bond initially ordered by the trial judge. Philip Morris also publicly stated at that time that there was a risk that immediate enforcement of the judgment would force a bankruptcy. In addition, on May 13, 2003, Alliance Tobacco Corporation, one of the SPMs, filed for bankruptcy in the Western District of Kentucky and, in September 2004, its plan of reorganization was confirmed. As part of the confirmed plan, Alliance Tobacco Corporation effectively ceased its operations in September 2004. Bekenton has filed for bankruptcy relief.

In the event of the bankruptcy of a PM, unless approval of the bankruptcy court is obtained, the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the County, the Agency, the Corporation, the Indenture Trustee, the Bondholders, or the beneficial owners of the Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of TSRs. If the MSA is determined in a bankruptcy case to be an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it. Furthermore, payments previously made to the Bondholders or the beneficial owners of the Series 2006A Bonds could be avoided as preferential payments, so that the Bondholders and the beneficial owners of the Series 2006A Bonds would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection of the State, the County, the Agency, the Corporation, the Indenture Trustee, the Bondholders, or the beneficial owners of the Series 2006A Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions or elimination of payments to the Bondholders or the beneficial owners of the Series 2006A Bonds. For a further discussion of certain bankruptcy issues, see "LEGAL CONSIDERATIONS" herein.

Recharacterization of Transfer of Sold County Tobacco Assets Could Void Transfer; Bankruptcy of the County

As a matter of California law, the County does not have the authority to borrow money secured by the Sold County Tobacco Assets. Thus, if the transfer from the County to the Corporation is not a sale of the Sold County Tobacco Assets, but is instead a borrowing by the County secured by the Sold County Tobacco Assets, the transfer of the Sold County Tobacco Assets to the Corporation may be void. The County and the Corporation, at the time of

the execution of the Sale Agreement, intended and structured the transfer of the Sold County Tobacco Assets to the Corporation as an absolute sale and not as the grant of a security interest in the Sold County Tobacco Assets to secure a borrowing of the County. Nonetheless, no assurance can be given that a court would not find that the transfer of the Sold County Tobacco Assets to the Corporation is a secured borrowing. Because neither the Corporation nor the Agency has any other funds with which to make payments on the Series 2006A Bonds, if there were such a finding, the Bondholders could suffer a loss of their entire investment.

Because the County is a governmental entity, it cannot be the subject of any involuntary bankruptcy case under the Bankruptcy Code. It can become a debtor only in a voluntary case.

The County and the Corporation, at the time of the execution of the Sale Agreement, intended and structured the transfer of the Sold County Tobacco Assets to the Corporation as an absolute sale and not as the grant of a security interest in the Sold County Tobacco Assets to secure a borrowing of the County. If the County were to become a debtor in a bankruptcy case, and a party in interest (including the County itself) were to take the position that the transfer of the Sold County Tobacco Assets to the Corporation should be recharacterized as a grant of a security interest in the Sold County Tobacco Assets, then delays or reductions or elimination of payments on the Series 2006A Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Series 2006A Bonds could result. Losses suffered by Bondholders could be even more severe because, under California state law, the County does not have the authority to borrow money secured by the Sold County Tobacco Assets, and thus, if the transfer from the County to the Corporation is recharacterized as a borrowing, the transfer of the Sold County Tobacco Assets to the Corporation may be void. Because neither the Corporation nor the Agency has any other funds with which to make payments on the Series 2006A Bonds, the Bondholders could suffer a loss of their entire investment in such circumstances.

The County, the Corporation, and the Agency have taken steps to minimize the risk that in the event the County were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the Corporation or the Agency be substantively consolidated with those of the County. The Corporation is a separate, special purpose not-for-profit corporation, the organizational documents of which provide that it shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors, although this restriction may not be enforceable. The Agency is a separate, special purpose joint powers authority, the organizational documents of which provide that it shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors, although this restriction may not be enforceable. If a party in interest (including the County itself) were to take the position that the assets and liabilities of the Corporation or the Agency should be substantively consolidated with those of the County delays in payments on the Series 2006A Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Series 2006A Bonds could result.

Actions could be taken in a bankruptcy of the County which would adversely affect the exclusion of interest on the Series 2006A Bonds from gross income for federal income tax purposes. There may be other possible effects of the bankruptcy of the County that could result in delays or reductions or elimination of payments on the Series 2006A Bonds.

Regardless of any specific adverse determinations in a County bankruptcy proceeding, the fact of a County bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2006A Bonds. For a further discussion of certain bankruptcy issues and a description of certain legal opinions to be delivered by Bond Counsel with respect to County bankruptcy matters, see "LEGAL CONSIDERATIONS" herein.

Uncertainty as to Timing of Turbo Redemption

No assurance can be given as to the timing of redemption of the Series 2006A Bonds. No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2006A Bonds will be as assumed, or that the other assumptions underlying the Series 2006A Bond Structuring Assumptions (as defined herein), including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Series 2006A Bond Structuring Assumptions, the amount of Revenues available to make Turbo Redemption Payments will be affected and the resulting weighted average lives of the Series 2006A Bonds will vary. Any reinvestment risks from faster amortization or extension risks from slower amortization of the Series 2006A Bonds than anticipated

will be borne entirely by the Holders of the Series 2006A Bonds. See "SUMMARY OF BOND STRUCTURING ASSUMPTIONS" herein. In addition, future increases in the rate of inflation above 3% per annum in the absence of other factors would materially shorten the life of the Series 2006A Bonds. No assurance can be given that these structuring assumptions, upon which the projections of the Series 2006A Bonds Turbo Redemptions are based, will be realized.

The ratings of the Series 2006A Bonds address the payment of interest on the Series 2006A Bonds when due and payment of Principal of the Series 2006A Bonds by their respective maturity. Owners of the Series 2006A Bonds bear the reinvestment risk from faster than expected amortization, as well as the extension risk from slower than expected amortization of the Series 2006A Bonds.

Limited Obligations of the Agency

The Series 2006A Bonds are limited obligations of the Agency, payable from and secured solely by Revenues and the other collateral pledged under the Indenture. The Bondholders have no recourse to other assets of the Agency, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Agency. The Series 2006A Bonds do not constitute a charge against the general credit of the Agency or any of its Members, including the County, and under no circumstances shall the Agency or any Member, including the County, be obligated to pay the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds, except from the Collateral pledged therefor under the Indenture. Neither the credit of the State, nor any public agency of the State (other than the Agency), nor any Member of the Agency, including the County, is pledged to the payment of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds. The Series 2006A Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Agency) or any Member of the Agency, including the County. The County is under no obligation to make payments of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds in the event that Revenues are insufficient for the payment thereof.

Limited Remedies

The Indenture Trustee is limited under the terms of the Loan Agreement and the Sale Agreement to enforcing the terms of such agreements and to receiving the Revenues and applying them in accordance with the Indenture. The Indenture Trustee cannot sell its rights under the Loan Agreement and the Sale Agreement. The County, the Corporation and the Agency have not made any representation or warranty that the MSA is enforceable. The MOU provides by its terms that the distribution of tobacco-related recoveries is not subject to alteration by legislative, judicial or executive action at any level and the County has made representations as to the enforceability of the MOU and the ARIMOU. However, such agreements cannot be enforced directly by the Corporation or the Agency and the County has agreed to use best reasonable efforts to enforce the MOU and the ARIMOU. Remedies under the Loan Agreement and the Sale Agreement do not include the repurchase by the County of the Sold County Tobacco Assets under any circumstances, including unenforceability of the MSA or breach of any representation or warranty. There is no direct right of enforcement by anyone other than the State against the PMs as obligors to make the TSR payments needed to make payments with respect to the Series 2006A Bonds.

Limited Liquidity of the Series 2006A Bonds; Price Volatility

There is currently a limited secondary market for securities such as the Series 2006A Bonds. Underwriters are under no obligation to make a secondary market. There can be no assurance that a secondary market for the Series 2006A Bonds will develop, or if a secondary market does develop, that it will provide Bondholders with liquidity or that it will continue for the life of the Series 2006A Bonds. Tobacco settlement securitization bonds generally have also exhibited greater price volatility than traditional municipal bonds. Any purchaser of the Series 2006A Bonds must be prepared to hold such securities for an indefinite period of time or until final redemption of such securities.

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

Any rating assigned to the Series 2006A Bonds by a Rating Agency will reflect such Rating Agency's assessment of the likelihood of the payment of principal or Accreted Value, interest when due on the Series 2006A

Bonds. Any such rating will not address the likelihood that the Turbo Redemptions will be made by any certain date. The ratings of the Series 2006A Bonds will not be a recommendation to purchase, hold or sell such Bonds and such ratings will not address the marketability of such Bonds, any market price or suitability for a particular investor. There is no assurance that any rating will remain for any given period of time or that any rating will not be lowered, suspended or withdrawn entirely by a Rating Agency if, in such Rating Agency's judgment, circumstances so warrant based on factors prevailing at the time. Any such reduction, suspension or withdrawal of a rating, if it were to occur, could adversely affect the availability of a market for, or the market price of, the Series 2006A Bonds.

LEGAL CONSIDERATIONS

The following discussion summarizes some, but not all, of the possible legal issues that could affect the Series 2006A Bonds. The discussion does not address every possible legal challenge that could result in a decision that would cause TSRs to be reduced or eliminated. References in the discussion to various opinions are incomplete summaries of such opinions and are qualified in their entirety by reference to the actual opinions.

Bankruptcy of a PM

Because the only significant source of payment for the Series 2006A Bonds is the TSRs paid by the PMs, if one or more PMs were to become a debtor in a case under the Bankruptcy Code, there could be delays or reductions in or elimination of payments on the Series 2006A Bonds. See "RISK FACTORS – Bankruptcy of a PM May Delay, Reduce, or Eliminate Payments of TSRs" herein.

In the event of bankruptcy of a PM (unless approval of the bankruptcy court was obtained), the automatic stay provisions of the Bankruptcy Code could prevent any action by the State, the Agency, the Corporation, the County, the Indenture Trustee, the Holders or the Beneficial Owners of the 2006 Bonds to collect any TSRs or any other amounts owing by the bankrupt PM. In addition, even if the bankrupt PM wanted to continue paying TSRs, it could be prohibited as a matter of law from making such payments. In particular, if it were to be determined that the MSA was not an "executory contract" under the Bankruptcy Code, then the PM may be unable to make further payments of TSRs. Bond Counsel will render an opinion that, subject to all the assumptions, qualifications, and limitations set forth therein, if a PM became the debtor in a case under the Bankruptcy Code, and the matter were properly briefed and presented to a federal court exercising jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that the MSA is an "executory contract" under Section 365 of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a particular court would not hold that the MSA is not an executory contract, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006A Bonds.

If the MSA is an "executory contract" under the Bankruptcy Code, the bankrupt PM may be able to repudiate the MSA and stop making payments under it, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006A Bonds.

Furthermore, payments previously made to the Holders or the Beneficial Owners of the Series 2006A Bonds could be avoided as preferential payments, so that the Holders and the Beneficial Owners would be required to return such payments to the bankrupt PM. Also, the bankrupt PM may have the power to alter the terms of its payment obligations under the MSA without the consent, and even over the objection, of the State, the Agency, the Corporation, the County, the Indenture Trustee and the Holders and Beneficial Owners of the Series 2006A Bonds. Finally, while there are provisions of the MSA that purport to deal with the situation when a PM goes into bankruptcy, such provisions may be unenforceable. There may be other possible effects of a bankruptcy of a PM that could result in delays or reductions in, or elimination of, payments on the Series 2006A Bonds.

Recharacterization of Transfer of Sold County Tobacco Assets Could Void Transfer

As a matter of State law, the County does not have the authority to borrow money secured by the Sold County Tobacco Assets. Thus, if the transfer from the County to the Corporation is not a sale of the Sold County Tobacco Assets, but is instead a borrowing by the County secured by the Sold County Tobacco Assets, the transfer of the Sold County Tobacco Assets to the Corporation may be void. The County and the Corporation have taken steps to structure the transfer of the Sold County Tobacco Assets to the Corporation as an absolute sale and not as the grant of a security interest in the Sold County Tobacco Assets to secure to secure a borrowing by the County. Nonetheless, no assurance can be given that a court would not find that the transfer of the Sold County Tobacco Assets to the Corporation is a secured borrowing. Because neither the Corporation nor the Agency has any other funds with which to make payments on the Series 2006A Bonds, if there were such a finding, the Bondholders and the Beneficial Owners could suffer a loss of their entire investment.

Bankruptcy of the County

Because the County is a governmental entity, it cannot be the subject of an involuntary bankruptcy case under the Bankruptcy Code. The County can become a debtor only in a voluntary case.

The County and the Corporation, pursuant to the Sale Agreement, intend and structured the transfer of the Sold County Tobacco Assets to the Corporation as an absolute sale and not as the grant of a security interest in the Sold County Tobacco Assets to secure a borrowing of the County. If the County were to become a debtor in a bankruptcy case, and a party in interest (including the County itself) were to take the position that the transfer of the Sold County Tobacco Assets to the Corporation should be recharacterized as the grant of a security interest in the Sold County Tobacco Assets, delays in payments on the Series 2006A Bonds could result. If a court were to adopt such position, then delays or reductions or elimination of payments on the Series 2006A Bonds could result. Losses suffered by Bondholders could be even more severe because, under California law, the County does not have the authority to borrow money secured by the Sold County Tobacco Assets, and thus, if the transfer from the County to the Corporation is recharacterized as a borrowing, the transfer of the Sold County Tobacco Assets to the Corporation may be void. Because neither the Corporation nor the Agency has any other funds with which to make payments on the Series 2006A Bonds, the Bondholders could suffer a loss of their entire investment in such circumstances. See "LEGAL CONSIDERATIONS – Recharacterization of Transfer of Sold County Tobacco Assets Could Void Transfer" herein.

Bond Counsel will render an opinion to the Rating Agencies that, subject to all the assumptions, qualifications, and limitations set forth therein, if the County became the debtor in a case under the Bankruptcy Code, and the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would hold that a transfer by the County to the Corporation, in the form and manner set forth in the Sale Agreement, of the right to be paid the Sold County Tobacco Assets would constitute an absolute sale of the right to be paid the Sold County Tobacco Assets, rather than a borrowing by the County secured by the right to be paid the Sold County Tobacco Assets, so that the right to be paid the Sold County Tobacco Assets would not be property of the estate of the County under Section 902(1) of the Bankruptcy Code. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that a court would not hold that the transfer to the Corporation of the right to be paid the Sold County Tobacco Assets should be recharacterized as the grant of a security interest in the right to be paid the Sold County Tobacco Assets, thus resulting in delays or reductions in, or elimination of, payments on the Series 2006A Bonds.

The County, the Corporation, and the Agency have taken steps to minimize the risk that in the event the County were to become the debtor in a bankruptcy case, a court would order that the assets and liabilities of the Corporation or the Agency be substantively consolidated with those of the County. The Corporation is a separate, special purpose nonprofit public benefit corporation, the organizational documents of which provide that it shall not commence a voluntary bankruptcy case without the unanimous affirmative vote of all of its directors, although this

restriction may not be enforceable. The Agency is a separate, special purpose joint powers authority. See "THE AGENCY" herein.

Bond Counsel will render an opinion to the Rating Agencies that, subject to all the assumptions, qualifications, and limitations set forth therein, should the County become the debtor in a case under the Bankruptcy Code, and if the matter were properly briefed and presented to a federal court with jurisdiction over such bankruptcy case, the court, exercising reasonable judgment after full consideration of all relevant factors, would not order, over the objection of the parties to the transaction documents, the substantive consolidation of the assets and liabilities of the Corporation or the Agency with those of the County. Certain of the assumptions contained in this opinion will be assumptions that certain facts or circumstances will exist or occur, and Bond Counsel can provide no assurance that such facts or circumstances will exist or occur as assumed in the opinion. This opinion will be based on an analysis of existing laws and court decisions, and will cover certain matters not directly addressed by such authorities. There are no court decisions directly on point, there are court decisions that could be viewed as contrary to the conclusions expressed in the opinion, and the matter is not free from doubt. Accordingly, no assurance can be given that if the County were to become a debtor in a bankruptcy case, a court would not order that the assets and liabilities of the Corporation or the Agency be consolidated with those of the County, thus resulting in delays or reductions in payments on the Series 2006A Bonds.

Actions could be taken in a bankruptcy of the County which would adversely affect the exclusion of interest on the Series 2006A Bonds from gross income for federal income tax purposes. There may be other possible effects of a bankruptcy of the County that could result in delays or reductions in payments on the Series 2006A Bonds.

Regardless of any specific adverse determinations in a County bankruptcy proceeding, the fact of a County bankruptcy proceeding could have an adverse effect on the liquidity and value of the Series 2006A Bonds.

MSA Enforceability

Most of the major provisions of the MSA are not severable. If a court materially modifies, renders unenforceable or finds unlawful any nonseverable provision, the attorneys general of the Settling States and the OPMs are required by the MSA to attempt to negotiate substitute terms. However, if any OPM does not agree to the substitute terms, the MSA would terminate in all Settling States affected by the court's ruling. Even if substitute terms are agreed upon, payments under such terms may be less than payments under the MSA and could reduce the amount available to the Corporation to pay Principal of and interest on the Series 2006A Bonds.

Certain cigarette manufacturers, cigarette importers, cigarette distributors, Native American tribes and smokers' rights organizations have filed actions against some, and in certain cases all, of the signatories to the MSA alleging, among other things, that the MSA violates provisions of the United States Constitution, federal antitrust laws, federal civil rights laws, state constitutions, state consumer protection laws and unfair competition laws, which actions, if ultimately successful, could result in a determination that the MSA is void or unenforceable. The lawsuits seek, among other things, an injunction against one or more of the Settling States from collecting any moneys under the MSA and barring the PMs from collecting cigarette price increases related to the MSA or a determination that the MSA is void or unenforceable. To date, such challenges have not been ultimately successful, although two cases have survived pre-trial motions and have proceeded to a stage of litigation where the ultimate outcome may be determined in part by findings of fact based on extrinsic evidence as to the operation and impact of the MSA and appeals are pending or still possible in certain other cases. The terms of the MSA are currently being challenged and may continue to be challenged in the future. A determination by a court that a nonseverable provision of the MSA is void or voidable would, in the absence of an agreement to a substitute term as described above, result in the termination of the MSA in any Settling States affected by the court's ruling. Accordingly, in the event of an adverse court ruling, Bondholders could incur a complete loss of their investment. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinion described below, Bond Counsel considered the claims asserted in the above-referenced lawsuits (see "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein), which it believes are representative of the legal theories that an opponent of the MSA would advance in an attempt to invalidate the MSA. On the Closing Date, Bond Counsel will render an opinion, subject to all the facts, assumptions and qualifications set forth therein, that, although there can be no assurance that a court

applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the MSA to be a valid, binding and enforceable agreement among the signatories thereto. This opinion as to the enforceability of the MSA and the obligations of the aforementioned signatories is also subject to the effect of bankruptcy, insolvency, and other laws affecting creditors' rights or remedies and general principles of equity, regardless of whether such enforceability is considered in a proceeding in equity or at law.

Qualifying Statute Constitutionality

The Qualifying Statutes and related legislation, like the MSA, have also been the subject of litigation in cases alleging that the Qualifying Statutes and related legislation violate certain provisions of the federal and state constitutions or are preempted by federal antitrust laws. The lawsuits seek, among other things, injunctions against the enforcement of the Qualifying Statutes and related legislation. To date such challenges have not been ultimately successful, although the enforcement of Allocable Share Release Amendments has been preliminarily enjoined in New York and certain other states. Appeals are pending or still possible in certain cases. The Qualifying Statutes and related legislation may also continue to be challenged in the future. Although a determination that the Qualifying Statute is unconstitutional would have no effect on the enforceability of the MSA, such a determination could have an adverse effect on payments to be made under the MSA if an NPM were to gain market share in the future and there occurred the requisite impact on the market share of PMs under the MSA. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

In rendering the opinions described below, Bond Counsel considered the claims asserted in the above-referenced lawsuits (see "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein) as well as other federal and state constitutional and statutory claims which it believes are representative of the legal theories that an opponent of the Qualifying Statute would advance in an attempt to invalidate the Qualifying Statute. On the Closing Date, Bond Counsel will render an opinion, subject to all the facts, assumptions and qualifications set forth therein, that, although there can be no assurance that a court applying existing legal principles would not hold otherwise, a court applying existing legal principles to the facts would find the State's Qualifying Statute to be constitutional and enforceable in all material respects. [In rendering its enforceability opinion with respect to California's Qualifying Statute, Bond Counsel will rely without investigation upon a letter from counsel to the OPMs confirming that the OPMs would not dispute that California's Qualifying Statute, if maintained in its current form without modification or addition, is a Qualifying Statute within the meaning of the MSA.]

Limitations on Opinions of Counsel

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

Enforcement of Rights to TSRs

It is possible that the State could in the future attempt to claim some or all of the TSRs for itself, or otherwise interfere with the security for the Series 2006A Bonds. In that event, the Bondholders, the Indenture Trustee, the Agency, the Corporation, or the County may assert claims based on contractual, fiduciary, or constitutional rights, but no prediction can be made as to the disposition of such claims.

Contractual Remedies. Under California law, settlements are treated as contracts and may be enforced according to their terms. The MOU is a court-approved settlement that establishes the County's right to receive the TSRs and to bring suit against the State to enforce its right to receive the TSRs. The Sale Agreement obligates the

County to take all necessary action to protect the Corporation's interest in the Sold County Tobacco Assets. Thus, if the State violates the provisions of the MOU so as to impair the County's right to the Sold County Tobacco Assets, the Indenture Trustee, as assignee of the Corporation rights under the Sale Agreement, could seek to compel the County to enforce its payment rights under the MOU. Such enforcement costs will be paid from the Operating Account. As interested parties, the Corporation on its own behalf and the Indenture Trustee on behalf of the Bondholders could also seek to enforce the County's rights under the MOU, although, since they are not parties to the MOU they may not have enforceable rights to do so.

Fiduciary Relationship Remedies. As the lead California plaintiff in the class action lawsuit underlying the MOU, the State stands in a relationship of faith and trust with the other class members, including the County. Among other fiduciary obligations, the State as lead plaintiff bears a duty to protect faithfully the settlement interests of the other class members. Consequently, action by the State, either unilaterally or by agreement with the OPMs, to amend the MOU, or otherwise impair the County's rights to the Sold County Tobacco Assets without its consent, may constitute a breach of the State's fiduciary duties, but it is likely that the State would deny such a breach and no prediction can be made as to the outcome of such a claim.

Constitutional Claims. The Bondholders are entitled to the benefit of the prohibitions in the United States Constitution's Contract Clause against any state's impairment of the obligation of contracts. The State has entered into the MOU and the ARIMOU allocating the State's share of the benefits of the MSA among itself, and Local Agencies, including the County. Other than certain of the proceeds of the Series 2006A Bonds on deposit in the Accounts, the Sold County Tobacco Assets and money derived therefrom are the sole source of payment for the Series 2006A Bonds.

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

Finally, the Bondholders may also have constitutional claims under the Due Process Clauses of the United States and State Constitutions.

No Assurance as to the Outcome of Litigation

With respect to all matters of litigation that have been brought and may in the future be brought against the PMs, or involving the enforceability of the MSA or constitutionality of the California Qualifying Statute or the enforcement of the right to the TSRs or otherwise filed in connection with the tobacco industry, the outcome of such litigation, in general, cannot be determined with certainty and depends, among other things, on (i) the issues being appropriately presented and argued before the courts (including the applicable appellate courts) and (ii) on the courts, having been presented with such issues, correctly applying applicable legal principles in reaching appropriate decisions regarding the merits. In addition, the courts may, in their exercise of equitable jurisdiction, reach judgments based not upon the legal merits but upon a balancing of the equities among the parties. Accordingly, no assurance can be given as to the outcome of any such litigation and any such adverse outcome could have a material and adverse impact on the amounts available to the Agency or the Corporation to make payments on the Series 2006A Bonds.

THE AGENCY

The Agency is a public entity created by a Joint Exercise of Powers Agreement (the "**Joint Powers Agreement**"), dated as of November 15, 2000, as amended, by and among the County and the Counties of Merced, Kern, Stanislaus, Marin, Placer, Fresno, Alameda and Sonoma, California, pursuant to Article 1 of Chapter 5 of Division 7 of Title 1 of the California Government Code (Section 6500 and following). The Agency was created, in part, to insure, hedge or otherwise manage the risk associated with the receipt of MSA payments by issuing bonds secured by the MSA payments of one or more Members, the proceeds of which Bonds will be used directly or indirectly to purchase all or a portion of the MSA payments from a Member or Members, and to provide for the exercise of additional powers given to a joint powers entity under the Act, including, but not limited to, the Marks-Roos Local Bond Pooling Act of 1985.

The Agency is a separate entity from its Members (including the County), and its debts, liabilities and obligations do not constitute debts, liabilities or obligations of the Members.

Commission

The Agency is administered by a Commission (the "**Commission**"), whose members (each a "**Commissioner**") are at all times appointees of the Board of Supervisors of each Member (who may include members of the appointing Board of Supervisors). The Board of Supervisors of each Member has designated two Commissioners to the Commission. The County and the other counties listed above are the only Members of the Agency.

The Commission will take no action except upon the affirmative vote of the majority of the Commissioners present, which majority, except as otherwise provided in the Joint Powers Agreement, must include at least one Commissioner representing each Member. For the purpose of taking any action relating to the issuance and sale of bonds secured by the TSRs of a single Member (the "**Affected Member**"), the Commission will consist of the Commissioners designated by the Board of Supervisors of the Affected Member and one additional Commissioner designated by resolution of the Commission or, in the absence of such resolution, as designated by the President of the Agency.

Officers

The officers of the Agency are the President, Vice President, Secretary, Treasurer and Auditor/Controller. The Commission annually elects a President from among its members and appoints a Secretary, who need not be a Commissioner. The Commission may elect a Vice President from among its members. The Treasurer of the County of Stanislaus will be the Treasurer until otherwise determined by the Commission and the Controller of the County of Stanislaus will be the Auditor/Controller of the Agency until otherwise determined by the Commission.

THE CORPORATION

The Corporation is organized under California law as a nonprofit public benefit corporation. The Corporation is governed by a three-person board of directors consisting of two directors who are employees of the County and one independent director who is not, and has not been for a period of five years prior to his or her appointment as independent director, (i) a customer, supplier or advisor of the County; (ii) an official, member, stockholder, director, officer, employee, agent or affiliate of the County (other than the Corporation); (iii) a person related to any person referred to in clause (i) or (ii); or (iv) a trustee, conservator or receiver for the County. The Corporation has no assets other than the Sold County Tobacco Assets. The Corporation was organized for the special purpose of financing the purchase of the Sold County Tobacco Assets.

ESTIMATED SOURCES AND USES OF FUNDS

Sources of Funds:	
Principal Amount of the Series 2006A Bonds	$
Net Original Issue Premium/Discount	
Total Sources	$
Uses of Funds:	
Net Proceeds to the Corporation	$
Debt Service Reserve Account	
Operating Account	
Costs of Issuance Account[1]	
Total Uses	$

[1] Includes underwriters' discount, legal fees, rating agencies fees, verification agents fees, printing costs and certain other expenses related to the issuance of the Series 2006A Bonds.

THE SERIES 2006A BONDS

The following summary describes certain terms of the Series 2006A Bonds. This summary does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the Indenture and the Series 2006A Bonds. Terms used herein and not previously defined have the meanings ascribed to them in Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto. Copies of the Indenture and the Sale Agreement may be obtained upon written request to the Indenture Trustee.

General

The Series 2006A Bonds will be dated their date of delivery and will initially accrue interest at the rates and mature on the dates set forth on the inside cover of this Offering Circular.

The Series 2006A Bonds will initially be represented by one certificate for each maturity of the Series 2006A Bonds registered in the name of DTC, New York, New York or its nominee. DTC will act as securities depository for the Series 2006A Bonds. Beneficial Owners of the Series 2006A Bonds will not receive physical delivery of the Series 2006A Bonds. See Appendix F – "BOOK-ENTRY ONLY SYSTEM" attached hereto. The Capital Appreciation Bonds will be issued in the initial principal amounts and with the Accreted Values at maturity set forth on the inside cover to this Offering Circular, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Maturity Date thereof. The Convertible Bonds will be issued in the initial principal amounts and with the Accreted Values at the Conversion Date thereof as set forth on the inside cover to this Offering Circular, in the authorized denomination of any integral multiple of $5,000 of Accreted Value at the Conversion Date thereof.

Payments on the Series 2006A Bonds

Payments of Interest. Interest on the Capital Appreciation Bonds accrues from their date of delivery, which interest shall be compounded on the first Distribution Date, and thereafter semiannually on the Distribution Dates until their respective maturity dates. Prior to the Conversion Date, interest on the Convertible Bonds will accrue from their date of delivery, be compounded on the first Distribution Date and thereafter semiannually on the Distribution Dates in each year. After the applicable Conversion Date, such Convertible Bonds will become Current Interest Bonds with interest thereon payable on each Distribution Date following such Conversion Date.

For each Distribution Date, payments will be made to Owners of record (the "**Owners**") as of the Record Date. "**Record Date**" means, with respect to Series 2006A Bonds, the 15th day of the calendar month immediately preceding the calendar month in which a Distribution Date occurs. The Indenture Trustee and the Agency may establish special record dates for the determination of the Owners for various purposes of the Indenture, including giving consent or direction to the Indenture Trustee.

Payments of Principal. The Principal of the Series 2006A Bonds will be paid by their respective maturity dates as set forth on the inside front cover of this Offering Circular. Principal includes Accreted Value ("**Accreted Value**"), which means, with respect to any Capital Appreciation Bond, an amount equal to the initial principal amount of such Bond, plus interest accrued thereon from its date compounded on each Distribution Date, commencing on the first Distribution Date after its issuance (through the maturity date of such Bond or in the case of a Convertible Bond, through the applicable Conversion Date) at the Accretion Interest Rate for such Bond, as set forth in the Indenture; provided, however, that the Indenture Trustee shall calculate or cause to be calculated the Accreted Value on any date other than a Distribution Date set forth in the Indenture by straight line interpolation of the Accreted Values as of the immediately preceding and succeeding Distribution Date. In performing such calculation, the Indenture Trustee shall be entitled to engage and rely upon a firm of accountants, consultants or financial advisors with appropriate knowledge and experience.

Turbo Redemption

The Series 2006A Bonds are subject to mandatory redemption in whole or in part prior to their stated maturity dates from amounts on deposit in the Turbo Redemption Account on each June 1 and December 1, commencing _____ 1, 20__, at the redemption price of 100% of the Accreted Value thereof to the date fixed for redemption without premium, with respect to the Capital Appreciation Bonds, and 100% of the Accreted Value thereof together with interest accrued after the Conversion Date to the date fixed for redemption without premium, with respect to the Convertible Bonds. The Series 2006A Bonds are subject to Turbo Redemption in order of maturity. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

Optional Redemption

The Capital Appreciation Bonds maturing on or prior to June 1, 20__ are not subject to optional redemption. The Capital Appreciation Bonds maturing on and after June 1, 20__ are subject to optional redemption, in whole or in part, on any date on or after June 1, 20__, at a redemption price of 100% of the Accreted Value thereof to the date fixed for redemption.

The Convertible Bonds maturing on or prior to June 1, 20__ are not subject to optional redemption. The Convertible Bonds maturing on and after June 1, 20__ are subject to optional redemption, in whole or in part, on any date on or after June 1, 20__, at a redemption price of 100% of the Principal thereof together with accrued interest after the Conversion Date to the date fixed for redemption.

Notice of Redemption

Pursuant to the Indenture, the Indenture Trustee will give 15 days' notice by mail, or otherwise transmit the redemption notice in accordance with any appropriate provisions of the Indenture, to the registered owners of any Series 2006A Bonds that are to be redeemed, at their addresses shown on the registration books of the Agency. Such notice may be waived by any Bondholders holding Series 2006A Bonds to be redeemed. Failure by a particular Bondholder to receive notice, or any defect in the notice to such Bondholder, will not affect the redemption of any other Series 2006A Bond. Any notice of redemption given pursuant to the Indenture may be rescinded by written notice to the Indenture Trustee by the Agency no later than 5 days prior to the date specified for redemption. The Indenture Trustee will give notice of such rescission as soon thereafter as practicable in the same manner and to the same persons, as notice of such redemption was given as described above.

Extraordinary Prepayment

If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the Principal amount thereof without premium. See "SECURITY FOR THE SERIES 2006A BONDS – Flow of Funds" herein.

Lump Sum Prepayment

The Series 2006A Bonds are subject to mandatory prepayment, in whole or in part prior to their stated maturity dates from amounts on deposit in the Lump Sum Prepayment Account on any date, at the prepayment price of 100% of the Accreted Value thereof to the date fixed for prepayment without premium, with respect to the Capital Appreciation Bonds, and 100% of the Accreted Value together with interest accrued after the Conversion Date to the date fixed for prepayment without premium, with respect to the Convertible Bonds. Any prepayment of Series 2006A Bonds from amounts in the Lump Sum Prepayment Account pursuant to the Indenture will be Pro Rata without regard to their order of maturity.

Partial Redemption; Partial Prepayment

If less than all the Outstanding Series 2006A Bonds of a maturity are to be redeemed or prepaid, the particular Series 2006A Bonds to be redeemed or prepaid shall be selected by the Indenture Trustee by such method as it shall deem fair and appropriate, including by lot, and the Indenture Trustee may provide for the selection for redemption or prepayment of portions (equal to any authorized denominations) of the principal of Series 2006A Bonds of a denomination larger than the minimum authorized denomination.

SECURITY FOR THE SERIES 2006A BONDS

General

Sale Agreement. Pursuant to the Sale Agreement, the County will sell to the Corporation and the Corporation will purchase from the County, a portion of the right, title and interest of the County in, to and under the MOU, the ARIMOU and the MSA and the Consent Decree, including, without limitation, a portion of the rights of the County to any moneys due to it after the issuance of the Series 2006A Bonds under the MOU, the ARIMOU and the MSA. The California Escrow Agent will be irrevocably instructed, pursuant to the ARIMOU, to disburse all of the Sold County Tobacco Assets from the California Local Government Escrow Account to the Indenture Trustee. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Sale Agreement" attached hereto.

Loan Agreement. Pursuant to the Loan Agreement, the Corporation has pledged and assigned to the Agency and granted a security interest in all right, title and interest of the Corporation in, to and under the following property, whether now owned or hereafter acquired: (a) the Sold County Tobacco Assets purchased from the County, (b) to the extent permitted by law (as to which no representation is made by the Corporation), corresponding present or future rights, if any, of the Corporation to enforce or cause the enforcement of payment of purchased Sold County Tobacco Assets pursuant to the MOU and the ARIMOU, (c) corresponding rights of the Corporation under the Sale Agreement, and (d) all proceeds of any and all of the foregoing. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Loan Agreement" attached hereto.

Indenture. The Series 2006A Bonds are to be issued pursuant to the Indenture and are secured by all the Agency's right, title and interest, whether now owned or hereafter acquired in the Collateral. Collateral is defined under the Indenture as (a) the Agency's rights with respect to the Loan Agreement, including but not limited to the right to receive loan payments and to enforce the obligations of the Corporation pursuant to the Loan Agreement, (b) the Corporation Tobacco Assets, (c) the Accounts, all money, instruments, investment property, or other property credited to or on deposit in the Accounts, and all investment earnings on amounts on deposit in or credited to the Accounts; (d) all present and future claims, demands, causes and things in action in respect of any or all of the foregoing and all payments on or under and all proceeds of every kind and nature whatsoever in respect of any or all of the foregoing, including all proceeds of the conversion, voluntary or involuntary, into cash or other liquid property, all cash proceeds, accounts, general intangibles, notes, drafts, acceptances, chattel paper, checks, deposit accounts, insurance proceeds, condemnation awards, rights to payment of any and every kind, and other forms of obligations and receivables, instruments and other property which at any time constitute all or part of or are included in the proceeds of any of the foregoing and (e) all proceeds of the foregoing. The Collateral does not include (i) the rights of the Agency to consent under the Loan Agreement or other action by the Agency, notice to the Agency, indemnity or the filing of documents with the Agency, or otherwise for its benefit and not for the benefit of the Owners of the Series 2006A Bonds or (ii) the Rebate Account and all money, instruments, investment property or

other property credited to or on deposit in the Rebate Account. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Indenture" attached hereto.

Defeasance. When, among other conditions set forth in the Indenture (including required notices), there is held by or for the account of the Indenture Trustee Defeasance Collateral in such principal amounts, bearing fixed interest at such rates and with such maturities, including any applicable redemption or prepayment premiums, as will provide sufficient funds to pay or redeem or prepay, in accordance with the terms of the Indenture, all obligations to Bondholders in whole (to be verified by a nationally recognized firm of independent verification agents), then upon written notice from the Agency to the Indenture Trustee, such Bondholders will cease to be entitled to any benefit or security under the Indenture except the right to receive payment of the funds so held and other rights which by their nature cannot be satisfied prior to or simultaneously with the termination of the lien under the Indenture, whether in whole or in part, the security interests created by the Indenture (except interests in such funds and investments) will terminate. Upon such defeasance, the funds and investments required to pay or redeem the Series 2006A Bonds will be irrevocably set aside for that purpose, subject, however, to the terms of the Indenture regarding unclaimed money. Money held for defeasance will be invested only as provided in the Indenture and applied by the Indenture Trustee to the retirement of the Series 2006A Bonds. Any funds or property held by the Indenture Trustee and not required for the payment or redemption of the Series 2006A Bonds will be distributed to the order of the Agency.

Subject to the requirements of federal tax law and to the right of the Agency to defease the Series 2006A Bonds in accordance with the optional redemption provisions of the Indenture, when all Bonds are to be defeased, the Agency shall provide for Turbo Redemption payment of the Principal of the Series 2006A Bonds, based on the assumption that the Outstanding principal balance on certain Distribution Dates (taking such Turbo Redemption payments into account) for the Series 2006A Bonds shall equal Term Bond Redemption payments as shown in [Table 4] in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein. If on the date of defeasance the principal amount of Bonds outstanding is greater than the scheduled principal balance from Table 4 (constituting an "**Excess**"), such excess balance must be redeemed within not more than 30 days of the date of defeasance. If on the date of defeasance the principal amount of Bonds outstanding is less than the scheduled principal balance from Table 4 (constituting a "**Deficiency**"), no principal payment of the Series 2006A Bonds shall occur until the Distribution Date on which the scheduled principal outstanding is attained, and after such date the Turbo Redemptions shall occur in the amounts and on the dates shown in [Table 4].

Limited Obligations

The Series 2006A Bonds are limited obligations of the Agency, payable from and secured solely by Revenues and the other collateral pledged under the Indenture. The Bondholders have no recourse to other assets of the Agency, including, but not limited to, any assets pledged to secure payment of any other debt obligation of the Agency. The Series 2006A Bonds do not constitute a charge against the general credit of the Agency or any of its Members, including the County, and under no circumstances shall the Agency or any Member, including the County, be obligated to pay the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds, except from the Collateral pledged therefor under the Indenture. Neither the credit of the State, nor any public agency of the State (other than the Agency), nor any Member of the Agency, including the County, is pledged to the payment of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds. The Series 2006A Bonds do not constitute a debt, liability or obligation of the State or any public agency of the State (other than the Agency) or any Member of the Agency, including the County. The County is under no obligation to make payments of the Principal of or redemption premiums, if any, or interest on the Series 2006A Bonds in the event that Revenues are insufficient for the payment thereof.

Debt Service Reserve Account

The Indenture provides for the funding of the Debt Service Reserve Account in an amount equal to $_____, the Debt Service Reserve Requirement. Amounts on deposit in the Debt Service Reserve Account will be available to pay principal of and interest on the Series 2006A Bonds, to the extent that Revenues are insufficient for such purpose. Amounts in the Debt Service Reserve Account shall not be available to make Turbo Redemption payments on the Series 2006A Bonds unless such amounts, together with all available Revenues, are sufficient to retire all bonds Outstanding under the Indenture, in which event such amounts shall be transferred to the Turbo Redemption Account. Unless an Event of Default has occurred, amounts withdrawn from the Debt Service Reserve

Account will be replenished from Revenues as described in the Indenture. See "SECURITY FOR THE SERIES 2006A BONDS – Flow of Funds" herein.

Flow of Funds

The Indenture Trustee will establish and maintain the following segregated trust accounts in the Indenture Trustee's name: the Collection Account, the Operating Account, the Debt Service Account, the Debt Service Reserve Account, the Extraordinary Prepayment Account, the Turbo Redemption Account, the Lump Sum Prepayment Account, the Capitalized Interest Account and the Costs of Issuance Account. Proceeds of the Series 2006A Bonds will not be used to fund the Capitalized Interest Account.

Any TSRs shall be promptly (and in no event later than two Business Days after receipt by the Indenture Trustee) deposited by the Indenture Trustee in the Collection Account. "**Business Day**" means any day other than (i) a Saturday or a Sunday, or (ii) a day on which banking institutions in New York, New York, Los Angeles, California, or San Francisco, California, or where the Corporate Trust Office of the Indenture Trustee is otherwise located, are required or authorized by law to be closed. Unless otherwise specified in the Indenture, the Indenture Trustee will deposit all Revenues it receives in the Collection Account.

As soon as possible following each deposit of Revenues to the Collection Account pursuant to the Indenture, the Indenture Trustee will withdraw remaining Revenues on deposit in the Collection Account and transfer such amounts as follows (provided, however, that all TSRs that have been identified by an Officer's Certificate as consisting of Lump Sum Payments received by the Indenture Trustee shall be promptly (and in any event, no later than the Business Day immediately preceding the next Distribution Date) transferred to the Lump Sump Prepayment Account, in accordance with instructions received by the Indenture Trustee pursuant to an Officer's Certificate):

(i) to the Operating Account, an amount specified in an Officer's Certificate (or certificate of an authorized officer of the Corporation, as appropriate), but not exceeding, when taken together with other applicable transfers, the Operating Cap for the current calendar year;

(ii) to the Debt Service Account, an amount sufficient to cause the amount therein, together with any amounts held therefor in the Capitalized Interest Account and investment earnings transferred from the Debt Service Reserve Account, to equal interest (including interest on (i) the principal of any Outstanding Current Interest Bonds, (ii) overdue interest on any Outstanding Current Interest Bonds, (iii) interest on overdue interest on any Outstanding Current Interest Bonds (to the extent legally permissible), and (iv) if no Current Interest Bonds are Outstanding, interest on Capital Appreciation Bonds at the applicable Accretion Interest Rate after the Maturity Date thereof, together with interest on any such interest (to the extent legally permissible)) due on the next succeeding Distribution Date;

(iii) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amount therein (without regard to amounts on deposit therein pursuant to (ii) above) to equal the principal of Outstanding Bonds due on the next succeeding Distribution Date;

(iv) unless an Event of Default has occurred and is continuing, to the Debt Service Reserve Account, an amount sufficient to cause the amounts therein to equal the Debt Service Reserve Requirement;

(v) unless an Event of Default has occurred and is continuing, to the Debt Service Account, an amount sufficient to cause the amounts therein (without regard to amounts on deposit therein pursuant to (ii) and (iii) above), together with any amounts held therefor in the Capitalized Interest Account (and not allocated pursuant to (ii) above) and investment earnings transferred from the Debt Service Reserve Account, to equal interest on Outstanding Current Interest Bonds due on the second succeeding Distribution Date;

(vi) if an Event of Default has occurred and is continuing, to the Extraordinary Prepayment Account all amounts remaining in the Collection Account;

(vii) to the Operating Account, an amount specified by an Officer's Certificate (or certificate of an authorized officer of the Corporation, as appropriate) to pay for any Operating Expenses in excess of the Operating Cap for the then current calendar year;

(viii) if any Bonds are subject to redemption from amounts on deposit in the Turbo Redemption Account on the next succeeding Distribution Date, to the Turbo Redemption Account, the amount remaining in the Collection Account; and

(ix) if no Bonds are subject to redemption from amounts on deposit in the Turbo Redemption Account on the next succeeding Distribution Date, to the Residual Trust (herein defined), the amount remaining in the Collection Account.

Except as otherwise provided in the Indenture, investment earnings on the Accounts shall be deposited in the Collection Account.

On each Distribution Date, the Indenture Trustee will apply amounts in the various Accounts in the following order of priority:

(1) from the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account, in that order, to pay interest (including interest on (i) the principal of any Outstanding Current Interest Bonds, (ii) overdue interest on any Outstanding Current Interest Bonds, (iii) interest on overdue interest on any Outstanding Current Interest Bonds (to the extent legally permissible), and (iv) if no Current Interest Bonds are Outstanding, interest on Capital Appreciation Bonds at the applicable Accretion Interest Rate after the Maturity Date thereof, together with interest on any such interest (to the extent legally permissible)) due on such Distribution Date;

(2) unless an Event of Default has occurred and is continuing, from the Debt Service Account and the Debt Service Reserve Account, in that order, to pay the principal of Outstanding Bonds due on such Distribution Date;

(3) unless an Event of Default has occurred and is continuing, from the Debt Service Reserve Account, any amount remaining in excess of the Debt Service Reserve Requirement, to the Debt Service Account;

(4) if an Event of Default has occurred and is continuing, from the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account to pay Extraordinary Prepayments on Bonds pursuant to the Indenture; and

(5) from the Turbo Redemption Account, to redeem the Series 2006A Bonds pursuant to the Indenture.

The Indenture Trustee shall apply on any day amounts from the Operating Account to the parties entitled thereto to pay Operating Expenses.

Pursuant to a Declaration and Agreement of Trust, dated as of _____ 1, 2006, by and between the Corporation and a Delaware trustee to be named therein (the "**Trust Agreement**"), a residual trust (the "**Residual Trust**") has been established by the Corporation. As a result of its ownership of a residual certificate issued under the Trust Agreement, the residual trust established by the Corporation is entitled to receive the revenues that are in excess of the Corporation's expenses, debt service and contractual obligations pursuant to the Loan Agreement.

See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS – The Indenture" attached hereto for a further description of the Accounts described above.

Non-Impairment Covenants

The Agency will not: (i) permit the validity or effectiveness of the Indenture to be impaired, or permit the lien of the Indenture to be amended, hypothecated, subordinated, terminated or discharged, or permit any Person to be released from any covenants or obligations with respect to Series 2006A Bonds under the Indenture except as may be expressly permitted in the Indenture, (ii) permit any lien, charge, excise, claim, security interest, mortgage or other encumbrance (other than the lien of the Indenture) to be created on or extend to or otherwise arise upon or burden the Collateral or any part thereof or any interest therein or the proceeds thereof or (iii) permit the lien of the Indenture not to constitute a valid first priority security interest in the Collateral.

Events of Default; Remedies

Events of Default. The occurrence of any of the following events will constitute an "Event of Default" under the Indenture:

(i) failure to pay when due interest on any payment date or principal on the applicable Maturity Date of any Series 2006A Bonds or failure to pay when due interest on and principal of any Series 2006A Bonds in accordance with any notice of redemption or prepayment;

(ii) failure of the Agency to observe or perform any other provision of the Indenture which is not remedied within 60 days after written notice thereof is given to the Agency by the Indenture Trustee or to the Agency and the Indenture Trustee by the Bondholders of at least 25% in principal amount of the Series 2006A Bonds then Outstanding;

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

(iv) an event of default has occurred and is continuing under the Loan Agreement, which events consist of (a) failure by the Corporation to pay, or cause to be paid, to the Indenture Trustee for deposit in the Collection Account established under the Indenture the portion of the TSRs relating to the Sold County Tobacco Assets as required pursuant to the Loan Agreement, (b) failure by the Corporation to observe or perform any other covenant, obligation, condition or agreement contained in the Loan Agreement and such failure shall continue for thirty (30) days from the date of written notice from the Agency or the Indenture Trustee of such failure, (c) any representation, warranty, certificate, information or other statement (financial or otherwise) made or furnished by or on behalf of the Corporation to the Agency in or in connection with the Loan Agreement shall be false, incorrect, incomplete or misleading in any material respect when made or furnished, (d) the Corporation shall (1) apply for or consent to the appointment of a receiver, trustee, liquidator or custodian of itself or of all or a substantial part of its property, (2) be unable, or admit in writing its inability, to pay its debts generally as they mature, (3) make a general assignment for the benefit of its or any of its creditors, (4) be dissolved or liquidated in full or in part, (5) become insolvent (as such term may be defined or interpreted under any applicable statute), (6) commence a voluntary case or other proceeding seeking liquidation, reorganization or other relief with respect to itself or its debts under any bankruptcy, insolvency or other similar law now or hereafter in effect or consent to any such relief or to the appointment of or taking possession of its property by any official in an involuntary case or other proceeding commenced against it, or (7) take any action for the purpose of effecting any of the foregoing, (e) proceedings for the appointment of a receiver, trustee, liquidator or custodian of the Corporation or of

all or a substantial part of the property thereof, or an involuntary case or other proceedings seeking liquidation, reorganization or other relief with respect to the Corporation or the debts thereof under any bankruptcy, insolvency or other similar law now or hereafter in effect shall be commenced and an order for relief entered or such proceeding shall not be dismissed or discharged within sixty (60) days of commencement, (f) the Loan Agreement or any material term thereof shall cease to be, or be asserted by the Corporation not to be, a legal, valid and binding obligation of the Corporation enforceable in accordance with its terms, and (g) the instructions to the Attorney General of the State regarding disbursing the Corporation Tobacco Assets to the Indenture Trustee as provided in the Loan Agreement shall be revoked or cease to be complied with.

Remedies Available to the Indenture Trustee. If an Event of Default occurs and is continuing:

(i) The Indenture Trustee may, and upon written request of the Bondholders of at least 25% in principal amount of the Series 2006A Bonds Outstanding will, in its own name by action or proceeding in accordance with law: (a) enforce all rights of the Bondholders and require the Agency to carry out its agreements with the Bondholders; (b) sue upon such Series 2006A Bonds; (c) require the Agency to account as if it were the trustee of an express trust for such Bondholders; and (d) enjoin any acts or things which may be unlawful or in violation of the rights of such Bondholders.

(ii) The Indenture Trustee will, in addition to the other provisions of the Indenture, have and possess all of the powers necessary or appropriate for the exercise of any functions incident to the general representation of Bondholders in the enforcement and protection of their rights.

(iii) Upon a Default of the Agency for failure to pay when due the interest on or principal of the Series 2006A Bonds or a failure actually known to an Authorized Officer of the Indenture Trustee to make any other payment required hereby within seven days after the same becomes due and payable, the Indenture Trustee will give written notice thereof to the Agency. The Indenture Trustee will give Default notices under the Indenture when instructed to do so by the written direction of another Fiduciary or the Bondholders of at least 25% in principal amount of the Outstanding Series 2006A Bonds. The Indenture Trustee will proceed under the Indenture for the benefit of the Bondholders in accordance with the written direction of at least 25% in principal amount of the Outstanding Series 2006A Bonds. The Indenture Trustee will not be required to take any remedial action (other than the giving of notice) unless reasonable indemnity is furnished for any expense or liability to be incurred therein. Upon receipt of written notice, direction and indemnity, and after making such investigation, if any, as it deems appropriate to verify the occurrence of any event of which it is notified as aforesaid, the Indenture Trustee will promptly pursue the remedies provided by the Indenture or any such remedies (not contrary to any such direction) as it deems appropriate for the protection of the Bondholders, and will act for the protection of the Bondholders with the same promptness and prudence as would be expected of a prudent person in the conduct of such person's own affairs.

Extraordinary Prepayment. If an Event of Default has occurred and is continuing, amounts on deposit in the Extraordinary Prepayment Account, the Capitalized Interest Account, the Debt Service Account and the Debt Service Reserve Account will be applied on each Distribution Date to prepay the Outstanding Bonds Pro Rata without regard to their order of maturity, at the Principal amount thereof without premium.

Additional Bonds

Subsequent to the issuance of the Series 2006A Bonds, additional series of bonds (the "**Additional Bonds**" and, together with the Series 2006A Bonds, the "**Bonds**") may be issued on a parity or subordinate basis, upon receipt by the Trustee of (i) a Rating Confirmation from each Rating Agency then rating the Outstanding Bonds and (ii) a certificate of the Agency that (x) no Event of Default has occurred hereunder, (y) the Debt Service Reserve Account is, after giving effect to the issuance of such Additional Bonds and the application of the proceeds thereof, funded at the Debt Service Reserve Requirement, and (z) as a result of the issuance of such Additional Bonds, the weighted average life of each Bond then Outstanding, projected in years from its date of issuance, will not exceed

the sum of (i) the weighted average life of each such Outstanding Bond as projected at the time such Bond was issued and set forth in the Series Supplement relating thereto and (ii) one. In calculating the weighted average life of each of the Outstanding Bonds for the purpose of the certificate required by clause (z) of the preceding sentence, the Agency shall take into consideration (1) the amount of Turbo Redemptions of such Bonds that have been paid prior to and including to the date of issuance of the Additional Bonds and (2) the amount of Turbo Redemptions projected by the Agency to be paid on each Distribution Date subsequent to the issuance of such Additional Bonds based upon the amount of Revenues then expected to be received by the Agency and available for payment of Turbo Redemptions of each Outstanding Bond. See Appendix E – "SUMMARY OF PRINCIPAL LEGAL DOCUMENTS" attached hereto.

SUMMARY OF THE MASTER SETTLEMENT AGREEMENT

The following is a brief summary of certain provisions of the MSA. This summary is not complete and is subject to, and qualified in its entirety by reference to, the copy of the MSA, as amended, which is attached hereto as Appendix B. Several amendments have been made to the MSA which are not included in Appendix B. Except for those amendments pursuant to which certain tobacco companies became SPMs (as defined below), such amendments involve technical and administrative provisions not material to the summary below.

General

The MSA is an industry wide settlement of litigation between the Settling States and the OPMs and was entered into between the attorneys general of the Settling States and the OPMs on November 23, 1998. The MSA provides for SPMs to become parties to the MSA. The three OPMs together with the SPMs are referred to as the PMs. Pursuant to the MSA, the Settling States agreed to settle all their past, present and future smoking related claims against the PMs in exchange for agreements and undertakings by the PMs concerning a number of issues. These issues include, among others, making payments to the Settling States, abiding by more stringent advertising restrictions, and funding educational programs, all in accordance with the terms and conditions set forth in the MSA. Distributors of PMs' products are also covered by the settlement of such claims to the same extent as the PMs.

Parties to the MSA

The Settling States are all of the states, territories and the District of Columbia, except for the four states (Florida, Minnesota, Mississippi and Texas) that separately settled with the OPMs prior to the adoption of the MSA (the "**Previously Settled States**"). According to the National Association of Attorneys General ("**NAAG**"), as of December 5, 2005, 46 PMs have signed the MSA. The chart below identifies each of the PMs which was a party to the MSA as of December 5, 2005:

OPMs	SPMs	
Lorillard Tobacco Company	Anderson Tobacco Company, LLC	Liberty Brands, LLC
Philip Morris, USA (formerly Philip Morris Incorporated)	Bekenton, S.A.	Liggett Group, Inc.
Reynolds American, Inc. (formerly R.J. Reynolds Tobacco Company and Brown & Williamson Tobacco Corporation)	Canary Islands Cigar Co.	Lignum-2, Inc.
	Caribbean-American Tobacco Corp. (CATCORP)	Mac Baren Tobacco Company A/S
	Chancellor Tobacco Company, PLC	Monte Paz (Compania Industrial de Tabacos Monte Paz S.A.)
	Commonwealth Brands, Inc.	Nasco Products Inc.
	Cutting Edge Enterprises, Inc.	P.T. Djarum
	Daughters & Ryan, Inc.	Pacific Stanford Marketing Corporation
	M/s. Dhanraj International	Peter Stokkebye International A/S
	Eastern Company S.A.E.	Planta Tabak-manufaktur Gmbh & Co.
	Farmer's Tobacco Co. of Cynthiana, Inc.	Poschl Tabak GmbH & Co. KG
	General Tobacco (Vibo Corporation d/b/a General Tobacco)	Premier Manufacturing Incorporated
	House of Prince A/S	Santa Fe Natural Tobacco Company, Inc.
	Imperial Tobacco Limited/ITL (USA) Limited	Sherman's 1400 Broadway N.Y.C. Inc.
	International Tobacco Group (Las Vegas), Inc.	Societe Nationale d'Exploitation Industrielle des Tabacs et Allumettes (SEITA)
	Japan Tobacco International USA, Inc.	Top Tobacco, LP
	King Maker Marketing	U.S. Flue-Cured Tobacco Growers, Inc.
	Konci G&D Management Group (USA) Inc.	Vector Tobacco Inc. (formerly Vector Tobacco Inc. and Medallion Company, Inc
		Virginia Carolina Corporation, Inc.

Kretek International Lane Limited	Von Eicken Group Wind River Tobacco Company, LLC VIP Tobacco USA, LTD. (formerly Winner Sales Company) ZNF International, LLC (no current brands)

The MSA restricts PMs from transferring their tobacco product brands, cigarette product formulas and cigarette businesses (unless they are being transferred exclusively for use outside the United States) to any entity that is not a PM under the MSA, unless the transferee agrees to assume the obligations of the transferring PM under the MSA related to such brands, formulas or businesses. The MSA expressly provides that the payment obligations of each PM are not the obligation or responsibility of any affiliate of such PM and, further, that the remedies, penalties or sanctions that may be imposed or assessed in connection with a breach or violation of the MSA will only apply to the PMs and not against any other person or entity. Obligations of the SPMs, to the extent that they differ from the obligations of the OPMs, are described below under "– Subsequent Participating Manufacturers" herein.

Scope of Release

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

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

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

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

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

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

Overview of Payments by the Participating Manufacturers; MSA Escrow Agent

The MSA requires that the PMs make several types of payments, including Initial Payments, Annual Payments and Strategic Contribution Payments.* See "Initial Payments," "Annual Payments" and "Strategic Contribution Fund Payments" below. These payments (with the exception of the up-front Initial Payment) are subject to various adjustments and offsets, some of which could be material. See "Adjustment to Payments" and "− Subsequent Participating Manufacturers" below. SPMs were not required to make Initial Payments. Thus far, the OPMs have made all of the Initial Payments, and the PMs have made the Annual Payments for 2000, 2001, 2002, 2003, 2004 and 2005 (subject to certain withholdings described in "RISK FACTORS − Other Potential Payment Decreases Under the Terms of the MSA" herein). See "Payments Made to Date" below. Strategic Contribution Fund Payments are scheduled to begin April 15, 2008 and continue through April 15, 2017.

Payments required to be made by the OPMs are calculated by reference to the OPM's domestic shipments of cigarettes, with the amount of the payments adjusted annually roughly in proportion to the changes in total volume of cigarettes shipped by the OPMs in the United States in the preceding year. Payments to be made by the PMs are recalculated each year, based on the United States market share of each individual PM for the prior year, with consideration under certain circumstances, for the profitability of each OPM. The Annual Payments and Strategic Contribution Fund Payments required to be made by the SPMs are based on increases in their shipment market share. See "− Subsequent Participating Manufacturers" below. Pursuant to an escrow agreement (the "**MSA Escrow Agreement**") established in conjunction with the MSA, remaining Annual Payments and Strategic Contribution Payments are to be made to Citibank, N.A., as escrow agent (the "**MSA Escrow Agent**"), which in turn will disburse the funds to the Settling States.

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

Initial Payments

Initial Payments were made only by the OPMs. In December 1998, the OPMs collectively made an up-front Initial Payment of $2.40 billion. The 2000 Initial Payment, which had a scheduled base amount of $2.47 billion, was paid in December 1999 in the approximate amount of $2.13 billion due to various adjustments. The 2001 Initial Payment, which had a scheduled base amount of $2.55 billion, was paid in December 2000 in the approximate amount of $2.04 billion after taking into account various adjustments and an earlier overpayment. The 2002 Initial Payment, which had a scheduled base amount of $2.62 billion, was paid in December 2001, in the approximate amount of $1.89 billion after taking into account various adjustments and a deposit made to the Disputed Payments Account. Approximately $204 million, which was substantially all of the money previously deposited in the Disputed Payments Account for payment to the Settling States, was distributed to the Settling States with the Annual Payment due April 15, 2002. The 2003 Initial Payment, which had a scheduled base amount of $2.70 billion, was paid in December 2002 and January 2003, in the approximate aggregate amount of $2.14 billion after taking into account various adjustments.

Annual Payments

The OPMs and the other PMs are required to make Annual Payments on each April 15 in perpetuity. The PMs made the first six Annual Payments due April 15 in each of the years 2000 through 2005, the scheduled base

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

amounts of which (before adjustments discussed below) were $4.5 billion, $5.0 billion, $6.5 billion, $6.5 billion, $8.0 billion and $8.0 billion, respectively. After application of the adjustments, the Annual Payment made (i) in April 2000 was approximately $3.5 billion, (ii) in April 2001 was approximately $4.1 billion, (iii) in April 2002 was approximately $5.2 billion, (iv) in April 2003 was approximately $5.1 billion, (v) in April 2004 was approximately $6.2 billion, and (vi) in April 2005 was approximately $6.3 billion. The scheduled base amount (before adjustments discussed below) of each Annual Payment, subject to adjustment, is set forth below:

Annual Payments

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

* The 2000 through 2005 Annual Payments have been made. However, subsequent adjustments to these Annual Payments may impact subsequent Annual Payments and Strategic Contribution Payments.

The respective portion of each base amount applicable to each OPM is calculated by multiplying the base amount by the OPM's Relative Market Share during the preceding calendar year. The base annual payments in the above table will be increased by at least the minimum 3% Inflation Adjustment, adjusted by the Volume Adjustment, reduced by the Previously Settled States Reduction, and further adjusted by the other adjustments described below. The SPMs are required to make Annual Payments if their respective market share increases above the higher of their respective 1998 Market Share or 125% of their 1997 Market Share. See "− Subsequent Participating Manufacturers" herein.

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

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

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

- the Offset for Claims-Over.

Application of these adjustments resulted in a material reduction of TSRs from the scheduled base amounts of the Annual Payments made by the PMs in April of the years 2000 through 2005, as discussed under the caption "Payments Made to Date" herein.

Strategic Contribution Fund Payments

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

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

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

Adjustments to Payments

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

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

Volume Adjustment. Each of the Initial Payments was, and each of the Annual Payments and Strategic Contribution Payments is, increased or decreased by an adjustment which accounts for fluctuations in the number of cigarettes shipped by the OPMs in or to the United States (the "**Volume Adjustment**").

If the aggregate number of cigarettes shipped in or to the United States by the OPMs in any given year (the "**Actual Volume**") is greater than 475,656,000,000 cigarettes (the "**Base Volume**"), the base amount allocable to the OPMs is adjusted to equal the base amount (in the case of Annual Payments and Strategic Contribution Payments after application of the Inflation Adjustment) multiplied by a ratio, the numerator of which is the Actual Volume and the denominator of which is the Base Volume.

If the Actual Volume in a given year is less than the Base Volume, the base amount due from the OPMs (in the case of Annual Payments and Strategic Contribution Payments, after application of the Inflation Adjustment) is decreased by 98% of the percentage by which the Actual Volume is less than the Base Volume, multiplied by such

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

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

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

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

NPM Adjustment = 50% +
[50% / (Base Aggregate Participating Manufacturer Market Share – 16 ⅔%)]
x[market share loss -16 ⅔%]

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

The NPM Adjustment is also state-specific, in that a Settling State may avoid or mitigate the effects of an NPM Adjustment by enacting and diligently enforcing the Model Statute or a Qualifying Statute (as defined herein). Any Settling State that adopts and diligently enforces a Model Statute or Qualifying Statute is exempt from the

NPM Adjustment. The State has adopted the Model Statute. The decrease in total funds available due to the NPM Adjustment is allocated on a Pro Rata basis among those Settling States that either (i) did not enact and diligently enforce the Model Statute or Qualifying Statute, or (ii) enacted a Model Statute or Qualifying Statute that is declared invalid or unenforceable by a court of competent jurisdiction. If a Settling State enacts and diligently enforces a Qualifying Statute that is the Model Statute but it is declared invalid or unenforceable by a court of competent jurisdiction, the NPM Adjustment will not exceed 65% of the amount of such state's allocated payment. If a Qualifying Statute that is not the Model Statute is held invalid or unenforceable, however, such state is not entitled to any protection from the NPM Adjustment. Moreover, if a state adopts a Model Statute or a Qualifying Statute but then repeals it or amends it in such fashion that it is no longer a Qualifying Statute, then such state will no longer be entitled to any protection from the NPM Adjustment. At all times, a state's protection from the NPM Adjustment is conditioned upon the diligent enforcement of its Model Statute or Qualifying Statute, as the case may be. See "RISK FACTORS – Other Potential Payment Decreases Under the Terms of the MSA" above and "– MSA Provisions Relating to Model/Qualifying Statutes" below, herein.

The MSA provides that if any Settling State resolves claims against any NPM that are comparable to any of the claims released in the MSA on overall terms more favorable to such NPM than the MSA does to the PMs, or relieves in any respect the obligation of any PM to make payments under the MSA, the terms of the MSA will be deemed modified to match the NPM settlement or such payment terms, but only with respect to the particular Settling State.

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

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

Offset for Claims-Over. If a Releasing Party pursues and collects on a released claim against an NPM or a retailer, supplier or distributor arising from the sale or distribution of tobacco products of any NPM or the supply of component parts of tobacco products to any NPM (collectively, the "**Non-Released Parties**"), and the Non-Released Party in turn successfully pursues a claim for contribution or indemnification against a Released Party (as defined herein), the Releasing Party must (i) reduce or credit against any judgment or settlement such Releasing Party obtains against the Non-Released Party the full amount of any judgment or settlement such Non-Released Party may obtain against the Released Party, and (ii) obtain from such Non-Released Party for the benefit of such Released Party a satisfaction in full of such Non-Released Party's judgment or settlement against the Released Party. In the event that such reduction or satisfaction in full does not fully relieve the Released Party of its duty to pay to the Non-Released Party, the PM is entitled to a dollar-for-dollar offset from its payment to the applicable Settling State (the "**Offset for Claims-Over**"). For purposes of the Offset for Claims-Over, any person or entity that is

enumerated in the definition of Releasing Party set forth above is treated as a Releasing Party without regard to whether the applicable attorney general had the power to release claims of such person or entity. The Offset for Claims-Over is state-specific and would apply only to MSA payments owed to the Settling State of the Releasing Party.

Subsequent Participating Manufacturers

SPMs are obligated to make Annual Payments and Strategic Contribution Fund Payments which are made at the same times as the Annual Payments and Strategic Contribution Fund Payments to be made by OPMs. Annual Payments and Strategic Contribution Fund Payments for SPMs are calculated differently, however, from Annual Payments and Strategic Contribution Fund Payments for OPMs. Each SPM's payment obligation is determined according to its market share if, and only if, its "**Market Share**" (defined in the MSA to mean a manufacturer's share, expressed as a percentage, of the total number of cigarettes sold in the United States in a given year, as measured by excise taxes (or similar taxes, in the case of Puerto Rico)), for the year preceding the payment exceeds its "**Base Share**," defined as the higher of its 1998 Market Share or 125% of its 1997 Market Share. If an SPM executes the MSA after February 22, 1999, its 1997 or 1998 Market Share, as applicable, is deemed to be zero. 14 of the current 43 SPMs signed the MSA on or before the February 22, 1999 deadline.

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

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

Payments Made to Date

As required, the OPMs have made all of the Initial Payments, the PMs have made the first six Annual Payments and the California Escrow Agent has disbursed to the County the County's allocable portions thereof and certain other amounts under the MSA totaling $686,660,821.59 to date. These amounts are not pledged to payment of the Series 2006A Bonds. Under the MSA, the computation of Initial Payments, Annual Payments and Strategic Contribution Payments by the MSA Auditor is confidential and may not be used for purposes other than those stated in the MSA. The sole sources of information regarding the computation and amount of such payments are the reports and accountings furnished to the County, the Corporation, and the Agency by the State.

MSA Payments Made to Date

Year	Type of Payment	Base Payment	Actual Payment
1999/2000	Upfront and Initial Payment	$	$112,031,860.06
2001	Initial Payment		31,443,637.61
2002	Initial Payment		915,606.31
2003	Initial Payment		34,547,335.06
2000	Annual Payment		59,156,470.39
2001	Annual Payment; Federal Tax Refund		70,351,989.34
2002	Annual Payment		88,598,589.66
2003	Annual Payment; Settlement Payment		86,375,470.58
2004	Annual Payment		101,471,465.10
2005	Annual Payment		101,768,397.50

[The State has advised the Agency that both the Settling States and the PMs are disputing or have disputed the calculations of the Initial Payments for 2000, 2001, 2002 and 2003 and Annual Payments for 2000, 2001, 2002 and 2003.] In addition, subsequent revisions in the information delivered to the MSA Auditor (on which the MSA Auditor's calculations of the Initial and Annual Payments are based) have in the past and may in the future result in a recalculation of the payments shown above. Such revisions may also result in routine recalculation of future payments. No assurance can be given as to the magnitude of any such recalculation and such recalculation could trigger the Offset for Miscalculated or Disputed Payments.

"Most Favored Nation" Provisions

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

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

State Specific Finality and Final Approval

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

"**State-Specific Finality**" means, with respect to an individual Settling State, that (i) such state has settled its pending or potential litigation against the tobacco companies with a consent decree, which decree has been approved and entered by a court within the Settling State and (ii) the time for all appeals against the consent decree has expired. If any Settling State failed to achieve State Specific Finality on or before December 31, 2001, its participation in the MSA would automatically terminate. State-Specific Finality for the State was achieved on October 28, 1999. As of December 12, 2000 all Settling States, had achieved State Specific Finality.

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

Disbursement of Funds from Escrow

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

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

Advertising and Marketing Restrictions; Educational Programs

The MSA prohibits the PMs from certain advertising, marketing and other activities that may promote the sale of cigarettes and smokeless tobacco products ("**Tobacco Products**"). Under the MSA, the PMs are generally prohibited from targeting persons under 18 years of age within the Settling States in the advertising, promotion or marketing of Tobacco Products and from taking any action to initiate, maintain or increase smoking by underage persons within the Settling States. Specifically, the PMs may not (i) use any cartoon characters in advertising, promoting, packaging or labeling Tobacco Products; (ii) distribute any free samples of Tobacco Products except in a restricted facility where the operator thereof is able to ensure that no underage persons are present; or (iii) provide to any underage person any item in exchange for the purchase of Tobacco Products or for the furnishing of proof-of-purchase coupons. The PMs are also prohibited from placing any new outdoor and transit advertising, and are committed to remove any existing outdoor and transit advertising for Tobacco Products in the Settling States. Other examples of prohibited activities include, subject to limited exceptions, the sponsorship of any athletic, musical, artistic or other social or cultural event in exchange for the use of tobacco brand names as part of the event; the making of payments to anyone to use, display, make reference to or use as a prop any Tobacco Product or item bearing a tobacco brand name in any motion picture, television show, theatrical production, music performance, commercial film or video game; the sale or distribution in the Settling States of any non-tobacco items containing tobacco brand names or selling messages; and the sale of packs of cigarettes containing fewer than 20 cigarettes until at least December 31, 2001.

In addition, the PMs have agreed under the MSA to provide funding for the organization and operation of a charitable foundation (the "**Foundation**") and educational programs to be operated within the Foundation. The main purpose of the Foundation will be to support programs to reduce the use of Tobacco Products by underage persons and to prevent diseases associated with the use of Tobacco Products. On March 31, 1999, and on March 31 of each subsequent year for a period of nine years thereafter, each OPM is required to pay its Relative Market Share of $25,000,000 (which is not subject to any adjustments, offsets or reductions pursuant to the MSA) to fund the Foundation. In addition, each OPM is required to pay its Relative Market Share of $250,000,000 on March 31, 1999, and $300,000,000 on March 31 of each of the subsequent four years to fund the Foundation. Furthermore, each PM may be required to pay its Relative Market Share of $300,000,000 on April 15, 2004, and on April 15 of each year thereafter in perpetuity if, during the year preceding the year when payment is due, the sum of the Market Shares of the PMs equals or exceeds 99.05%. The Foundation may also be funded by contributions made by other entities.

Remedies upon the Failure of a PM to Make a Payment

Each PM is obligated to pay when due the undisputed portions of the total amount calculated as due from it by the MSA Auditor's final calculation. Failure to pay such portion shall render the PM liable for interest thereon from the date such payment is due to (but not including) the date paid at the prime rate published from time to time by *The Wall Street Journal* or, in the event *The Wall Street Journal* is no longer published or no longer publishes

such rate, an equivalent successor reference to rate determined by the MSA Auditor, plus three percentage points. In addition, any Settling State may bring an action in court to enforce the terms of the MSA. Before initiating such proceeding, the Settling State is required to provide thirty (30) days' written notice to the attorney general of each Settling State, to NAAG and to each PM of its intent to initiate proceedings.

Termination of Agreement

Any Settling State's participation in the MSA is automatically terminated if such Settling State does not reach State Specific Finality on or before December 31, 2001. The State achieved State-Specific Finality on October 28, 1999. The MSA is also terminated as to a Settling State (i) if the MSA or consent decree in that Settling State is disapproved by a court and the time for an appeal has expired, the appeal is dismissed or the disapproval is affirmed or (ii) if the representations and warranties of the attorney general of that state relating to the ability to release claims are breached or not effectively given. In addition, in the event that a PM enters bankruptcy and fails to perform its financial obligations under the MSA, the Settling States, by vote of at least 75% of the Settling States, both in terms of number and of entitlement to the proceeds of the MSA, may terminate certain financial obligations of that particular manufacturer under the MSA.

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

Severability

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

Amendments and Waivers

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

MSA Provisions Relating to Model/Qualifying Statutes

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

Settling States may eliminate or mitigate the effect of the NPM Adjustment by taking certain actions, including the adoption of a statute, law, regulation or rule (a "**Qualifying Statute**") which eliminates the cost disadvantages that PMs experience in relation to NPMs as a result of the provisions of the MSA. "Qualifying Statute," as defined in Section IX(d)(2)(E) of the MSA, means a statute, regulation, law, or rule adopted by a Settling State that "effectively and fully neutralizes the cost disadvantages that PMs experience vis-a-vis NPMs within such Settling State as a result of the provisions of the MSA." Exhibit T to the MSA sets forth the model form of Qualifying Statute (the "**Model Statute**") that will qualify as a Qualifying Statute so long as the statute is enacted without modification or addition (except for particularized state procedural or technical requirements) and is not enacted in conjunction with any other legislative or regulatory proposal. The MSA also provides a procedure by which a Settling State may enact a statute that is not the Model Statute and receive a determination from a nationally recognized firm of economic consultants that such statute is a Qualifying Statute.

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

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

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

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

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

The State's Qualifying Statute defines "units sold" as the number of individual cigarettes sold in the State by the applicable tobacco product manufacturer, whether directly or through a distributor, retailer, or similar intermediary or intermediaries, during the year in question, as measured by excise taxes collected by the State on packs bearing the excise tax stamp or imprint of the State, or on roll-your-own tobacco.

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

In recent years legislation has been enacted in at least 44 of the Settling States, including the State, to amend the Qualifying or Model Statutes in those states by eliminating the reference to the allocable share and limiting the possible release an NPM may obtain under a Model Statute to the excess above the total payment that the NPM would have paid for its cigarettes had it been a PM (each an "Allocable Share Release Amendment").

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

Status of California Model Statute. The California Model Statue, in the form of the Model Statute attached to the MSA as Exhibit T, has been enacted as Part 3, Chapter 1, Section 10455 et seq. of the California Health and Safety Code. Counsel for the OPMs has confirmed in writing that the California Model Statute, if maintained and preserved in its current form, would constitute a Model Statute within the meaning of the MSA. See "RISK FACTORS – Litigation Challenging the MSA, the Qualifying Statutes and Related Legislation" herein.

THE CALIFORNIA CONSENT DECREE, THE MOU, THE ARIMOU AND THE CALIFORNIA ESCROW AGREEMENT

There follows a brief description of the California Consent Decree, the MOU, the ARIMOU and the California Escrow Agreement. This description is not complete and is subject to, and qualified in its entirety by reference to, the terms of the MOU, the ARIMOU, the Consent Decree and the California Escrow Agreement, each of which is attached to this Offering Circular as Appendix C.

General Description

On December 9, 1998, the Consent Decree and Final Judgment that governs the class action portion of the State's action against the tobacco companies, was entered in the Superior Court of the State of California for the County of San Diego. The Decree, which is final and non appealable, settled the litigation brought by the State against the OPMs and resulted in the achievement of California State Specific Finality under the MSA. The Decree incorporated by reference the MOU. The Superior Court of the State of California for the County of San Diego entered an order approving the ARIMOU on January 18, 2000. On June 3, 2001, a proposed order was issued by the Superior Court of the State of California for San Diego County amending the ARIMOU with respect to the right of each Eligible City or County to transfer its MOU Proportional Allocable Shares in tobacco securitizations without approval of the indenture trustee.

Prior to the entering of the Decree, the plaintiffs of certain pending lawsuits agreed, among other things, to coordinate their pending cases and to allocate certain portions of the recovery among the State and the Participating Jurisdictions. This agreement was memorialized in the MOU. To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU among the State and the Participating Jurisdictions, the parties entered into the ARIMOU. Upon satisfying certain conditions set forth in the MOU and the ARIMOU, the Participating Jurisdictions are deemed to be "eligible" to receive a share of the TSRs to which the State is entitled under the MSA. As of the date of this Offering Circular, all of the Participating Jurisdictions under the MOU and ARIMOU, including the County, have satisfied the conditions of the MOU and the ARIMOU and are eligible to receive funds under the MOU and the ARIMOU. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – State-Specific Finality and Final Approval" herein.

Under the MOU, 45% of the State's allocation of TSRs under the MSA is allocated to the Participating Jurisdictions that are counties, 5% is allocated to the four Participating Jurisdictions that are cities, and 50% is retained by the State. The 45% share of the TSRs allocated to the Participating Jurisdictions that are counties is allocated among the counties based on population, on a per capita basis as reported in the Official United States Decennial Census. The last Official United States Decennial Census for which official information is available is 2000. The allocations made to the Participating Jurisdictions through December 2001 have been based upon the 1990 Census data, which entitled the County to receive 1.574% of the total statewide Participating Jurisdictions' share of TSRs. Pursuant to the proportional allocable share provided in the MOU and the ARIMOU (based upon the 2000 Census data), the County is entitled to receive 1.6255% of the total statewide share of the TSRs allocated to Participating Jurisdictions that are counties within the State. This percentage is subject to adjustment for population and other factors as described below. See "– Flow of Funds and California Escrow Agreement" below.

To set forth the understanding of the interpretation to be given to the terms of the MOU and to establish procedures for the resolution of any future disputes that may arise regarding the interpretation of the MOU among the State and the Participating Jurisdictions, the parties entered into the ARIMOU.

Flow of Funds and California Escrow Agreement

Under the MSA, the State's portion of the TSRs are deposited into the California State Specific Account held by the MSA Escrow Agent. Pursuant to the terms of the MOU, the ARIMOU and an Escrow Agreement between the State the California Escrow Agent, the State has instructed the MSA Escrow Agent to transfer (upon receipt thereof) all amounts in the California State Local Agency Escrow Account to the California Escrow Agent. The California Escrow Agent will deposit the State's 50% share of the TSRs in an account for the benefit of the State, and the remaining 50% of the TSRs into separate accounts within the California Local Government Escrow Account for the benefit of the Participating Jurisdictions. The transfer of the TSRs into the California Local Government Escrow Account is not subject to legislative appropriation by the State or any further act by the State, nor are such funds subject to any lien of the State.

Pursuant to the California Escrow Agreement, the California Escrow Agent will distribute to each Participating Jurisdiction (including the County) its allocable proportional share of the TSRs as determined by the MOU and the ARIMOU, within one business day of a deposit into the California Local Government Escrow Account, unless the California Escrow Agent receives different instructions in writing from the State three business days prior to a deposit. The State may make any necessary adjustment to the allocable proportional shares following the issuance of each Official United States Decennial Census. See the ARIMOU attached hereto as Appendix C for a list of the Participating Jurisdictions and their proportional allocable share under the ARIMOU.

On July 30, 2001, an order was issued by the Superior Court of the State of California for the County of San Diego amending the ARIMOU (the "**ARIMOU Amendment**"). The order provides that an Eligible City or Eligible County participating in a tobacco securitization may provide that, once the related bonds are issued and so long as the related bonds are Outstanding, all amounts of its MOU Proportional Allocable Share may be transferred directly to the indenture trustee for the related bonds, and that so long as such bonds are Outstanding, no further transfer instructions may be provided to the State for transmission to the California Escrow Agent unless countersigned by the indenture trustee and, after the related bonds are repaid, unless countersigned by the relevant buyer. The County will execute instructions to provide for transfer of its MOU Proportional Allocable Share directly to the Indenture Trustee pursuant to the ARIMOU Amendment.

All fees and expenses due and owing the California Escrow Agent will be deducted equally from the State Escrow Account and the California Local Government Escrow Account prior to the disbursement of any funds pursuant to the California Escrow Agreement. Such fees are set forth in the California Escrow Agreement and may be adjusted to conform to its then current guidelines. If at any time the California Escrow Agent is served with any judicial or administrative order or consent decree that affects the amounts deposited with the California Escrow Agent, the California Escrow Agent is authorized to comply with such order or consent decree in any manner it or its legal counsel deems appropriate. If any fees, expenses or costs incurred by the California Escrow Agent or its legal counsel are not promptly paid, the Escrow Agent may reimburse itself from TSRs in escrow. The California Escrow Agreement provides that only the State and the California Escrow Agent, and their respective permitted successors, are entitled to its benefits. Pursuant to the Loan Agreement, an event of default will have occurred if the

County revokes its instructions under the California Escrow Agreement, which will, in turn, cause an Event of Default under the Indenture.

The California Escrow Agreement also provides a mechanism for the State to escrow TSRs to satisfy "claims over" entitling a PM to an offset for amounts paid under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustment to Payments – *Offset for Claims Over*" herein.

Enforcement Provisions of the Decree, the MOU and the ARIMOU

The MOU provides that the distribution of tobacco-related recoveries is not subject to alteration by legislative, judicial or executive action at any level, and, if such alteration were to occur and survive legal challenge, any modification would be borne proportionally by the State and the Participating Jurisdictions. The Decree specifically incorporates the entire the MOU as if it were set forth in full in the Decree. Thus, the allocation of the State's TSRs under the MSA among the State and the Participating Jurisdictions set forth in the MOU is final and non-appealable. However, the MSA provides (and the Decree confirms) that only the State is entitled to enforce the PMs' payment obligations under the MSA, and the State is prohibited expressly from assigning or transferring its enforcement rights. In addition, the State and the Participating Jurisdictions are the only intended beneficiaries of the ARIMOU and the only parties entitled to enforce its terms and those provisions of the MOU incorporated into the ARIMOU.

Release and Dismissal of Claims

The MSA provides that, effective upon the occurrence of State Specific Finality in the State, the State will release and discharge all past, present and future smoking related claims against all Released Parties. In the MOU and the ARIMOU, the County and the other Participating Jurisdictions agreed that the sharing of the recovery in the State's TSRs was conditioned upon the release by each Participating Jurisdiction of all tobacco related claims consistent with the extent of the State's release and a dismissal with prejudice of any state or county's pending action. The County has taken the necessary action to satisfy this condition.

Potential Payment Adjustments under the MOU and the ARIMOU

The MOU provides that the amounts of TSRs payable thereunder are subject to numerous adjustments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments" and "RISK FACTORS – Potential Payment Adjustments under the MOU and the ARIMOU" herein.

CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY

The following description of the domestic tobacco industry has been compiled from certain publicly available documents of the tobacco companies and their parent companies and certain publicly available analyses of the tobacco industry and other public sources. Certain of the companies file annual, quarterly, and certain other reports with the Securities and Exchange Commission (the "SEC"). Such reports are available on the SEC's website (www.sec.gov). The following information does not, nor is it intended to, provide a comprehensive description of the domestic tobacco industry, the business, legal and regulatory environment of the participants therein, or the financial performance or capability of such participants. Although the Agency has no independent knowledge of any facts indicating that the following information is inaccurate in any material respect, the Agency has not independently verified this information and cannot and does not warrant the accuracy or completeness of this information. To the extent that reports submitted to the MSA Auditor by the PMs pursuant to the requirements of the MSA provide information that is pertinent to the following discussion, including market share information, the California Attorney General has not consented to the release of such information pursuant to the confidentiality provisions of the MSA. Prospective investors in the Series 2006A Bonds should conduct their own independent investigations of the domestic tobacco industry to determine if an investment in the Series 2006A Bonds is consistent with their investment objectives.

Retail market share information, based upon shipments or sales as reported by the OPMs for purposes of their filings with the SEC, may be different from Relative Market Share for purposes of the MSA and the respective obligations of the PMs to contribute to Annual Payments and Strategic Contribution Payments. The Relative

Market Share information reported is confidential under the MSA. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Overview of Payments by the Participating Manufacturers; MSA Escrow Agent " – Annual Payments" and " – Strategic Contribution Payments" herein. Additionally, aggregate market share information, based upon shipments as reported by Loews Corporation and reflected in the chart below entitled "Manufacturers' Domestic Market Share Based on Shipments" is different from that utilized in the bond structuring assumptions. See "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" herein.

MSA payments are computed based in part on cigarette shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given point in time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Industry Overview

According to publicly available documents of Loews Corporation, the three leading manufacturers of tobacco products in the United States in 2004 collectively accounted for approximately 85.0% of the domestic cigarette retail industry when measured by shipment volume. The market for cigarettes in the United States divides generally into premium and discount sales, approximately 71.3% and 28.7%, respectively, measured by volume of all domestic cigarette sales as of the third quarter of 2005, as reported by Loews Corporation.

Philip Morris USA Inc. ("**Philip Morris**"), a wholly-owned subsidiary of Altria Group, Inc. ("**Altria**"), is the largest tobacco company in the United States. Prior to a name change on January 27, 2003, the Altria Group, Inc. was named Philip Morris Companies Inc. In its Annual Report on Form 10 K filed with the SEC for the year ended December 31, 2004, Altria reported that Philip Morris' domestic retail market share in 2004 was 49.8% (based on sales), which represents an increase of 1.1 share points from its self-reported 2003 domestic retail market share (based on sales) of 48.7%. In its quarterly report on Form 10Q filed with the SEC for the three months ended September 30, 2005, Altria reported that Philip Morris' domestic retail market share for such quarter was 50.1 % (based on sales), which represents an increase of 0.2 share points from its reported domestic retail market share (based on sales) of 49.9 % for the comparable quarter of 2004. Philip Morris' major premium brands are Marlboro, Virginia Slims and Parliament. Its principal discount brand is Basic. Marlboro is the largest selling cigarette brand in the United States, with approximately 39.6% of the United States domestic retail share for the third quarter of 2004 and 40.1% for the third quarter of 2005, and has been the world's largest-selling cigarette brand since 1972. Philip Morris' market share information is based on data from the IRI/Capstone Total Retail Panel ("**IRI/Capstone**"), which was designed to measure market share in retail stores selling cigarettes, but was not designed to capture Internet or direct mail sales.

Reynolds American Inc. ("**Reynolds American**"), is the second largest tobacco company in the United States. Reynolds American became the parent company of R.J. Reynolds Tobacco Company ("**Reynolds Tobacco**") on July 30, 2004, following a transaction that combined Reynolds Tobacco and the U.S. operations of Brown & Williamson Tobacco Corp. ("**B&W**"), previously the third largest tobacco company in the United States, under the Reynolds Tobacco name. In connection with this merger, Reynolds American assumed all pre-merger liabilities, costs and expenses of B&W, including those related to the MSA and related agreements and with respect to pre-merger litigation of B&W. Reynolds American is also the parent company of Lane Limited, a manufacturer and marketer of specialty tobacco products, and Santa Fe Natural Tobacco Company, Inc., both of which are SPMs. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004, Reynolds American reported that its domestic retail market share in 2004 was 30.8% (measured by sales volume), which represents a decrease of 1.3 share points from the 32.1% 2003 combined domestic retail market share of Reynolds Tobacco and B&W. In its quarterly report on Form 10Q filed with the SEC for the three months ended September 30, 2005, Reynolds American reported that its domestic retail market share for the quarter was 29.66% (measured by sales volume), which represents a decrease of 1.08 share points from its reported domestic retail market share of 30.75% (measured by sales volume) for the comparable quarter of 2004. Reynolds American's major premium brands are Camel, Kool, Winston and Salem. Its discount brands include Doral and Pall Mall. Reynolds American's market share information is based on IRI/Capstone data.

Lorillard, Inc. ("**Lorillard**"), a wholly-owned subsidiary of Loews Corporation, is the third largest tobacco company in the United States. On February 6, 2002, in an initial public offering, Loews Corporation issued shares of Carolina Group stock, which is intended to reflect the economic performance of Loews Corporation's stock in Lorillard. Carolina Group is not a separate legal entity. In its Annual Report on Form 10-K filed with the SEC for the year ended December 31, 2004, Loews Corporation reported that Lorillard's domestic retail market share in 2004 was 8.8% (measured by shipment volume), which represents an increase of 0.2 share points from its self-reported 2003 domestic retail market share of 8.6%. In its quarterly report on Form 10-Q filed with the SEC for the three months ended September 30, 2005, Loews Corporation reported that Lorillard's domestic retail market share for the quarter was 9.2% (measured by shipment volume) which represents an increase of 0.5 share points from its reported domestic retail share (measured by shipment volume) of 8.7% for the comparable quarter of 2004. Lorillard's principal brands are Newport, Kent, True, Maverick, and Old Gold. Its largest selling brand is Newport, which accounted for approximately 91% of Lorillard's unit sales in 2004. Market share data reported by Lorillard is based on data made available by Management Science Associates, Inc. ("**MSAI**"), an independent third-party database management organization that collects wholesale shipment data.

Based on the domestic retail market shares discussed above, the remaining share of the United States retail cigarette market in 2004 was held by a number of other domestic and foreign cigarette manufacturers, including Liggett Group, Inc. ("**Liggett**"), a wholly-owned subsidiary of Vector Group Ltd. ("**Vector**"). Liggett, the operating successor to the Liggett & Myers Tobacco Company, is the fourth largest tobacco company in the United States. In its Form 10-K filed with the SEC for the year ended December 31, 2004, Vector reported that Liggett's domestic retail market share in 2004 was 2.3% (measured by shipment volume and using MSAI data), which represents a decrease of 0.1 share points from its self-reported 2003 domestic retail market share of 2.4%. All of Liggett's unit volume in 2004 was in the discount segment. Its brands include Liggett Select, Eve, Jade, Pyramid and USA. In November 2001, Vector Group launched OMNI, which Vector Group claims is the first reduced-carcinogen cigarette that tastes, smokes and burns like other premium cigarettes. Additionally, Vector Group announced that it has introduced three varieties of a low nicotine cigarette in eight states, one of which is reported to be virtually nicotine free, under the brand name QUEST. Liggett and Vector Group Ltd. are SPMs under the MSA.

Shipment Trends

The following table sets forth the approximate comparative positions of the leading producers in the United States domestic tobacco industry, each of which is an OPM under the MSA, based upon cigarette shipments. Individual domestic OPM shipments are as reported in the publicly available documents of the OPMs. Total industry shipments are based on data made available by MSAI, as reported in publicly available documents of Loews Corporation.

Effective in June of 2004, MSAI changed the way it reports market share information to include actual units shipped by Commonwealth Brands, Inc. ("**CBI**"), an SPM who markets deep discount brands, and implemented a new model for estimating unit sales of smaller, primarily deep discount marketers. MSAI has restated its reports to reflect these changes as of January 1, 2001. As a result of these changes, market shares for the three OPMs are lower than had been reflected under MSAI's prior methodology and market shares for CBI and other low volume companies are higher. All industry volume and market share information herein reflects MSAI's revised reporting data.

Despite the effects of MSAI's new estimation model for deep discount manufacturers, Lorillard management has indicated that it continues to believe that volume and market share information for the deep discount manufacturers are understated and, correspondingly, market share information for the larger manufacturers are overstated by MSAI.

Manufacturers' Domestic Market Share Based on Shipments*

Manufacturer	2002	2003	2004
Philip Morris	45.7%	46.7%	47.4%
Reynolds American**	32.1	29.6	28.8
Lorillard	8.5	8.6	8.8
Other***	13.7	15.1	15.0

* Aggregate market share as reported by Loews Corporation is different from that utilized in the bond structuring assumptions and may differ from the market share information reported by the OPMs for purposes of their filings with the SEC.

** Prior to July 2004, represents the combined market share of Reynolds Tobacco and B&W.

*** The market share based on shipments of the tobacco manufacturers, other than the OPMs, has been determined by subtracting the total retail market share percentages of the OPMs as reported in the publicly available documents of Loews Corporation from 100%.

The following table sets forth the industry's cigarette shipments in the United States for the three years ended December 31, 2004. The MSA payments are calculated in part on shipments by the OPMs in or to the United States rather than consumption.

Years Ended December 31	Shipments (Billions of Cigarettes)*
2002	418.4
2003	401.2
2004	394.5

* As reported in SEC filings and other publicly available documents of the Loews Corporation, based on MSAI data.

The information in the foregoing tables, which has been obtained from publicly available documents but has not been independently verified, may differ materially from the amounts used by the MSA Auditor for calculating Annual Payments and Strategic Contribution Payments under the MSA.

Consumption Trends

According to April 2005 and September 2005 estimates of the United States Department of Agriculture (the "**USDA**") Economic Research Service ("**USDA-ERS**"), smokers in the United States consumed an estimated 388 billion cigarettes in 2004, which would represent a decrease of approximately 2.5% from the previous year. The USDA-ERS attributes declining cigarette use to a combination of higher consumer costs due to tax and price increases, restrictions on where people can smoke and greater awareness of the health risks associated with smoking. Annual per capita consumption (per adult over 18) has dropped from 2,505 cigarettes in 1995 to an estimated 1,791 in 2004. The following chart sets forth domestic cigarette consumption from 2000 through 2004:

Years Ended December 31	U.S. Domestic Consumption (Billions of Cigarettes)*
2000	430
2001	425
2002	415
2003	400
2004	388

* USDA-ERS. The MSA Payments are calculated in part based on domestic industry shipments rather than consumption. The Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed within the 50 states of the United States, the District of Columbia and Puerto Rico may not match at any given time as a result of various factors, such as inventory adjustments, but are substantially the same when compared over a period of time.

Distribution, Competition and Raw Materials

Cigarette manufacturers sell tobacco products to wholesalers (including distributors), large retail organizations, including chain stores, and the armed services. They and their affiliates and licensees also market

cigarettes and other tobacco products worldwide, directly or through export sales organizations and other entities with which they have contractual arrangements.

The market for tobacco products is highly competitive and is characterized by brand recognition and loyalty, with product quality, price, marketing and packaging constituting the significant methods of competition. Promotional activities include, in certain instances, allowances, the distribution of incentive items, price reductions and other discounts. Considerable marketing support, merchandising display and competitive pricing are generally necessary to maintain or improve a brand's market position. Increased selling prices and taxes on cigarettes have resulted in additional price sensitivity of cigarettes at the consumer level and in a proliferation of discounts and of brands in the discount segment of the market. Generally, sales of cigarettes in the discount segment are not as profitable as those in the premium segment.

The tobacco products of the cigarette manufacturers and their affiliates and licensees are advertised and promoted through various media, although television and radio advertising of cigarettes is prohibited in the United States. The domestic tobacco manufacturers have agreed to additional marketing restrictions in the United States as part of the MSA and other settlement agreements. They are still permitted, however, to conduct advertising campaigns in magazines, at retail cigarette locations, in direct mail campaigns targeted at adult smokers, and in other adult media.

Grey Market

A price differential exists between cigarettes manufactured for sale abroad and cigarettes manufactured for United States sale. Consequently, a domestic grey market has developed in cigarettes manufactured for sale abroad, but instead diverted for domestic sales that compete with cigarettes manufactured for domestic sale. The U.S. federal government and all states, except Massachusetts, have enacted legislation prohibiting the sale and distribution of grey market cigarettes. In addition, Reynolds American has reported that it has taken legal action against certain distributors and retailers who engage in such practices.

Regulatory Issues

Regulatory Restrictions and Legislative Initiatives. The tobacco industry is subject to a wide range of laws and regulations regarding the marketing, sale, taxation and use of tobacco products imposed by local, state, federal and foreign governments. Various state governments have adopted or are considering, among other things, legislation and regulations that would increase their excise taxes on cigarettes, restrict displays and advertising of tobacco products, establish ignition propensity standards for cigarettes, raise the minimum age to possess or purchase tobacco products, ban the sale of "flavored" cigarette brands, require the disclosure of ingredients used in the manufacture of tobacco products, impose restrictions on smoking in public and private areas, and restrict the sale of tobacco products directly to consumers or other unlicensed recipients, including over the Internet. In addition, the U.S. Congress may consider legislation further increasing the federal excise tax, regulation of cigarette manufacturing and sale by the U.S. Food and Drug Administration (the "**FDA**"), amendments to the Federal Cigarette Labeling and Advertising Act to require additional warnings, reduction or elimination of the tax deductibility of advertising expenses, implementation of a national standard for "fire-safe" cigarettes, regulation of the retail sale of cigarettes over the Internet and in other non-face-to-face retail transactions, such as by mail order and telephone, and banning the delivery of cigarettes by the U.S. Postal Service. In March 2005, for example, bipartisan legislation was reintroduced in the U.S. Congress which would provide the FDA with authority to broadly regulate tobacco products. Philip Morris has indicated its strong support for this legislation. No assurance can be given that future federal or state legislation or administrative regulations will not seek to further regulate, restrict or discourage the manufacture, sale and use of cigarettes.

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

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

- establishes an interagency committee on smoking and health that is charged with carrying out a program to inform the public of any dangers to human health presented by cigarette smoking;
- requires a series of four health warnings to be printed on cigarette packages and advertising on a rotating basis;
- increases type size and area of the warning required in cigarette advertisements; and
- requires that cigarette manufacturers provide annually, on a confidential basis, a list of ingredients added to tobacco in the manufacture of cigarettes to the Secretary of Health and Human Services.

Since the initial report in 1964, the Secretary of Health, Education and Welfare (now the Secretary of Health and Human Services) and the Surgeon General have issued a number of other reports which purport to find the nicotine in cigarettes addictive and to link cigarette smoking and exposure to cigarette smoke with certain health hazards, including various types of cancer, coronary heart disease and chronic obstructive lung disease. These reports have recommended various governmental measures to reduce the incidence of smoking. In 1992, the federal Alcohol, Drug Abuse and Mental Health Act was signed into law. This act requires states to adopt a minimum age of 18 for purchases of tobacco products and to establish a system to monitor, report and reduce the illegal sale of tobacco products to minors in order to continue receiving federal funding for mental health and drug abuse programs. Federal law prohibits smoking in scheduled passenger aircraft, and the U.S. Interstate Commerce Commission has banned smoking on buses transporting passengers interstate. Certain common carriers have imposed additional restrictions on passenger smoking.

State and Local Regulation; Private Restrictions: Legislation imposing various restrictions on public smoking also has been enacted in all of the states and many local jurisdictions. A number of states have enacted legislation designating a portion of increased cigarette excise taxes to fund either anti-smoking programs, healthcare programs or cancer research. In addition, educational and research programs addressing healthcare issues related to smoking are being funded from industry payments made or to be made under the MSA.

In December 2003, the California Environmental Protection Agency Air Resources Board issued a "Proposed Identification of Environmental Tobacco Smoke as a Toxic Air Contaminant" for public review. If environmental tobacco smoke is identified as a "Toxic air contaminant," the Air Resources Board is required to prepare a report assessing the need and appropriate degree of control of environmental tobacco smoke.

Several states have enacted or have proposed legislation or regulations that would require cigarette manufacturers to disclose the ingredients used in the manufacture of cigarettes. In September 2003, the Massachusetts Department of Public Health ("**MDPH**") announced its intention to hold public hearings on amendments to its tobacco regulations. The proposed regulations would delete any ingredients-reporting requirement. (The United States Court of Appeals for the Second Circuit previously affirmed a ruling that the Massachusetts ingredient-reporting law was unconstitutional.) MDPH has proposed to inaugurate extensive changes to its regulations requiring tobacco companies to report nicotine yield rating for cigarettes according to methods prescribed by MDPH. Because MDPH withdrew its notice for a public hearing in November 2003, it is impossible to predict the final form any new regulations will take or the effect they will have on the PMs.

On May 21, 1999, the OPMs filed lawsuits in the United States District Court for the District of Massachusetts to enjoin implementation of certain Massachusetts attorney general regulations concerning the advertisement and display of tobacco products. The regulations went beyond those required by the MSA, and banned outdoor advertising of tobacco products within 1,000 feet of any school or playground, as well as any indoor tobacco advertising placed lower than five feet in stores within the 1,000-foot zone. The district court ruled against the industry on January 25, 2000, and the United States Court of Appeals for the First Circuit affirmed. The United States Supreme Court granted the industry's petition for writ of certiorari on January 8, 2001, and ruled in favor of RJR Tobacco and the rest of the industry on June 28, 2001. The Supreme Court found that the regulations were preempted by the Federal Cigarette Labeling and Advertising Act, which precludes states from imposing any

requirement or prohibition based on smoking and health with respect to the advertising or promotion of cigarettes labeled in conformity with federal law.

In June 2000, the New York state legislature passed legislation charging New York's Office of Fire Prevention and Control ("**OFPC**") with developing standards for "fire-safe" or self-extinguishing cigarettes. On December 31, 2003, OFPC issued a final standard with accompanying regulations that requires all cigarettes offered for sale in New York State after June 28, 2004 to achieve specified test results when placed on 10 layers of filter paper in controlled laboratory conditions. Reynolds American's operating companies that sell cigarettes in New York state have provided written certification to both the OFPC and the Office of the Attorney General for New York that each of their cigarette brand styles currently sold in New York has been tested and has met the performance standards set forth in the OFPC's regulations. Design and manufacturing changes were made for cigarettes manufactured for sale in New York to comply with the standard. In June 2005, Vermont became the second state to pass legislation requiring that all cigarettes sold within the state be self-extinguishing. Vermont's legislation goes into effect May 1, 2006. In October 2005, California enacted a similar law that will take effect on January 1, 2007. Similar legislation is being considered in a number of other states. Varying standards from state to state could have an adverse effect on the PMs.

According to the Cigarette Consumption Report, all of the states and the District of Columbia now require smoke-free indoor air to some degree or in some public places. The most comprehensive bans have been enacted since 1998 in nine states and a few large cities. California imposed comprehensive statewide smoking bans in 1998 and banned smoking in its prisons effective July 1, 2005. Delaware banned smoking in all indoor public areas in 2002. On March 26, 2003, New York State enacted legislation banning smoking in indoor workplaces, including restaurants and bars. Also in 2003, Connecticut, Maine, and Florida passed laws which ban smoking in restaurants and bars. Similarly comprehensive bans took effect in March 2003 in New York City and Dallas and in Boston in May 2003. Since then Georgia, Massachusetts, Montana, Rhode Island, and Vermont have established similar bans. Voters in Washington State passed a ballot initiative on November 8, 2005 which will ban smoking in all public places effective January 2006. The restrictions are stronger than those in other states as they include a ban on outdoor smoking within 25 feet of the entrances of restaurants and other public places. The District of Columbia and the City of Chicago have also been considering comprehensive bans. The American Nonsmokers' Rights Foundation also documents clean indoor air ordinances by local governments throughout the U.S. As of October 4, 2005, there were 2,057 municipalities with indoor smoking restrictions.

In addition, the Settling States' Attorneys General were recently successful in obtaining agreement from Philip Morris and Reynolds American stating that they will remove product advertising from various magazines that are circulated in schools for educational purposes.

Voluntary Private Sector Regulation. In recent years, many employers have initiated programs restricting or eliminating smoking in the workplace, and many common carriers have imposed restrictions on passenger smoking more stringent than those required by governmental regulations. Similarly, many restaurants, hotels and other public facilities have imposed smoking restrictions or prohibitions more stringent than those required by governmental regulations, including outright bans.

International Agreements. On March 1, 2003, the member nations of the World Health Organization concluded four years of negotiations on an international treaty, the Framework Convention on Tobacco Control (the "**FCTC**"), aimed at imposing greater legal liability on tobacco manufacturers, banning advertisements of tobacco products (especially to youths), raising taxes and requiring safety labeling and comprehensive listing of ingredients on packaging, among other things. The FCTC entered into force on February 27, 2005 for the first forty countries, including the United States, that had ratified the treaty prior to November 30, 2004. As of April 27, 2005, 168 countries signed and 64 countries ratified the FCTC. On June 29, 2004 the FCTC was closed for signature, but there is no deadline for ratification. It has been reported that as of November 3, 2005, 100 countries had ratified the FCTC.

Excise Taxes. Cigarettes are also currently subject to substantial excise taxes in the United States. The federal excise tax per pack of 20 cigarettes is $0.39 as of [July 1], 2005. All states, the District of Columbia and the Commonwealth of Puerto Rico currently impose taxes at levels ranging from $0.07 per pack in South Carolina to $2.46 per pack in Rhode Island. In addition, certain municipalities also impose an excise tax on cigarettes ranging up to $1.50 per pack in New York City. According to the Cigarette Consumption Report, excise tax increases were

enacted in 20 states and New York City in 2002, in 13 states in 2003, in 11 states in 2004, and in 8 states (Kentucky, Maine, Minnesota, New Hampshire, North Carolina, Ohio, Virginia, and Washington) thus far in 2005. The population-weighted average state excise tax as of November 2005 is $0.913 per pack.

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

Civil Litigation

The tobacco industry has been the target of litigation for many years. Both individual and class action lawsuits have been brought by or on behalf of smokers alleging that smoking has been injurious to their health, and by non-smokers alleging harm from ETS. Plaintiffs in these actions seek compensatory and punitive damages aggregating billions of dollars. Philip Morris, for example, has reported that, as of September 30, 2005, there were 13 cases on appeal in which verdicts were returned against Philip Morris, including a compensatory and punitive damages verdict totaling approximately $10.1 billion in the *Price* case in Illinois. The Supreme Court of Illinois heard the defendant's appeal in *Price* and dismissed the case. See "– Class Action Lawsuits" below. The MSA does not release PMs from liability in either individual or class action cases. Healthcare cost recovery cases have also been brought by governmental and non-governmental healthcare providers seeking, among other things, reimbursement for healthcare expenditures incurred in connection with the treatment of medical conditions allegedly caused by smoking. The PMs are also exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims of the Settling States. Litigation has also been brought against certain PMs and their affiliates in foreign countries.

Pending claims related to tobacco products generally fall within four categories: (i) smoking and health cases alleging personal injury and purporting to be brought on behalf of a class of individual plaintiffs, including cases brought pursuant to a 1997 settlement agreement involving claims by flight attendants alleging injury from exposure to ETS in aircraft cabins (the *Broin II* cases, discussed below), (ii) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs, (iii) healthcare cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for healthcare expenditures allegedly caused by cigarette smoking and/or disgorgement of profits, and (iv) other tobacco-related litigation, including class action suits alleging that the use of the terms "Lights" and "Ultra Lights" constitute deceptive and unfair trade practices, suits by former asbestos manufacturers seeking contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking, and various antitrust suits and suits by foreign governments seeking to recover damages for taxes lost as a result of the allegedly illegal importation of cigarettes into their jurisdictions. Plaintiffs seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, legal fees, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, statutes of limitation and preemption by the Federal Cigarette Labeling and Advertising Act.

According to Altria, since January 1999 and through September 30, 2005, verdicts have been returned in 43 smoking and health cases, Lights/Ultra Lights cases and healthcare cost recovery cases in which Philip Morris was a defendant. Verdicts in favor of Philip Morris and other tobacco industry defendants were returned in 27 of these cases. Verdicts in favor of plaintiffs were returned in 16 cases. Appeals or post-trial motions by defendants and by plaintiffs are pending in many of these cases. Of the 16 cases in which verdicts were returned in favor of plaintiffs, three have reached final resolution with respect to Philip Morris. A $17.8 million verdict against defendants in a healthcare cost recovery case in New York was reversed, and all claims were dismissed with prejudice in February 2005 in the Blue Cross/Blue Shield case. In October 2004, after exhausting all appeals, Philip Morris paid $3.3 million in an individual smoking and health case in Florida (the Eastman case, discussed below). In March 2005, after exhausting all appeals, Philip Morris paid $17 million in an individual smoking and health case in California (the Henley case, discussed below). In addition, in February 2005, after exhausting all appeals, Reynolds Tobacco, due to its obligation to indemnify B&W, paid approximately $9.1 million in the *Boerner* case (see below) and on June 17, 2005, after exhausting all appeals, Reynolds Tobacco paid a $196,416 plus interest and costs judgment in an individual case in Kansas (the Burton case, discussed below).

Individual Plaintiffs' Lawsuits. The MSA does not release PMs from liability in individual plaintiffs' cases. Numerous cases have been brought by individual plaintiffs who allege that their cancer or other health effects have resulted from their use of cigarettes, addiction to smoking, or exposure to environmental tobacco smoke. Individual plaintiffs' allegations of liability are based on various theories of recovery, including but not limited to, negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, restitution, indemnification, violations of deceptive trade practice laws and consumer protection statutes, and claims under federal and state RICO statutes. The tobacco industry has traditionally defended individual health and smoking lawsuits by asserting, among other defenses, assumption of risk and/or comparative fault on the part of the plaintiff, as well as lack of proximate cause.

Altria has reported that as of November 1, 2005, there were approximately 1,157 individual plaintiff smoking and health cases pending in the United States against it (many of which cases include other tobacco industry defendants), including 928 cases pending before a single West Virginia state court in a consolidated proceeding. In addition, approximately 2,650 additional individual cases (referred to herein as the *Broin II* cases) are pending in Florida by individual current and former flight attendants claiming personal injury allegedly related to ETS in airline cabins. The individuals in the *Broin II* cases are limited by the settlement of a previous class action lawsuit, *Broin v. Philip Morris* (known as *Broin I*), to the recovery of compensatory damages only, and are precluded from seeking or recovering punitive damages. As a result of the settlement, however, the burden of proof as to whether ETS causes certain illnesses such as lung cancer and emphysema was shifted to the tobacco industry defendants. To date, seven individual *Broin II* flight attendant cases have gone to trial, one of which has resulted in a jury verdict against the tobacco industry defendants. The defendants' appeal in that case is pending. See also "Class Action Lawsuits" below.

In the last ten years, juries have returned verdicts in individual smoking and health cases against the tobacco industry, including one or more of the PMs. Thus far, a number of those cases have resulted in significant verdicts against the defendants and some have been appealed, some have been overturned and others have been affirmed. All post-trial motions and appeals have been exhausted and plaintiffs have been paid in only four cases.

By way of example only, and not as an exclusive or complete list, the following individual matters are illustrative of individual cases.

- In February 1999, a California jury in *Henley v. Philip Morris* awarded $1.5 million in compensatory damages and $50 million in punitive damages. The award was subsequently reduced by the trial judge to $25 million in punitive damages, and both Philip Morris and the plaintiff appealed. In September 2003, a California Court of Appeal further reduced the punitive damage award to $9 million, but otherwise affirmed the judgment for compensatory damages, and Philip Morris appealed to the California Supreme Court. In September 2004, the California Supreme Court dismissed Philip Morris' appeal. In October 2004, the California Court of Appeal issued an order allowing the execution of the judgment. In December 2004, Philip Morris filed with the United States Supreme Court a petition for a writ of certiorari. On March 21, 2005, the United States Supreme Court denied Philip Morris' petition. Philip Morris subsequently satisfied the judgment, paying $1.5 million in compensatory damages, $9 million in punitive damages and $6.4 million in accumulated interest.

- In March 1999, an Oregon jury in *Williams-Branch v. Philip Morris* awarded $821,500 in actual damages and $79.5 million in punitive damages. The trial judge subsequently reduced the punitive damages award to $32 million, but the reduction was overturned and the full amount of the punitive damages award was reinstated by the Oregon Court of Appeals. The Oregon Supreme Court declined to review the reinstated punitive damage award and Philip Morris petitioned the United States Supreme Court for further review. In October 2003, the United States Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of *State Farm v. Campbell*. In June 2004, the Oregon Court of Appeals reinstated the punitive damages award. In December 2004, the Oregon Supreme Court granted Philip Morris' petition for review of the case. Oral argument occurred on May 10, 2005. The appeal is pending.

- In April 1999, a Maryland jury in *Connor v. Lorillard* awarded $2.25 million in damages. An appellate court has remanded the case for a determination of the date of injury to determine whether a statutory cap on non-economic damages applies.

- In March 2000, a California jury in *Whiteley v. Raybestos-Manhattan, Inc.* returned a verdict in favor of the plaintiffs and found the defendants, including Philip Morris and Reynolds Tobacco, liable for negligent product design and fraud, and awarded $1.72 million in compensatory damages and $20 million in punitive damages. Both damage awards were upheld by the trial judge, who denied the defendants' post-verdict challenge. The defendants appealed the verdict. In April 2004, the California Court of Appeal reversed the judgment and remanded the case for a new trial. The plaintiff's motion for rehearing was denied on April 29, 2004. It is not known whether the plaintiffs will retry the case.

- In October 2000, a Tampa, Florida jury in *Jones v. R.J. Reynolds Tobacco Co.* found Reynolds Tobacco liable for negligence and strict liability and returned a verdict in favor of the widower of a deceased smoker, awarding approximately $200,000 in compensatory damages; the jury rejected the plaintiff's conspiracy claim and did not award punitive damages. Reynolds Tobacco filed a motion for judgment notwithstanding the verdict, or, in the alternative, for a new trial. On December 28, 2000, the court granted the motion for a new trial and on August 30, 2002 the Second District Court of Appeal of Florida affirmed the decision to grant a new trial. The plaintiff has filed for permission to appeal to the Florida Supreme Court. On December 9, 2002, the Supreme Court of Florida issued an order to show cause as to why Jones' notice of appeal should not be treated as a notice to invoke discretionary jurisdiction. On April 27, 2005 the Florida Supreme Court denied the plaintiff's notice of appeal without prejudice. On May 25, 2005 the plaintiff served an amended notice of intent to invoke discretionary jurisdiction. On June 22, 2005 the defendants filed their response.

- In November 2000, the Supreme Court of Florida reinstated the verdict by a Florida jury in *Carter v. Brown & Williamson Tobacco Corporation* to award $750,000 in damages to the plaintiff. In 1996, the jury had found that cigarettes were a defective product and that B&W was negligent for not warning people of the danger, but an appeals court reversed this decision. In March 2001, the plaintiff received slightly over $1 million from a trust account that contained the $750,000 jury award plus interest and became the first smoker to be paid by a tobacco company in an individual lawsuit. On June 29, 2001, the United States Supreme Court denied B&W's petition for a writ of certiorari, thus leaving the jury verdict intact.

- In June 2001, in *Boeken v. Philip Morris Incorporated*, a California state court jury found against Philip Morris on all six claims of fraud, negligence and making a defective product alleged by the plaintiff. The jury awarded the plaintiff $5.5 million in compensatory damages and $3 billion in punitive damages. The $3 billion punitive damages award was reduced to $100 million post-trial. Philip Morris appealed. In September 2004, the California Second District Court of Appeal further reduced the punitive damage award to $50 million, but otherwise affirmed the judgment entered in the case. In October 2004 the Court of Appeal granted the parties' motions for rehearing and, in April 2005, reaffirmed the amount of the September 2004 ruling. On August 10, 2005, the California Supreme Court denied Philip Morris's request for review.

- In December 2001, a Florida state court jury awarded the plaintiff $165,500 in compensatory damages but no punitive damages in *Kenyon v. R.J. Reynolds Tobacco Co.* Reynolds Tobacco appealed to the Second District Court of Appeal of Florida, which, on May 30, 2003, affirmed per curium (that is, without writing an opinion) the trial court's judgment in favor of the plaintiff. Reynolds Tobacco sent the plaintiff's counsel the amount of the judgment plus accrued interest ($196,000) in order to pursue further appeals. On September 5, 2003, Reynolds Tobacco petitioned the Florida Supreme Court to require the Second District Court of Appeal to write an opinion. On April 22, 2004, the Florida Supreme Court denied the petition. On January 26, 2004, the United States Supreme Court denied Reynolds Tobacco's petition for a writ of certiorari, thus

leaving the jury verdict intact. The only issue remaining in this case is the amount of attorneys' fees to be awarded to plaintiff's counsel.

- In February 2002, a federal jury in Kansas City awarded $198,000 in compensatory damages to a former smoker in *Burton v. R.J. Reynolds Tobacco Co*. The jury also determined that punitive damages were appropriate and, after a separate hearing was held to address that issue, the court awarded the plaintiff $15 million in punitive damages. On February 9, 2005, the United States Court of Appeals for the Tenth Circuit upheld the compensatory damages award, but unanimously reversed the award of punitive damages in its entirety. On May 17, 2005, the District Court entered a second amended judgment for $196,416 plus interest and costs. On June 17, 2005, Reynolds Tobacco paid the judgment.

- In March 2002, a Portland, Oregon jury awarded approximately $168,500 in compensatory damages and $150 million in punitive damages to the family of a light cigarette smoker in *Schwarz v. Philip Morris Incorporated*. The trial judge subsequently reduced the punitive damages awarded to $100 million. Philip Morris and the plaintiffs have each appealed.

- In September 2002, in *Figueroa-Cruz v. R.J. Reynolds Tobacco Co*., a Puerto Rico jury awarded two sons of a deceased smoker $500,000 each. The trial judge vacated one of the awards on statute of limitations grounds, and granted Reynolds Tobacco's motion for judgment as a matter of law on the other award on October 9, 2002. On October 28, 2003, the United States Court of Appeals for the First Circuit affirmed the trial court's ruling. The plaintiffs' petition for a writ of certiorari was denied by the United States Supreme Court in November 2004.

- In October 2002, in *Bullock v. Philip Morris, Inc*., a Los Angeles, California jury awarded a smoker $850,000 in compensatory damages. In October 2002, the same jury awarded the plaintiff $28 billion in punitive damages. In December 2002, the trial judge reduced the punitive damage award to $28 million. Philip Morris and the plaintiff have each appealed.

- In April 2003, in *Eastman v. Philip Morris*, a Florida jury awarded a smoker $3.255 million in damages, after reducing the award to reflect the plaintiff's partial responsibility. Defendants Philip Morris and B&W appealed to the Second District of Florida Court of Appeal. In May 2004, the Second District Court of Appeal rejected the appeal in a per curium decision (that is, without a written opinion). The defendants' petition for a written opinion and rehearing was denied on October 14, 2004, and that ruling is not subject to review by the Florida Supreme Court. On October 29, 2004, Philip Morris and Reynolds Tobacco, due to its obligation to indemnify B&W, satisfied their respective portions the judgment.

- In May 2003, in *Boerner v. Brown & Williamson*, an Arkansas jury awarded the plaintiff $15 million in punitive damages and $4 million in compensatory damages. Following a series of appeals, on January 7, 2005, the United States Court of Appeals for the Eighth Circuit affirmed the trial court's May 2003 judgment, but reduced the punitive damages award to $5 million. Reynolds Tobacco, due to its obligation to indemnify B&W, satisfied the approximately $9.1 million judgment on February 16, 2005.

- In November 2003, in *Thompson v. Philip Morris, Inc*., a Missouri jury returned a split verdict, awarding approximately $1.6 million in compensatory damages to the plaintiff and an additional $500,000 in damages to his wife. The jury apportioned 40% of fault to Philip Morris, 10% of fault to B&W and the remaining 50% to the plaintiff. Accordingly, under Missouri law, the court must reduce the damages award by half. The defendants appealed to the Missouri Court of Appeals for the Western District on March 8, 2004. The defendants' opening appellate brief was filed on May 23, 2005. The appeal is pending.

- In December 2003, in *Frankson v. Brown & Williamson*, a New York jury awarded the plaintiff $350,000 in compensatory damages and $20 million in punitive damages. On June 22, 2004, the

trial judge granted a new trial unless the parties agree to an increase in compensatory damages to $500,000 and a decrease in punitive damages to $5 million. On January 21, 2005, the plaintiff stipulated to the court's reduction in the amount of punitive damages. Defendants have appealed.

- In April 2004, a Florida jury returned a verdict in favor of the plaintiff in *Davis v. Liggett Group, Inc.*, awarding a total of $540,000 in actual damages. In addition, the jury awarded legal fees of $752,000. The jury did not award punitive damages. Liggett has appealed.

- In October 2004, in *Arnitz v. Philip Morris, Inc.*, a Florida jury returned a verdict in favor of the plaintiff, who claims that as a result of his smoking he developed lung cancer and emphysema. The jury awarded a total of $240,000 in compensatory damages. Philip Morris, the sole defendant in the case, has appealed to the Florida Second District Court of Appeals.

- In February 2005, in *Smith v. Brown & Williamson*, a Missouri state court jury returned a split verdict, finding in favor of the defendant on counts of fraudulent concealment and conspiracy and in favor of the plaintiffs on a negligence count. The jury awarded the plaintiffs $500,000 in compensatory damages and $20 million in punitive damages. On March 10, 2005, the defendant filed a motion for judgment notwithstanding the verdict or, in the alternative, for a new trial. On May 23, 2005, the trial court denied defendant's motion and on June 1, 2005, the defendant appealed.

- In March 2005, in *Rose v. Philip Morris*, a New York jury awarded $3.42 million in compensatory damages against B&W and Philip Morris. The jury also returned a punitive damages award totaling $17.1 million against Philip Morris. Post trial motions were filed on May 27, 2005 and Philip Morris announced that it would file motions challenging the verdict. Briefing is complete.

In August 2002, the California Supreme Court issued a decision limiting evidence of wrongdoing between 1988 and 1998 by tobacco companies. One OPM has reported that this decision worked to the advantage of the tobacco industry defendants in the *Whiteley* case and it believes that it will have a favorable impact for tobacco industry defendants in other California cases, both at the trial court level and on appeal.

Class Action Lawsuits. The MSA does not release the PMs from liability in class action lawsuits. Plaintiffs have brought claims as class actions on behalf of large numbers of individuals for damages allegedly caused by smoking, price fixing and consumer fraud. One OPM has reported that, as of November 1, 2005, there were 35 such class actions pending against it in the United States, as well as one each in Poland, Brazil and Israel. Plaintiffs in class action smoking and health lawsuits allege essentially the same theories of liability against the tobacco industry as those in the individual lawsuits. Other class action plaintiffs allege consumer fraud or violations of consumer protection or unfair trade statutes. Plaintiffs historically have had limited success in obtaining class certification, a prerequisite to proceeding as a class action lawsuit, because of the individual circumstances related to each smoker's election to smoke and the individual nature of the alleged harm. One OPM reports that class certification has been denied or reversed in 56 smoking and health class actions involving that OPM.

To date, plaintiffs have successfully maintained class certification in federal and state court class action cases in at least the following states: California, Florida, Illinois, Louisiana, Massachusetts, Minnesota, Missouri, New York, North Carolina, Ohio, Oregon, Washington and West Virginia. One OPM reports that 17 federal courts that have considered the issue, including two courts of appeals, have rejected class certification in smoking and health cases. Only one federal district court has certified a smoker class action (*In re Simon (II) Litigation*, discussed below); but that class was subsequently decertified by the United States Court of Appeals for the Second Circuit.

On September 6, 2000, in *In re Simon (II) Litigation*, lawyers for plaintiffs in ten tobacco-related cases pending in United States District Court for the Eastern District of New York filed suit in the same court (before Judge Weinstein) to consolidate the pending cases and seek certification of a class and subclasses to obtain compensatory and punitive damages from the tobacco industry defendants. The pending cases included individual and purported nationwide class action lawsuits alleging tobacco-related personal injuries, as well as healthcare cost recovery cases brought by union trust funds, an insurance plan and an asbestos fund. The suit sought to certify a

nationwide class action to consolidate all punitive damage aspects of the pending cases for a single trial and to try the compensatory damage aspects of the pending claims separately. On September 19, 2002, Judge Weinstein certified a class to hear the punitive damages claims. The class consisted of all smokers diagnosed with a variety of illnesses, including lung cancer, emphysema and some forms of heart disease, after April 9, 1993. In May 2005, the U.S. Court of Appeals for the Second Circuit, in a unanimous opinion, decertified the class. Plaintiffs' motion for rehearing en banc was denied on August 8, 2005. Two of the 10 original cases, *Falise v. American Tobacco Co.*, and *H.K. Porter Company, Inc. v. The American Tobacco Company* were dismissed in June 2001 and July 2001, respectively. Other plaintiffs who would have been part of the *Simon II* class remain free to pursue their own individual lawsuits.

A number of state courts also have rejected class certification. In May 2000, Maryland's highest court ordered the trial court to vacate its certification of a class in *Richardson v. Philip Morris*. The parties agreed to dismiss the case in March 2001. In September 2000, in *Walls v. American Tobacco Co.*, an Oklahoma state court answered a series of state law questions, certified to the state court by the federal court where the purported class was filed, in such a way that led the parties to stipulate that the case should not be certified as a class action in federal court and that the individual plaintiffs would dismiss their federal court cases without prejudice. In October 2000, the federal court issued its order refusing to certify the case as a class action, and dismissed the individual plaintiffs' cases.

In December 2000, in *Geiger v. American Tobacco Co.*, the Appellate Division of the Supreme Court of New York affirmed the trial court's denial of class action status to a purported class defined as all New York residents, including their heirs, representatives, and estates, who contracted lung or throat cancer as a result of smoking cigarettes. Plaintiffs filed a motion for leave to appeal the order denying certification to the New York Court of Appeals, the highest court in the state. The New York Court of Appeals dismissed the plaintiff's appeal in February 2001.

In *Engle v. R.J. Reynolds Tobacco Co.*, a Florida state court certified a class of Florida smokers alleging injury due to their tobacco use. The estimated size of the class ranges from 300,000 to 700,000 members. The court determined that the lawsuit could be tried as a class action because, even though certain factual issues are unique to individual plaintiffs and must be tried separately, certain other factual issues were common to all class members and could be tried in one proceeding for the whole class. In July 1999, in the first phase of a three-phase trial, the jury found against the defendants regarding the issues common to the class, such as whether smoking caused certain diseases, whether tobacco was addictive, and whether the tobacco companies withheld information from the public. In July 2000, in the second phase of the *Engle* trial, the jury returned a verdict assessing punitive damages totaling approximately $145 billion against the tobacco industry defendants. Following entry of judgment, the defendants appealed. The defendants posted bonds to stay collection of the final judgment with respect to the punitive damages against them and statutory interest thereon pending the exhaustion of all appeals. In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the trial court and instructed the trial court to order the decertification of the class. The plaintiffs petitioned the Florida Supreme Court for further review and, in May 2004, the Florida Supreme Court agreed to review the case. Oral arguments were heard in November 2004.

Florida has enacted legislation capping the amount of the appeal bond necessary to stay execution of the punitive judgment pending appeal to the lesser of (i) the amount of punitive damages, plus twice the statutory rate of interest or (ii) 10% of a defendant's net worth, but in no case more than $100 million. Thirty-two other states have passed and several additional states are considering statutes limiting the amount of bonds required to file an appeal of an adverse judgment in state court. The limitation on the amount of such bonds generally ranges from $25 million to $150 million. Such bonding statutes allow defendants that are subject to large adverse judgments, such as cigarette manufacturers, to reasonably bond such judgments and pursue the appellate process. In six jurisdictions – Connecticut, Maine, Massachusetts, New Hampshire, Vermont and Puerto Rico – the filing of a notice of appeal automatically stays the judgment of the trial court.

One OPM has reported that the *Engle* plaintiffs believe the Florida appeal bond legislation is unconstitutional. In the event that a court of final jurisdiction were to declare the legislation unconstitutional, one OPM has stated that in a worst case scenario, it is possible that a judgment for punitive damages could be entered in an amount not capable of being bonded, resulting in an execution of the judgment before it could be set aside on appeal. On May 7, 2001, the trial court approved a stipulation (the "**Stipulation**") among Philip Morris, Lorillard and Liggett (the "**Stipulating Defendants**"), the plaintiffs, and the plaintiff class that provides that execution or

enforcement of the punitive damages component of the *Engle* judgment will remain stayed against the Stipulating Defendants through the completion of all judicial review, regardless of a challenge, if any, to the Florida bond statute. Under the Stipulation, Philip Morris has placed $1.2 billion into an interest-bearing escrow account. Should Philip Morris prevail in its appeal of the case, this escrow amount is to be returned to Philip Morris, together with its $100 million appeal bond previously posted. In addition, Philip Morris, Lorillard and Liggett have also placed $500 million, $200 million (including Lorillard's appeal bond), and $9.72 million (including Liggett's appeal bond), respectively, into a separate interest-bearing escrow account for the benefit of the *Engle* class (the "**Guaranteed Amount**"). Even if the Stipulating Defendants prevail on appeal, the Guaranteed Amount will be paid to the court, and the court will determine how to allocate or distribute it consistent with the Florida Rules of Civil Procedure.

One *Engle* class member has already gone to trial. In *Lukacs v. Reynolds Tobacco*, a Florida appellate court granted the plaintiff the right to proceed before he died, but stated that any award in favor of the plaintiff would not be enforced until after the *Engle* appeal is decided. On June 11, 2002, a Florida jury awarded $37.5 million in compensatory damages to the plaintiff. On April 1, 2003, the Dade County Circuit Court granted in part the defendants' motion for remittitur, reducing the total award to $25.125 million. Because no final judgment will be entered until the *Engle* appeal is resolved, the defendants time to appeal the case has not yet begun to run. One OPM reports that it is a defendant in 11 separate cases pending in Florida courts in which the plaintiffs claim that they are members of the *Engle* class, that all liability issues associated with their claims were resolved in the earlier phases of the *Engle* proceedings, and that trials on their claims should proceed immediately. That OPM also reports that none of the cases in which plaintiffs contend they are members of the *Engle* class are expected to proceed until all appellate activity in *Engle* is concluded.

In October 1997, the tobacco industry defendants settled another class action case, *Broin I*. *Broin I* was brought in Florida state court by flight attendants alleging injuries related to ETS. See "*Individual Plaintiffs' Lawsuits*" above. The *Broin I* settlement established a protocol for the resolution of individual claims by class members against the tobacco companies. In addition to shifting the burden of proof to defendants as to whether ETS causes certain illnesses such as lung cancer and emphysema, the *Broin I* settlement required defendants to pay $300 million to be used to establish a foundation to sponsor research with respect to the early detection and cure of tobacco-related diseases. Individual members of the *Broin I* class retained the right to bring individual claims, although they are limited to non-fraud type claims and may not seek punitive damages. One OPM has reported that as of November 1, 2005, approximately 2,650 of these individual cases (known as *Broin II* cases) are pending in Florida. In October 2000, Judge Robert P. Kaye, the presiding judge of the original *Broin I* class action, held that the flight attendants will not be required to prove the substantive liability elements of their claims for negligence, strict liability and breach of implied warranty in order to recover damages, if any. The court also ruled that the trials of these suits will address whether the plaintiffs' alleged injuries were caused by their exposure to ETS and, if so, the amount of damages. The defendants' appeal of these rulings was dismissed by the intermediate appellate court on the basis that the appeal was premature and that the court lacked jurisdiction. On January 23, 2002, the defendants asked the Florida Supreme Court to review the district court's order. That request was denied.

Seven *Broin II* cases have gone to trial since Judge Kaye's ruling in October 2000. Six of these cases have resulted in verdicts for the defendants: *Fontana* in June 2001, Tucker in June 2002, *Janoff* in October 2002, *Seal* in February 2003, *Routh* in October 2003 and *Swaty* in May 2005. Appeals are pending in some of these cases. On September 12, 2002, the plaintiff in the *Janoff* case filed a motion for a new trial, which the judge granted on January 8, 2003. The defendants appealed to the Florida Third District Court of Appeal, which, on October 27, 2004, affirmed the trial court's order granting a new trial. The defendants' motion for rehearing was denied. The defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court on June 17, 2005. In *Swaty*, the plaintiff filed a motion for a new trial on May 12, 2005, which was denied on June 23, 2005. On May 17, 2005, the court entered a final judgment in favor of the defendants. The plaintiff's motion for a new trial was denied on June 23, 2005. The plaintiff filed a notice of appeal on July 21, 2005. The one plaintiff's verdict was returned in *French v. Philip Morris*. On June 18, 2002, the *French* jury awarded the plaintiff $5.5 million in damages, finding that the flight attendant's sinus disease was cause by ETS. On September 13, 2002, the judge reduced the award to $500,000. The defendants appealed the trial court's final judgment to the Florida Third District Court of Appeal on various grounds, the primary one being that under Judge Kaye's October 2000 ruling, the burden of proof was erroneously shifted and the plaintiff was not required to show that the tobacco companies' cigarettes were defective, that the tobacco company defendants acted negligently or that a warranty was made and breached. In December 2004, the Florida Third District Court of Appeal affirmed the judgment awarding plaintiff

$500,000 and directed the trial court to hold the defendants jointly and severally liable. In April 2005, the appellate court denied defendants' motion for a rehearing. On May 11, 2005, the defendants filed a notice of intent to invoke the discretionary jurisdiction of the Florida Supreme Court. Jurisdictional briefing is complete.

In *Scott v. American Tobacco Company, Inc.*, a Louisiana medical monitoring and smoking cessation case, the court certified a class consisting of smokers desiring to participate in a program designed to assist them in the cessation of smoking and monitor the medical condition of class members to ascertain whether they might be suffering from diseases caused by cigarette smoking. The class members may also choose to bring individual smoking and health lawsuits. On July 28, 2003, following the first phase of a trial, the jury returned a verdict in favor of the tobacco industry defendants on the medical monitoring claim and found that cigarettes were not defective products. The jury found against the defendants, however, on claims relating to fraud, conspiracy, marketing to minors and smoking cessation. On March 31, 2004, phase two of the trial began to address the scope and cost of smoking cessation programs. On May 21, 2004, the jury returned a verdict in the amount of $591 million ($590 million plus prejudgment interest accruing from the date the suit commenced) on the class's claim for a smoking cessation program. On July 1, 2004, the judge upheld the jury's verdict and awarded the plaintiffs prejudgment interest, which, as of November 1, 2005, totals $384 million. On August 31, 2004, the defendants' motion for judgment notwithstanding the verdict or, in the alternative, for a new trial was denied. On September 29, 2004, pursuant to a stipulation of the parties, the defendants posted a $50 million bond (pursuant to legislation that limits the amount of the bond to $50 million collectively for MSA signatories) and noticed their appeal, which is pending. Under the terms of the stipulation, the plaintiffs reserved the right to contest the constitutionality of the bond cap law.

In August 2000, a West Virginia state court conditionally certified, only to the extent of medical monitoring, in *In re Tobacco Litigation* (formerly known as *Blankenship*), a class of West Virginia residents. The plaintiffs proposed that the class include all West Virginia residents who (1) on or after January 1, 1995, smoked cigarettes supplied by defendants; (2) smoked at least a pack a day for five years without having developed any of a specified list of tobacco-related illness; and (3) do not receive healthcare paid or reimbursed by the state of West Virginia. Trial began in January 2001. On January 25, 2001, the trial court granted a motion for a mistrial, ruling that the plaintiffs had improperly introduced testimony about addiction to smoking as a basis for claiming damages. In March 2001, the court denied the defendants' motion to decertify the class. The retrial began in September 2001, and on November 14, 2001 the jury returned a verdict that defendants were not liable for funding the medical monitoring program. On July 18, 2002, the plaintiffs petitioned the Supreme Court of West Virginia for leave to appeal, which was granted on February 25, 2003. The Supreme Court of West Virginia affirmed the judgment for the defendants on May 6, 2004. On July 1, 2004, the class's petition for rehearing was denied. The plaintiffs did not seek review by the United States Supreme Court.

Approximately 1,009 cases against tobacco industry defendants are pending in a single West Virginia court in a consolidated proceeding. The West Virginia court has scheduled a single trial for these consolidated cases, but it has certified a question to the Supreme Court of Appeals of West Virginia requesting a determination of the extent to which the claims in these individual cases can be consolidated in a single trial.

In *Daniels v. Philip Morris*, a California state court case, the court certified a class comprised of individuals who were minors residing in California, who were exposed to defendants' marketing and advertising activities, and who smoked one or more cigarettes within the applicable time period. Certification was granted as to plaintiff's claims that defendants violated the state's unfair business practice laws. On September 12, 2002, the trial court judge granted the defendants' motion for summary judgment on First Amendment and preemption (Federal Cigarette Labeling and Advertising Act) claims. In November 2002, the court confirmed its earlier rulings granting defendant's motion for summary judgment. The plaintiffs filed a petition for review with the California Supreme Court. On February 26, 2005, the California Supreme Court granted the petition. Briefing by the parties is complete. The Attorney General of the State has filed an amicus curiae brief in support of the plaintiffs' position.

During April 2001, a California state court issued an oral ruling in the case of *Brown v. The American Tobacco Company, Inc.*, in which it granted in part plaintiff's motion for class certification and certified a class comprised of residents of California who smoked at least one of defendants' cigarettes during the period from June 10, 1993 through April 23, 2001 and who were exposed to defendants' marketing and advertising activities in California. Certification was granted as to plaintiff's claims that defendants violated California Business and Professions Code Sections 17200 and 17500. The court denied the motion for class certification as to plaintiff's

claims under the California Legal Remedies Act. Defendants' writ with the court of appeals challenging the trial court's class certification was denied on January 16, 2002. The defendants filed a motion for summary judgment on January 31, 2003. On August 4, 2004, the defendants motion for summary judgment was granted in part and denied in part. Following the November 2004 election, and the passage of a proposition in California that brought about a change in the law regarding the requirements for filing cases of this nature, the defendants filed a motion to decertify the class based on the changes in the law. On March 7, 2005, the court granted the defendants' motion to decertify the class. On March 17, 2005, plaintiffs filed a motion for reconsideration of the court's ruling decertifying the class. The trial judge denied the plaintiffs' motion on April 20, 2005 and the plaintiffs have appealed on May 19, 2005.

Altria has reported that, as of November 1, 2005, there were 25 putative class actions pending against Philip Morris in the United States on behalf of individuals who purchased and consumed various brands of cigarettes, including Marlboro Lights, Marlboro Ultra Lights, Virginia Slims Lights, Merit Lights and Cambridge Lights. These actions allege, among other things, that the use of the terms "Lights" or "Ultra Lights" constitutes deceptive and unfair trade practices and seek injunctive and equitable relief, including restitution. Classes have been certified in cases pending in Illinois, Massachusetts, Minnesota and Missouri, and in two cases pending in Ohio. Philip Morris has appealed or otherwise challenged these class certification orders. Additionally, an appellate court in Florida has overturned a class certification by a trial court in that state, and the plaintiffs have petitioned the Florida Supreme Court for further review. The Florida Supreme Court has stayed further proceedings pending its decision in the *Engle* case.

In one of these cases, *Price v. Philip Morris Cos., Inc.* (formerly known as *Miles v. Philip Morris, Inc.*), a Madison County Illinois state court judge certified a class comprised of all residents of Illinois who purchased and consumed Cambridge Lights and Marlboro Lights within a specified time period but who do not have a claim for personal injury resulting from the purchase or consumption of cigarettes. The plaintiffs in the *Price* case allege consumer fraud claims and sought economic damages in the form of a refund of purchase costs of the cigarettes. On March 21, 2003, after a non-jury trial, the trial court judge ruled in favor of the plaintiffs, ordering Philip Morris to pay $10.1 billion ($7.1 billion in compensatory damages, $3.0 billion in punitive damages) to the State of Illinois, and $1.78 billion in plaintiff lawyer fees to be paid from the $10.1 billion. The court also stayed execution of the judgment for 30 days.

After entry of the judgment on March 21, 2003, Philip Morris had 30 days within which to file a notice of appeal. Under Illinois state court rules applicable at the time, the enforcement of a trial court's money judgment may be stayed only if, among other things, an appeal bond in an amount sufficient to cover the amount of the judgment, interest and costs is posted by a defendant within the 30-day period during which an appeal may be taken. With the approval of the trial court, such 30-day period may be extended for up to an additional 15 days. The trial court judge initially set the bond in the amount of $12 billion. Because of the difficulty of posting a bond of that magnitude, Philip Morris pursued various avenues of relief from the $12 billion bond requirement. In April 2003, the judge reduced the amount of the appeal bond. He ordered the bond to be secured by $800 million, payable in four equal quarterly installments beginning in September 2003, and a pre-existing 7.0%, $6 billion long-term note from Altria Group, Inc. to Philip Morris to be placed in an escrow account pending resolution of the case. The plaintiffs appealed the judge's order reducing the amount of the bond. On July 14, 2003, the Illinois Fifth District Court of Appeals ruled that the trial court had exceeded its authority in reducing the bond and ordered the trial judge to reinstate the original bond. On September 16, 2003, the Illinois Supreme Court upheld the reduced bond set by the trial court and agreed to hear Philip Morris' appeal without the need for intermediate appellate court review. On December 15, 2005, the Illinois Supreme Court reversed the trial court's judgment and remanded the case to the trial court with instructions to dismiss the case in its entirety. In its decision, the court held that the defendant's conduct alleged by the plaintiffs to be fraudulent under the Illinois Consumer Fraud Act was specifically authorized by the Federal Trade Commission and that the Illinois Consumer Fraud Act specifically exempts conduct so authorized by a regulatory body acting under the authority of the United States. The court declined to review the case on the merits, concluding that the action was barred entirely by the Illinois Consumer Fraud Act. It is possible that the plaintiffs will seek further appeals and/or rehearings. No assurance can be given that that such appeals and/or rehearings will not be granted or decided in the plaintiffs' favor. Madison County Illinois courts have certified similar classes in *Turner v. R.J. Reynolds Tobacco Co.* and *Howard v. Brown & Williamson*. In *Turner*, for example, the state court judge certified a class defined as "[a]ll persons who purchased defendants' Doral Lights, Winston Lights, Salem Lights and Camel Lights, in Illinois, for personal consumption, between the first date that

defendants sold Doral Lights, Winston Lights, Salem Lights and Camel Lights through the date the court certifies this suit as a class action…." On June 6, 2003, Reynolds Tobacco filed a motion to stay the case pending Philip Morris' appeal of the *Price* case. On July 11, 2003, the court denied the motion, and Reynolds Tobacco appealed to the Illinois Fifth District Court of Appeals. The Court of Appeals denied this motion on October 17, 2003. On October 20, 2003, the trial judge ordered that the case be stayed for 90 days, or pending the result of the *Price* appeal. The order stated that a hearing would be held at the end of the 90-day period to determine if the stay should be continued. However, on October 24, 2003, a justice on the Illinois Supreme Court ordered an emergency stay of all proceedings pending review by the entire Illinois Supreme Court of Reynolds Tobacco's emergency stay order request filed on October 15, 2003. On November 5, 2003, the Illinois Supreme Court granted Reynolds Tobacco's motion for a stay pending the court's final appeal decision in *Price*. [Update to come.] The *Howard* case also remains stayed by order of the trial judge, although the plaintiffs have appealed this stay order to the Illinois Fifth District Court of Appeals. [Update to come.]

On December 31, 2003, a Missouri state court judge certified a similar class in *Collora v. R.J. Reynolds Tobacco Co.* On January 14, 2004, Reynolds Tobacco removed the case to the United States District Court for the Eastern District of Missouri. On September 30, 2004, the case was remanded to the Circuit Court for the City of St. Louis. In August 2004, Massachusetts' highest court affirmed the class certification order in another "lights" case, *Aspinall v. Philip Morris Cos*. In March 2005, a Minnesota appeals court declined to review a state trial court's denial of class certification in a "lights" case, *Curtis v. Philip Morris*. In May 2005, also in Minnesota, a state court judge dismissed in its entirety a similar case, *Dahl v. R.J. Reynolds Tobacco Company*, ruling that the claims of the plaintiffs conflicted with the federal Cigarette Labeling and Advertising Act. On July 11, 2005, the plaintiffs filed a notice of appeal with the Minnesota Court of Appeals.

According to Reynolds American, six other similar "lights" cases are pending against Reynolds Tobacco, although no classes have yet been certified in any of those cases. In August 2005, the Missouri Court of Appeals, Eastern District, affirmed the class certification order in *Craft v. Philip Morris Cos*. On August 31, 2005, a Louisiana federal district court ruled in a proposed class action, *Sullivan v. Philip Morris*, that the Federal Cigarette Labeling and Advertising Act (FCLAA) does not preempt plaintiffs' claims of a breach of express warranty and certain state law remedies with respect to manufacturing defects. On September 14, 2005, the same district court ruled in a proposed class action, *Brown v. Brown & Williamson*, that the FCLAA does not preempt plaintiffs' fraudulent misrepresentation/concealment and defective product claims. On June 9, 2005, a proposed "lights" class action was filed in a federal District Court in New Mexico. On June 27, 2005, a similar class action was filed in a Kansas state court against Philip Morris and its parent Altria. Philip Morris and Altria are reportedly seeking to have the Kansas case transferred to federal court in Kansas, and that on August 13, 2005, three individuals filed a similar class action in the U.S. District Court for the District of Maine against the same defendants.

In *Schwab v. Philip Morris USA, Inc.*, smokers of "Lights" cigarettes filed a purported class action suit in the United States District Court for the Eastern District of New York against the OPMs and their parent companies, Liggett and certain other entities. Plaintiffs allege that the defendants formed an "association-in-fact" enterprise, in violation of the federal RICO statute, to defraud the public into believing that "light" cigarettes were healthier alternatives to regular cigarettes. Plaintiffs seek to certify a nationwide class of smokers comprising all purchasers of "light" cigarettes manufactured by the defendants since the 1970's. Oral argument on the plaintiffs' motion for class certification occurred on September 12, 2005. The defendants filed a motion to deny class certification and to dismiss the complaint, asserting that the plaintiffs' request – that any determination as to damages payable to a certified class be allocated among class members on a "fluid recovery" basis – is illegal. On November 14, 2005, the court denied the defendants' motion, ruling that the plaintiffs' request for "fluid recovery" is not illegal and does not require denial of class certification or dismissal of the action.

On May 23, 2001, a lawsuit was filed in the United States District Court for the District of Columbia styled *Sims v. Philip Morris Incorporated*, which sought class action status for millions of youths who began smoking cigarettes before they were legally allowed to buy cigarettes. Plaintiffs sought to recover moneys that underage smokers spent on cigarettes before they were legally allowed to buy cigarettes, whether or not they have suffered health problems, and/or profits the tobacco manufacturers have earned from sales to children. The lawsuit alleged that tobacco manufacturers concealed the addictive nature of cigarettes and concealed the health risks of smoking in their advertising. In February 2003, the court denied plaintiffs' motion for class certification.

On April 3, 2002, in *Deloach v. Philip Morris*, a federal district court in North Carolina granted class certification to a group of tobacco growers and quota-holders from Alabama, Florida, Georgia, North Carolina, South Carolina and Tennessee. The class accused cigarette manufacturers of conspiring to set prices offered for tobacco in violation of antitrust laws. In June 2002, the defendants' petition to the Fourth Circuit Court of Appeals seeking permission to appeal the class certification was denied. In May 2003, the plaintiffs reached a settlement with all of the tobacco industry defendants other than Reynolds Tobacco. The settling defendants agreed to pay $210 million to the plaintiffs, to pay plaintiffs' attorney fees of $75.3 million as set by the court and to purchase a minimum amount of U.S. leaf for ten years. The case continued against Reynolds Tobacco. On April 22, 2004, after the trial began, the parties settled the case. Under the settlement, Reynolds Tobacco has paid $33 million into a settlement fund, which, after deductions for attorneys' fees and administrative costs, will be distributed to the class pending final settlement approval. Reynolds Tobacco has also agreed to purchase a minimum amount of U.S. leaf for the next ten years. On March 21, 2005, the court approved the settlement and dismissed the suit.

Healthcare Cost Recovery Lawsuits. In certain pending proceedings, domestic and foreign governmental entities and non-governmental plaintiffs, including Native American tribes, insurers and self-insurers such as Blue Cross and Blue Shield plans, hospitals and others, are seeking reimbursement of healthcare cost expenditures allegedly caused by tobacco products and, in some cases, of future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees. The PMs are exposed to liability in these cases, because the MSA only settled healthcare cost recovery claims belonging to the Settling States. Altria has reported that as of November 1, 2005, there were six healthcare cost recovery actions pending against Philip Morris in the United States. In addition, it has been reported that on August 4, 2005, a national senior citizens' organization has filed a lawsuit against cigarette manufacturers under the federal "Medicare as Secondary Payer" statute, which permits Medicare beneficiaries or others to bring actions on behalf of Medicare to recover healthcare costs paid by Medicare for which another party may be liable. The plaintiffs are reportedly seeking to recover more than $60 billion in alleged Medicare spending on treatment of smoking related illnesses since 1999. This lawsuit reportedly does not seek to recover Medicare payments in Florida, where a similar suit has been filed. The Florida case was dismissed on July 26, 2005 and the plaintiffs have appealed.

The claims asserted in the healthcare cost recovery actions include the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of healthcare costs allegedly attributable to smoking, the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal Racketeer Influenced and Corrupt Organizations Act ("**RICO**") and parallel state statutes.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, "unclean hands" (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust standing and injury, federal preemption, lack of statutory authority to bring suit, and statutes of limitations. In addition, defendants argue that they should be entitled to "set off" any alleged damages to the extent the plaintiff benefits economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer) can seek recovery of healthcare costs from a third party solely by "standing in the shoes" of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual healthcare recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most courts that have decided motions in these cases have dismissed all or most of the claims against the industry. In addition, eight federal circuit courts of appeals, the Second, Third, Fifth, Seventh, Eighth, Ninth, Eleventh and District of Columbia circuits, as well as California, Florida, New York and Tennessee intermediate appellate courts, relying primarily on grounds that plaintiffs' claims were too remote, have affirmed dismissals of, or reversed trial courts that had refused to dismiss,

healthcare cost recovery actions. The United States Supreme Court has refused to consider plaintiffs' appeals from the cases decided by the courts of appeals for the Second, Third, Fifth, Ninth and District of Columbia circuits.

A number of foreign governmental entities have filed suit in state and federal courts in the United States against tobacco industry defendants to recover funds for healthcare and medical and other assistance paid by those foreign governments to their citizens. Such suits have been brought in the United States by 13 countries, a Canadian province, 11 Brazilian states and 11 Brazilian cities. Thirty-four of these suits have been dismissed and two remain pending. In addition to these cases brought in the United States, healthcare cost recovery actions have also been brought in Israel, the Marshall Islands (where the suit was dismissed), Canada, France and Spain. In September 2003, the case pending in France was dismissed and the plaintiff has appealed. In May 2004, the case pending in Spain was dismissed and the plaintiff has appealed. Other governmental entities have stated that they are considering filing such actions. On September 29, 2005, the Supreme Court of Canada upheld legislation passed in 1998 by the province of British Columbia allowing the provincial government to seek damages from tobacco companies for healthcare costs incurred during the past 50 years, as well as for future illness-related expenses in connection with tobacco use. The legislation also lightens the required burden of proof and curtails certain traditional defenses in civil suits. Other provinces are reported to have already adopted or are expected to adopt similar legislation.

In September 1999, the United States government filed a lawsuit in the United States District Court for the District of Columbia against the OPMs, certain related parent companies and two tobacco industry research and lobbying organizations, seeking medical cost recovery for federal funds spent to treat alleged tobacco-related illnesses and asserting violation of RICO. In September 2000, the trial court dismissed the government's medical cost recovery claims, but permitted discovery to proceed on the government's claims for relief under RICO. The government alleged that disgorgement by defendants of approximately $280 billion is an appropriate remedy. In May 2004, the court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In June 2004, the trial court certified that order for immediate appeal, and in July 2004, the United States Court of Appeals for the District of Columbia agreed to hear the appeal on an expedited basis. On February 4, 2005, the appeals court, in a 2-1 decision, ruled that disgorgement is not an available remedy in this case. This ruling eliminated the government's claim for $280 billion and limits the government's potential remedies principally to forward-looking relief, including funding for anti-smoking programs. The government appealed this ruling to seek a rehearing en banc. On April 20, 2005, the appeals court denied the government's appeal. On July 18, 2005, the government appealed the ruling with regard to the $280 billion disgorgement decision to the United States Supreme Court. On October 17, 2005 the U.S. Supreme Court, without comment, denied the appeal.

In addition to the claim for disgorgement, the government seeks relief consisting of, among other things, (i) prohibitory injunctions (including prohibitions on committing acts of racketeering, making false or misleading statements about cigarettes, and on youth marketing); (ii) disclosure of documents concerning the health risks and addictive nature of smoking, the ability to develop less hazardous cigarettes and youth marketing campaigns; (iii) mandatory corrective statements about the health risks of smoking and the addictive properties of nicotine in future marketing campaigns; and (iv) funding of remedial programs (including research, public education campaigns, medical monitoring programs, and smoking cessation programs). The trial phase of the case concluded on June 9, 2005. In its closing argument and submissions, the government requested that the tobacco industry be required to fund an up to ten-year, $14 billion smoking cessation program. The government has reportedly also asked the court to appoint a lawyer as monitor with power to order the defendants to sell off their research and development facilities related to developing so-called safer cigarettes. The monitor would also have power to review the business policies of the defendants. The government has also reportedly requested that restrictions be placed on the defendants' ability to sell their cigarette businesses and that the defendants be compelled to run public advertisements regarding the dangers of smoking. It has been reported that the defendants have filed a motion to dismiss the government's request for the $14 billion award, arguing that the award was barred by the February 4, 2005 appellate decision. On July 22, 2005, the District Court judge granted the motion made under Federal Rule of Civil Procedure 24 by six public interest groups to intervene in this action for the very limited purpose of being heard on the issue of permissible and appropriate remedies in this case, should the government prevail on its claims with respect to smoking cessation programs.

In January of 2001, the Canadian Province of British Columbia enacted the Damages and Healthcare Costs Recovery Act (the "**HCCR Act**"). The HCCR Act authorizes an action by the government of British Columbia

against a manufacturer of tobacco products for the recovery by the government of the present value of past and reasonably expected future healthcare expenditures incurred by the government in treating British Columbians with diseases caused by exposure to tobacco products, where such exposure was caused by a manufacturer's tort in British Columbia or a breach of a duty owed to persons in British Columbia. The HCCR Act allows the government to bring such action for expenditures related to a particular individual or on an aggregate basis for a population of persons. In an action brought on an aggregate basis, the Act does not require the government identify a particular person or to prove particular injury, healthcare costs or causation of harm with respect to any particular person. Where the government proves in an aggregate claim with respect of a type of tobacco product that a manufacturer breached a legal duty owed to persons who have been or might become exposed to the tobacco product and that exposure to the tobacco product can cause or contribute to a disease, the court is required to presume that (1) the population of persons who were exposed to the tobacco product would not have been exposed to the product but for the breach of duty and (2) such exposure caused or contributed to disease or risk of disease in such population of persons. In such cases, the court is required to determine on an aggregate basis the cost of healthcare benefits provided after the date of the breach of duty and to assess liability among defendants based on the proportion of the aggregate cost equal to each defendant's market share in the type of tobacco product. Statistical information and information derived from epidemiological and other relevant studies is admissible as evidence under the HCCR Act to establish causation and for quantifying damages in an action brought by the government under the HCCR Act or in an action brought by a class of persons under Canada's class action statute.

Subsequently to the enactment of the HCCR Act, the government of British Columbia brought an action under the HCCR Act against certain foreign and domestic tobacco manufacturers, including Philip Morris International, a subsidiary of Altria. The defendants challenged the constitutionality of the HCCR Act and in a decision dated June 5, 2003, British Columbia's trial level court held that the HCCR Act was unconstitutional as exceeding the territorial jurisdiction of the Province. On appeal, British Columbia's highest court reversed the lower court in a decision dated May 20, 2004, holding that the HCCR Act was constitutional. The matter was appealed to the Canadian Supreme Court, Canada's highest court. By a unanimous decision dated September 29, 2005 the Canadian Supreme Court affirmed the lower court, holding that the HCCR Act was constitutional. In the decision, the court also vacated the stay of proceedings and the action will now continue. While the judgment only applies to British Columbia, it is expected that other provincial governments may follow suit. It has been reported that Newfoundland has enacted and Saskatchewan and Nova Scotia are considering enacting legislation similar to the HCCR Act.

Other Tobacco-Related Litigation. The tobacco industry is also the target of other litigation. By way of example only, and not as an exclusive or complete list, the following are additional tobacco-related litigation:

- *Asbestos Contribution Cases*. These cases, which have been brought against cigarette manufacturers on behalf of former asbestos manufacturers, their personal injury settlement trusts and insurers, seek, among other things, contribution or reimbursement for amounts expended in connection with the defense and payment of asbestos claims that were allegedly caused in whole or in part by cigarette smoking. In January 2005, one case was dismissed; currently, one case (*Fibreboard Corp. v. R.J. Reynolds Tobacco Co.*) remains pending.

- *Cigarette Price-Fixing Cases*. According to one OPM, as of August 1, 2005, there were two cases pending against domestic cigarette manufacturers in Kansas (*Smith v. Philip Morris*) and New Mexico (*Romero v. Philip Morris*), alleging that defendants conspired to fix cigarette prices in violation of antitrust laws. The plaintiffs' motions for class certification have been granted in both cases. In February 2005, the New Mexico Court of Appeals affirmed the class certification decision in the Romero case.

- *Cigarette Contraband Cases*. In May 2001 and August 2001, various governmental entities of Colombia, the European Community and ten member states filed suits in the United States against certain PMs, alleging that defendants sold to distributors cigarettes that would be illegally imported into various jurisdictions. The claims asserted in these cases include negligence, negligent misrepresentation, fraud, unjust enrichment, violations of RICO and its state-law equivalents and conspiracy. Plaintiffs in these cases seek actual damages, treble damages and undisclosed injunctive relief. In February 2002, the trial court granted defendants' motions to

dismiss all of the actions. Plaintiffs in each case have appealed. In January 2004, the United States Court of Appeals for the Second Circuit affirmed the dismissals of the cases. In April 2004, plaintiffs petitioned the United States Supreme Court for further review. The European Community and the 10 member states moved to dismiss their petition in July 2004 following an agreement entered into among Philip Morris, the European Commission and 10 member states of the European Community. The terms of this cooperation agreement provide for broad cooperation with European law enforcement agencies on anti-contraband and anti-counterfeit efforts and resolve all disputes between the parties on these issues. In May 2005, the U.S. Supreme Court granted the petitions for review, vacated the judgment of the Second Circuit Court of Appeals and remanded the case to that court for further review in light of the Supreme Court's recent decision in U.S. v. Pasquantino. On September 13, 2005, the Second Circuit Court of Appeals found that Pasquantino was inapplicable to the case and affirmed its earlier decision that the revenue rule bars foreign sovereigns' civil claims for recovery of lost tax revenue and law enforcement costs related to cigarette smuggling. One OPM has stated that it is possible that future litigation related to cigarette contraband issues may be brought.

- *Patent Litigation*. In 2001 and 2002, Star Scientific, Inc. ("**Star**") filed two patent infringement actions against Reynolds Tobacco in the United States District Court for the District of Maryland. Such actions have been consolidated. Reynolds Tobacco filed various motions for summary judgment, which were all denied. Reynolds Tobacco has also filed counterclaims seeking a declaration that the claims of the two Star patents in dispute are invalid, unenforceable and not infringed by Reynolds Tobacco. Between January 31, 2005 and February 8, 2005, the District Court held a first bench trial on Reynolds Tobacco's affirmative defense and counterclaim based upon inequitable conduct. The District Court has not yet issued a ruling on this issue. Additionally, in response to the court's invitation, Reynolds Tobacco filed two summary judgment motions on January 20, 2005. The District Court has indicated that it will rule on Reynolds Tobacco's two pending summary judgment motions and the issue of inequitable conduct at the same time. The District Court has not yet set a trial date for the remaining issues in the case.

- *Vermont Litigation*. On July 22, 2005, Vermont announced that it had sued Reynolds Tobacco for using false and misleading advertising to promote its "Eclipse" brand of cigarettes. The lawsuit charges that Reynolds Tobacco's advertising, which claims that smoking Eclipse cigarettes is less harmful than smoking other brands of cigarettes, violated Vermont's consumer protection statutes. According to the Vermont Attorney General, the offices of Attorneys General across the country, including California, Connecticut, the District of Columbia, Idaho, Illinois, Iowa, Maine, New York and Tennessee, have actively participated in the investigation leading up to this lawsuit and will continue to assist Vermont in it.

- *Foreign Lawsuits*. Lawsuits have been filed in foreign jurisdictions against certain OPMs and/or their subsidiaries and affiliates, including individual smoking and health actions, class actions and healthcare cost recovery suits.

The foregoing discussion of civil litigation against the tobacco industry is not exhaustive and is not based upon the Agency's examination or analysis of the court records of the cases mentioned or of any other court records. It is based on SEC filings by OPMs and on other publicly available information published by the OPMs or others. Prospective purchasers of the Series 2006A Bonds are referred to the reports filed with the SEC by certain of the OPMs and applicable court records for additional descriptions thereof.

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

or prices of securities such as the Series 2006A Bonds payable from tobacco settlement payments made under the MSA.

CIGARETTE CONSUMPTION REPORT

The following information has been extracted from the Cigarette Consumption Report, a copy of which is attached hereto as Appendix A. This summary does not purport to be complete and the Cigarette Consumption Report should be read in its entirety for an understanding of the assumptions on which it is based and the conclusions it reaches. The Cigarette Consumption Report forecasts future United States domestic cigarette consumption. The MSA payments are based in part on cigarettes shipped in and to the United States. Cigarette shipments and cigarette consumption may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

General

Global Insight, Inc., formerly known as DRI•WEFA, Inc., has prepared a report dated December 21, 2005 on the consumption of cigarettes in the United States from 2004 through 2045 entitled, "*A Forecast of U.S. Cigarette Consumption (2004-2045) for the Los Angeles County Securitization Corporation*." Global Insight is an internationally recognized econometric and consulting firm of over 200 economists in 16 offices worldwide. Global Insight is a privately held subsidiary of Global Insight, Inc., a publicly traded company which is a provider of financial, economic and market research information.

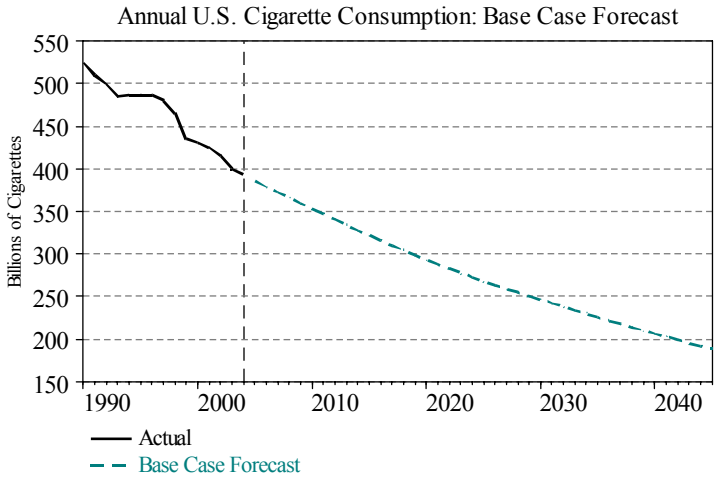
Global Insight has developed a cigarette consumption model based on historical United States data between 1965 and 2003. Global Insight constructed this cigarette consumption model after considering the impact of demographics, cigarette prices, disposable income, employment and unemployment, industry advertising expenditures, the future effect of the incidence of smoking among underage youth and qualitative variables that captured the impact of anti-smoking regulations, legislation, and health warnings. After determining which variables were effective in building this cigarette consumption model (real cigarette prices, real per capita disposable personal income, the impact of restrictions on smoking in public places, and the trend over time in individual behavior and preferences), Global Insight employed standard multivariate regression analysis to determine the nature of the economic relationship between these variables and adult per capita cigarette consumption in the United States. The multivariate regression analysis showed: (i) long run price elasticity of demand of -0.33; (ii) income elasticity of demand of 0.27; and (iii) a trend decline in adult per capita cigarette consumption of 2.40% per year holding other recognized significant factors constant.

Global Insight's model, coupled with its long term forecast of the United States economy, was then used to project total United States cigarette consumption from 2004 through 2045 (the "**Base Case Forecast**"). The Base Case Forecast indicates that the total United States cigarette consumption in 2045 will be 188 billion cigarettes (approximately 9.4 billion packs), a 53% decline from the 2003 level. After 2003, the rate of decline in total cigarette consumption is projected to moderate and average less than 2% per year. From 2004 through 2045, the average annual rate of decline is projected to be 1.78%. On a per capita basis, consumption is forecast to fall during the same period at an average annual rate of 2.54%. Total consumption of cigarettes in the United States is forecast to fall from an estimated 393 billion in 2004 to 385 billion in 2005, to under 300 billion by 2019, and under 200 billion by 2042, as set forth in the following table. The Cigarette Consumption Report states that Global Insight believes that the assumptions on which the Base Case Forecast is based are reasonable.

Global Insight Base Case Forecast of Cigarette Consumption

Year	Cigarettes (billions)	Year	Cigarettes (billions)
2004	393.00	2025	268.13
2005	385.10	2026	263.58
2006	378.67	2027	259.12
2007	372.43	2028	254.77
2008	366.17	2029	250.49
2009	359.37	2030	246.28
2010	353.07	2031	242.04
2011	346.82	2032	237.93
2012	340.38	2033	233.89
2013	333.89	2034	229.87
2014	327.38	2035	225.49
2015	321.60	2036	221.53
2016	315.88	2037	217.67
2017	310.02	2038	213.95
2018	304.28	2039	210.08
2019	298.49	2040	206.33
2020	293.13	2041	202.69
2021	287.77	2042	198.98
2022	282.63	2043	195.36
2023	277.53	2044	191.82
2024	272.80	2045	188.40

The following graph displays the projected time trend of cigarette consumption in the United States:



The Cigarette Consumption Report also presents alternative forecasts that project higher and lower paths of cigarette consumption, predicting that by 2045 total United States consumption could be as low as 174 billion or as high as 201 billion cigarettes. In addition, the Cigarette Consumption Report presents scenarios with more extreme variations in assumptions for the purposes of illustrating alternative paths of consumption.

Comparison with Prior Forecasts

In October 2001, Global Insight (then DRI•WEFA, Inc.) presented another similar study "*A Forecast of U.S. Cigarette Consumption (2000-2034)*." Its long run conclusions were quite similar to those in the Cigarette Consumption Report. The Cigarette Consumption Report forecast of consumption for the year 2034 is 1.4% less than that of the 2001 study, 229.9 billion versus 233.2 billion. At that time Global Insight projected that 2002

consumption would be 394 billion cigarettes, a 3.4% decline from 2001. The USDA however has since estimated that 2000 consumption levels, at 430 billion, were higher than reported at that time. Consumption levels for 2002 were then estimated by USDA at 415 billion cigarettes. Global Insight incorporated this and other new data available into the Cigarette Consumption Report forecast. The new data available, now for over five years after the MSA, has allowed Global Insight to re-estimate and update the econometric coefficients of its consumption model. In doing so, Global Insight modified, on the basis of the statistical evidence through 2003, two important parameters used in its forecast model. First, Global Insight found that, when taking into account the consumption response to the large price increases from 1999 to 2003, the price elasticity of demand is slightly higher, at -0.33, than the -0.31 previously estimated. The implication is that each additional 10% increase in the real price of cigarettes will reduce consumption by 3.3%. Previously Global Insight's model had assumed a consumption response of 3.1% following a 10% price change. Second, the underlying trend decline in per-capita cigarette consumption has been found, also based on statistical evidence through 2003, to be 2.4% per year, slightly higher than the 2.3% per year assumed in the earlier report. The implications of these changes are to increase the long term rate of decline of consumption to 1.81% per year, from 1.77% as projected in 2001. The net result of all of these changes is that 2034 consumption is now projected to be 3.3 billion cigarettes lower than Global Insight's 2001 forecast.

Historical Cigarette Consumption

The USDA, which has compiled data on cigarette consumption since 1900, reports that consumption (which is defined as taxable United States consumer sales, plus shipments to overseas armed forces, ship stores, Puerto Rico and other United States possessions, and small tax-exempt categories, as reported by the Bureau of Alcohol, Tobacco and Firearms) grew from 2.5 billion in 1900 to a peak of 640 billion in 1981. Consumption declined in the 1980's and 1990's, reaching a level of 465 billion cigarettes in 1998, and decreasing to less than 400 billion cigarettes in 2004.

The following table sets forth United States domestic cigarette consumption for the seven years ended December 31, 2004. The data in this table vary from statistics on cigarette shipments in the United States. While the Cigarette Consumption Report is based on consumption, payments under the MSA are computed based in part on shipments in or to the 50 states of the United States, the District of Columbia and Puerto Rico. The quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time.

U.S. Cigarette Consumption

Year Ended December 31	Consumption (Billions of Cigarettes)	Percentage Change
2004	393(*est.*)	-1.75%
2003	400	-3.61
2002	415	-2.35
2001	425	-1.16
2000	430	-1.15
1999	435	-6.45
1998	465	-3.13

Factors Affecting Cigarette Consumption

Most empirical studies have found a common set of variables that are relevant in building a model of cigarette demand. These conventional analyses usually evaluate one or more of the following factors: (i) general population growth, (ii) price elasticity of demand and price increases, (iii) changes in disposable income, (iv) youth consumption, (v) trends over time, (vi) smoking bans in public places, (vii) nicotine dependence, and (viii) health warnings. While some of these factors were not found to have a measurable impact on changes in demand for cigarettes, all of these factors are thought to affect smoking in some manner and to be incorporated into current levels of consumption. Since 1964 there has been a significant decline in United States adult per capita cigarette consumption. The 1964 Surgeon General's health warning and numerous subsequent health warnings, together with

the increased health awareness of the population over the past 30 years, may have contributed to decreases in cigarette consumption levels. If, as assumed by Global Insight, the awareness of the adult population continues to change in this way, overall consumption of cigarettes will decline gradually over time. Global Insight's analysis includes a time trend variable in order to capture the impact of these changing health trends and the effects of other such variables which are difficult to quantify.

THE STATE DEPARTMENT OF FINANCE POPULATION PROJECTIONS

The Department of Finance periodically releases forecasts of population for each county in the State. [The Department of Finance released a 40-year forecast in 1998, and, in June 2001, the Department of Finance released a revised set of population forecasts. These reports are available at the Department of Finance website at www.dof.ca.gov/HTML/ DEMOGRAP/repndat.htm. The 2001 forecast covered only 20 years. The projections for the County are set forth in the following table:]

Year	Los Angeles County % Share of State of California Population
2000	%
2010	
2020	
2030*	
2040*	

* [1998 Department of Finance estimates. The 1998 Department of Finance projection of the County's share of the population for 2000, 2010 and 2020 was 0.71680423%, 0.64710818% and 0.59106296%, respectively.]

METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS

Introduction

The following discussion describes the methodology and assumptions used to calculate a forecast of Sold County Tobacco Assets to be received by the Agency (the "**Collection Methodology and Assumptions**"), as well as the methodology and assumptions used to structure the schedules of Principal and to calculate the projected Turbo Redemptions for the Series 2006A Bonds (the "**Structuring Assumptions**"). For sensitivity analyses which evaluate the impact of different consumption levels on Turbo Redemptions, see "– Effect of Changes in Consumption Level on Turbo Redemptions" below. The assumptions are only assumptions and no guarantee can be made as to the ultimate outcome of certain events assumed here. If actual results are different from those assumed, it could have a material effect on the forecast of Sold County Tobacco Assets as well as assumed Turbo Redemptions.

Collection Methodology and Assumptions

In calculating a forecast of Sold County Tobacco Assets to be received by the Agency, the forecast of cigarette consumption in the United States developed by Global Insight and described as the Base Case Forecast, was applied to calculate Annual Payments and Strategic Contribution Payments to be made by the PMs pursuant to the MSA. The calculation of payments required to be made was performed in accordance with the terms of the MSA; however, as described below, certain assumptions were made with respect to consumption of cigarettes in the United States and the applicability of certain adjustments and offsets to such payments set forth in the MSA. In addition, it was assumed that the PMs make all payments required to be made by them pursuant to the MSA, and that the relative market share for each of the PMs remains constant throughout the forecast period at 84.4% for the OPMs, 9.4% for the SPMs and 6.2% for the NPMs.† It was further assumed that each company that is currently a PM remains such throughout the term of the Series 2006A Bonds.

† The aggregate market share information utilized in the bond structuring assumptions may differ materially from the market share information used by the MSA Auditor in calculating adjustments to Annual Payments and (*continued…*)

In applying the consumption forecast from the Cigarette Consumption Report, it was assumed that United States consumption, which was forecasted by Global Insight, was equal to the number of cigarettes shipped in and to the United States, the District of Columbia and Puerto Rico, which is the number that is applied to determine the Volume Adjustment. The Cigarette Consumption Report states that the quantities of cigarettes shipped and cigarettes consumed may not match at any given point in time as a result of various factors such as inventory adjustments, but are substantially the same when compared over a period of time. Global Insight's Base Case Forecast for United States cigarette consumption is set forth herein in Appendix A – "CIGARETTE CONSUMPTION REPORT" attached hereto. See Appendix A for a discussion of the assumptions underlying the projections of cigarette consumption contained in the Cigarette Consumption Report.

Annual Payments

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

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Annual Payments set forth in the MSA. Inflation was assumed to be at a rate of ___% for 20__, ___% for 20__ through 20__, and ___% for 20__. Thereafter, the rate of inflation was assumed to be the minimum provided in the MSA, at a rate of 3% per year, compounded annually, for the rest of the forecast period.

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

Previously Settled States Reduction. Next, the annual amounts calculated for each year after application of the Inflation Adjustment and the Volume Adjustment were reduced by the Previously Settled States Reduction which applies only to the payments owed by the OPMs. The Previously Settled States Reduction is as follows for each year of the following period:

2000 through 2007	12.4500000%
2008 through 2017	12.2373756%
2018 and after	11.0666667%

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

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

[*Population Adjustment.* The MOU provides that the amounts of TSRs payable are subject to adjustments for population changes. The amount of the TSRs distributed to Participating Jurisdictions, including the County,

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Strategic Contribution Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT — Adjustments to Payments" herein.

pursuant to the MOU and the ARIMOU is allocated on a per capita basis, calculated using the then most current official United States Decennial Census figures, which are currently updated every ten years.]

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

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

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

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

State Allocation Percentage. The amount of Annual Payments, after application of the Inflation Adjustment, the Volume Adjustment and the Previously-Settled States Reduction for each year was multiplied by the State Allocation Percentage (12.7639554%) in order to determine the amount of Annual Payments to be made by the PMs in each year to be allocated to the California State-Specific Account.

The following table shows the projection of Sold County Tobacco Assets to be received by the Indenture Trustee from Annual Payments through the year 20__, calculated in accordance with the Collection Methodology and Assumptions.

Projection of Annual Payments to be Received by Indenture Trustee

Date	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Annual Payments	Inflation Adjustment	Volume Adjustment	Previously Settled States Reduction	Subtotal	State of California Allocation	Annual Payments to State of California	Sold County Tobacco Assets Allocation	Total OPM Payments to Indenture Trustee	SPM Payments to Indenture Trustee	Total Annu Payments for I Debt Servic

Strategic Contribution Payments

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

Inflation Adjustment. First, the Inflation Adjustment was applied to the schedule of base amounts for the Strategic Contribution Payments set forth in the MSA. Inflation was assumed to be at a rate of __% for 20__, __% for 20__ through 20__, and __% for 20__. Thereafter, the rate of inflation was assumed to be the minimum provided in the MSA, at a rate of 3% per year, compounded annually, for the rest of the forecast period.

Volume Adjustment. Next, the Strategic Contribution Payments calculated for each year after application of the Inflation Adjustment was adjusted for the Volume Adjustment by applying the Global Insight Base Case Forecast for United States cigarette consumption to the market share of the OPMs for the prior year. No add back or benefit was assumed from any Income Adjustment as it does not apply to Strategic Contribution Payments. See "SUMMARY OF THE MASTER SETTLEMENT AGREEMENT – Adjustments to Payments – *Volume Adjustment*" for a description of the formula used to calculate the Volume Adjustment.

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

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

[*Population Adjustment.* The MOU provides that the amounts of TSRs payable are subject to adjustments for population changes. The amount of the TSRs distributed to Participating Jurisdictions, including the County, pursuant to the MOU and the ARIMOU is allocated on a per capita basis, calculated using the then most current official United States Decennial Census figures, which are currently updated every ten years.]

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

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

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

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

State Allocation Percentage. The amount of Strategic Contribution Payments, after application of the Inflation Adjustment and the Volume Adjustment for each year was multiplied by the State Allocation Percentage (5.1730408%) in order to determine the amount of Strategic Contribution Payments to be made by the PMs in each year to be allocated to the California State-Specific Account.

The following table shows the projection of Strategic Contribution Payments and total payments (including Annual Payments) to be received by the Indenture Trustee as Sold County Tobacco Assets through the year 20__, calculated in accordance with the Collection Methodology and Assumptions.

Projection of Strategic and Total Payments to be Received by Indenture Trustee

			Strategic Contribution Payments								Total Payments		
Date	Global Insight Base Case Consumption Forecast	OPM-Adjusted Consumption	Base Strategic Contribution Payments	Inflation Adjustment	Volume Adjustment	Subtotal	State of California Allocation	Annual Payments to State of California	Sold County Tobacco Assets Allocation	Strategic Contribution Payments to Indenture Trustee	SPM Payments to Indenture Trustee	Total Annual Payments to Indenture Trustee	Total Strategic Contribution Payments to Indenture Trustee	Total Payments to Indenture Trustee

Interest Earnings

The Collection Methodology and Assumptions assume that the Indenture Trustee will receive ten days after April 15 the Sold County Tobacco Assets in 20__ and each year thereafter. Interest is assumed to be earned on amounts on deposit in the Debt Service Account at the rate of ___% per annum. Moneys deposited in the Debt Service Reserve Account will be invested in an investment contract and are assumed to earn interest at the rate of ___% per annum.

Structuring Assumptions

General

The Structuring Assumptions for the Series 2006A Bonds were applied to the forecast of Sold County Tobacco Assets described above. Principal payments on the Series 2006A Bonds were structured consistent with the credit ratings on the respective series of Series 2006A Bonds. Each maturity of the Series 2006A Bonds, is sized by developing a hypothetical schedule, "**Sizing Amounts for Series 2006A Bond Maturities**." The Principal of the Capital Appreciation Bonds due in ____ is equal to the sum of all Sizing Amounts on or before____; the Principal of the Convertible Bonds due in ____ is equal to the sum of all Sizing Amounts from ____ through____. The ratings on the Series 2006A Bonds are not based upon the Agency's ability to make payments in accordance with the Sizing Amounts for Series 2006A Bond Maturities, rather, they are based on payment of the Series 2006A Bonds by ____ 1, ____ and ____ 1, ____, respectively. As used herein, "**Sizing Amounts for Series 2006A Bond Maturities debt service coverage ratio**" means, for any period, a fraction, expressed as a multiple, the numerator of which is the amount of Sold County Tobacco Assets plus Debt Service Reserve Account investment earnings received in such period less (-) Operating Expenses, and the denominator of which is the sum of interest, and the Sizing Amounts for Series 2006A Bond Maturities in such period.

The Structuring Assumptions are described below:

Sizing. The Agency's objective in issuing the Series 2006A Bonds is to receive net proceeds sufficient to enable the Agency to provide for the loan to the Corporation, the proceeds of which will be used to (i) purchase the Sold County Tobacco Assets, (ii) fund the Debt Service Reserve Account for the Series 2006A Bonds, (iii) fund the Operating Account for the Series 2006A Bonds, and (iv) pay the costs of issuance incurred in connection with the issuance of the Series 2006A Bonds.

Debt Service Reserve Account. The Debt Service Reserve Account was established for the Series 2006A Bonds with an initial deposit of $_____. So long as Series 2006A Bonds remain Outstanding, the Debt Service Reserve Account must be maintained, to the extent of available funds, at $_____. All earnings on amounts in the Debt Service Reserve Account will be retained therein if the Debt Service Reserve Account balance is not equal to the Debt Service Reserve Requirement.

Debt Service Coverage Ratios. The debt service coverage ratios were targeted differently for each maturity of the Series 2006A Bonds, with average and minimum debt service coverage ratios as described under "*— Principal of the Series 2006A Bonds*" below.

Operating Expense Assumptions. Operating expenses of the Agency have been assumed at $_____ upon delivery of the Series 2006A Bonds and then at the Operating Cap of $_____ inflated at __% per year starting in 2006. No arbitrage rebate expense was assumed since it has been assumed that the yield on the Agency investments will not exceed the yield on the Series 2006A Bonds.

Issuance Date. The Series 2006A Bonds were assumed to be issued on _____.

Interest Rates and Accretion. The Series 2006A Bonds were assumed to bear or accrue interest at the rates set forth on the inside cover hereof.

Principal of the Series 2006A Bonds. The Principal payments for the Series 2006A Bonds were structured to repay the Series 2006A Bonds in the aggregate within __ years from the date of issuance of such Series 2006A Bonds and to achieve Sizing Amounts for Series 2006A Bond Maturities debt service coverage ratios consistent with the credit ratings of the Series 2006A Bonds taking into account the amount of Sold County Tobacco Assets projected based on the Global Insight Base Case Forecast and the Structuring Assumptions. The Sizing Amounts for Series 2006A Bond Maturities were determined by targeting an average debt service coverage ratio of _____x, with a minimum debt service coverage ratio in any annual period of ____x.

Failure to pay Principal of the Series 2006A Bonds due as of any applicable Maturity Date will constitute an Event of Default. Sizing Amounts for Series 2006A Bond Maturities are used solely for sizing Series 2006A Bonds maturities and are not terms of the Series 2006A Bonds and thus failure to make payments in such amounts and on such dates as set forth in Schedule below in such amounts will not constitute an Event of Default. The rating assigned to the Series 2006A Bonds by a Rating Agency addresses only such Rating Agency's assessment of the ability of the Agency to pay interest when due and to pay Principal on the Series 2006A Bonds by their respective maturity dates. Money on deposit in the Debt Service Reserve Account will be available to pay interest and Principal on the Series 2006A Bonds if money in the Debt Service Account is insufficient for such purpose. The denominator of the coverage ratios does not include Turbo Redemptions from Revenues and calculations of coverage ratios are based on the assumption that no such Turbo Redemptions will occur.

Set forth below is a Schedule showing estimated Sizing Amounts for Series 2006A Bond Maturities for the Series 2006A Bonds and the resulting estimated Sizing Amounts for Series 2006A Bond Maturities debt service coverage ratios, assuming that Sold County Tobacco Assets are received in accordance with the Collection Methodology and Assumptions, and that no Principal is paid in advance of the schedule of Sizing Amounts for Series 2006A Bond Maturities, as described above under "– Structuring Assumptions."

The estimated Sizing Amounts for Series 2006A Bond Maturities debt service coverage ratios shown in the table above assume that Sold County Tobacco Assets are received in accordance with the Collection Methodology Assumptions and applied, subject to the payment priorities set forth in the Indenture, to pay expenses and interest and principal in amounts equal to Sizing Amounts for Series 2006A Bond Maturities. The actual coverage ratios will be higher than those shown in the above table if Sold County Tobacco Assets are sufficient to pay Turbo Redemptions on each Turbo Redemption Date in excess of the Sizing Amounts for Series 2006A Bond Maturities. No assurance can be given, however, that sufficient Sold County Tobacco Assets will be received to make Turbo Redemptions on each Distribution Date.

Effect of Changes in Consumption Level on Turbo Redemptions

Weighted Average Lives and Final Principal Payments. The tables below have been prepared to show the effect of changes in consumption on the weighted average lives and final Principal payments on the Series 2006A Bonds. For the purpose of measuring the effect of changes in consumption level, the Series 2006A Bonds were assumed to have a coupons as shown on the inside cover. The tables are based on the Collection Methodology and Assumptions and the Structuring Assumptions, except that the annual cigarette consumption varies in each case. In addition to the Global Insight Base Case Forecast, several alternative cigarette consumption scenarios are presented below, including four alternative forecasts of Global Insight (the Global Insight High Forecast, the Global Insight Low Case 1, the Global Insight Low Case 2 and the Global Insight Low Case 3, each as hereinafter defined) and two other consumption scenarios prepared by Global Insight (assuming a 3.5% and a 4.0% annual consumption decline). In each case, if actual cigarette consumption in the United States is as forecast and assumed, and events occur as assumed by the Collection Methodology and Assumptions and the Structuring Assumptions, the final Principal payments and weighted average lives (in years) of the Series 2006A Bonds will be as set forth in such tables. The tables presented below are for illustrative purposes only. Actual cigarette consumption in the United States cannot be definitively forecast. To the degree actual consumption and other structuring variables vary from the alternative scenarios presented below, the weighted average lives (and final principal payment dates) for the Series 2006A Bonds will be either shorter (sooner) or longer (later) than projected below.

Series 2006A Bonds Maturing ____ 1, 20__*

Consumption Forecast	Weighted Average Life (Years)	Final Principal Payment Date (Years)*
Global Insight Base Case Forecast		
Global Insight High Forecast		
Global Insight Low Case 1		
Global Insight Low Case 2		
Global Insight Low Case 3		
3.5% Annual Consumption Decline		
4.0% Annual Consumption Decline		

* Preliminary, subject to change.

Series 2006A Bonds Maturing ____ 1, 20__*

Consumption Forecast	Weighted Average Life (Years)	Final Principal Payment Date (Years)*
Global Insight Base Case Forecast		
Global Insight High Forecast		
Global Insight Low Case 1		
Global Insight Low Case 2		
Global Insight Low Case 3		
3.5% Annual Consumption Decline		
4.0% Annual Consumption Decline		

Turbo Redemptions of the Series 2006A Bonds. The tables below have been prepared to show the effect of changes in cigarette consumption on the estimated Turbo Redemptions with respect to the Series 2006A Bonds. The tables are based upon the same assumptions and utilize the same alternative Global Insight forecasts as shown in the preceding paragraph and tables.

* Preliminary, subject to change.

Projected Outstanding Amounts of Series 2006A Bonds with a Maturity Date of ___ 1, 20__*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1 Forecast	Global Insight Low Case 2 Forecast	Global Insight Low Case 3 Forecast	___% Annual Consumption Decline	__% Annual Consumption Decline

* Outstanding amounts represent principal balances after the application of Surplus Collections to Turbo Redemptions on the referenced date.

Projected Outstanding Amounts of Series 2006A Bonds with a Maturity Date of ___ 1, 20__*

Date	Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1 Forecast	Global Insight Low Case 2 Forecast	Global Insight Low Case 3 Forecast	___% Annual Consumption Decline	__% Annual Consumption Decline

* Outstanding amounts represent principal balances after the application of Surplus Collections to Turbo Redemptions on the referenced date.

Explanation of Alternative Global Insight Forecasts

The alternative Global Insight forecast of cigarette consumption decline are based upon the methodology described below. See also "CIGARETTE CONSUMPTION REPORT" herein and Appendix A – "CIGARETTE CONSUMPTION REPORT" attached hereto.

Global Insight's high forecast of consumption (the "**Global Insight High Forecast**") deviates from the Base Case Forecast by assuming a lower price forecast, under which prices are increasing at an annual rate 0.5% more slowly than the Base Case Forecast. Under the Global Insight High Forecast, the average annual rate of decline in cigarette consumption is moderated slightly, from an average annual rate in the Base Case Forecast of 1.78%, to 1.62%.

Global Insight's low forecast of consumption (the "**Global Insight Low Case 1**") deviates from the Base Case Forecast by assuming a sharper price elasticity of demand. The Global Insight Base Case Forecast applied a price elasticity of demand of -0.33. However, in order to develop the lowest consumption forecast that Global Insight believed may be reasonably anticipated, a price elasticity of -0.4 was applied. Under the Global Insight Low Case 1, the average rate of decline in cigarette consumption increased to 1.96%. Under the Base Case Forecast, the rate of decline was 1.78%.

Although beyond the range of Global Insight's reasonably anticipated decline in consumption, Global Insight also prepared an alternative low case (the "**Global Insight Low Case 2**") that deviated from the Base Case Forecast by assuming a price elasticity of demand of -0.5. This produces a decline in consumption of an average annual rate of 2.17%. Global Insight prepared another alternative low case (the "**Global Insight Low Case 3**") that deviated from the Base Case Forecast by assuming an adverse federal government settlement and tort claims of three times the size of the MSA, resulting in an immediate real price increase of 57% and a decline in consumption of 18% over two years. Despite the higher prices, this scenario would result in higher consumption than in the Global Insight Low Case 2, using the estimated price elasticity of -0.33. Under the Global Insight Low Case 3, the average annual rate of decline in cigarette consumption would be 2.26%, compared to the Base Case Forecast of 1.78%.

Finally, for comparative purposes Global Insight calculated the volume of total cigarette consumption under two alternative annual rates of decline, 3.5% and 4.0%. Global Insight states that at 3.5% per year consumption falls to 91 billion by 2045, and at 4.0% it falls to 74 billion by 2045.

Average Annual Rate of Cigarette Consumption Decline (2004-2045)

Global Insight Base Case Forecast	Global Insight High Forecast	Global Insight Low Case 1	Global Insight Low Case 2	Global Insight Low Case 3
1.78%	1.62%	1.96%	2.17%	2.26%

No assurance can be given that actual cigarette consumption in the United States during the term of the Series 2006A Bonds will be as assumed, or that the other assumptions underlying the Collection Methodology and Assumptions and Structuring Assumptions, including that certain adjustments and offsets will not apply to payments due under the MSA, will be consistent with future events. If actual events deviate from one or more of the assumptions underlying the Collection Methodology and Assumptions or the Structuring Assumptions, the amount of Sold County Tobacco Assets available to pay the Principal of and interest on the Series 2006A Bonds (and, accordingly, the amount of Sold County Tobacco Assets available to make Turbo Redemptions of the Series 2006A Bonds) could be adversely affected. See "RISK FACTORS" herein.

CONTINUING DISCLOSURE UNDERTAKING

Pursuant to the Indenture, the Agency has agreed to provide or cause to be provided, for the benefit of the Holders of the Outstanding Series 2006A Bonds, (1) within 210 days after the end of each Fiscal Year (commencing with the report for the Fiscal Year ended June 30, 2006), to each Repository (a) its core financial information and operating data for the prior Fiscal Year, including its audited financial statements, prepared in accordance with generally accepted accounting principles in effect from time to time, (b) an update of operating data for the preceding Fiscal Year set forth under the last three columns titled "Total Payments" in the table captioned

"Projection of Strategic Contribution Fund Payments and Total Payments to be Received by the Trustee" in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS" in the Offering Circular, and (c) the actual debt service coverage ratio for such preceding Fiscal Year, determined in substantially the manner described in "METHODOLOGY AND BOND STRUCTURING ASSUMPTIONS – Structuring Assumptions Debt Service Coverage Ratios" in the Offering Circular; and (2) in a timely manner, to each nationally recognized municipal securities information repository or to the Municipal Securities Rulemaking Board, and to any State information depository, notice of any of the following events with respect to the Series 2006A Bonds, if material: (i) principal payments and interest payment delinquencies; (ii) non-payment related defaults; (iii) unscheduled draws on debt service reserves reflecting financial difficulties; (iv) unscheduled draws on credit enhancements reflecting financial difficulties; (v) substitution of credit or liquidity providers, or their failure to perform; (vi) adverse tax opinions or events affecting the tax-exempt status of the Series 2006A Bonds; (vii) modifications to rights of Series 2006A Bondholders; (viii) Series 2006A Bond calls; (ix) defeasances; (x) release, substitution, or sale of property securing repayment of the Series 2006A Bonds; (xi) rating changes; and (xii) failure to comply with clause (1) above. These covenants have been made in order to assist the Underwriter in complying with the Rule. The Agency has never failed to comply in all material respects with any previous undertakings with regard to the Rule to provide annual reports or notices of material events.

LITIGATION

There is no litigation pending in any State or federal court to restrain or enjoin the issuance or delivery of the Series 2006A Bonds or questioning the creation, organization or existence of the Agency or the Corporation, the validity or enforceability of the Indenture, the Loan Agreement, the Sale Agreement or the sale of the Sold County Tobacco Assets by the County to the Corporation, the proceedings for the authorization, execution, authentication and delivery of the Series 2006A Bonds or the validity of the Series 2006A Bonds. For a discussion of other legal matters, including certain pending litigation involving the MSA and the PMs, see "RISK FACTORS," "CERTAIN INFORMATION RELATING TO THE TOBACCO INDUSTRY" and "LEGAL CONSIDERATIONS" herein.

TAX MATTERS

Tax Exemption

Exclusion from Gross Income. In the opinion of Bond Counsel, based on existing law, and assuming compliance with certain covenants in the Indenture, the Loan Agreement and other documents relating to the Series 2006A Bonds and requirements of the Internal Revenue Code of 1986, as amended (the "**Code**"), regarding the use, expenditure and investment of proceeds of the Series 2006A Bonds and the timely payment of certain investment earnings to the United States, interest on the Series 2006A Bonds is not includable in the gross income of the holders of the Series 2006A Bonds for federal income tax purposes. [Failure to comply with such covenants and requirements with respect to the Series 2006A Bonds may cause the interest on the Series 2006A Bonds to be included in the gross income of the holders thereof retroactively to the date of issue of the Series 2006A Bonds.]

In the further opinion of Bond Counsel, interest on the Series 2006A Bonds is not treated as an item of tax preference in calculating the alternative minimum taxable income of individuals and corporations. Such interest, however, is included as an adjustment in the calculation of federal corporate alternative minimum taxable income and may therefore affect a corporation's alternative minimum tax liability.

Ownership of, or the receipt of interest on or with respect to, tax-exempt obligations may result in collateral tax consequences to certain taxpayers, including, without limitation, financial institutions, property and casualty insurance companies, certain foreign corporations doing business in the United States, certain S corporations with excess passive income, individual recipients of Social Security or Railroad Retirement benefits, taxpayers that may be deemed to have incurred or continued indebtedness to purchase or carry tax-exempt obligations and taxpayers who may be eligible for the earned income tax credit. Bond Counsel expresses no opinion with respect to any collateral tax consequences and, accordingly, prospective purchasers of the Series 2006A Bonds should consult their tax advisors as to the applicability of any collateral tax consequences.

Certain requirements and procedures contained or referred to in the Indenture, the Loan Agreement or other documents pertaining to the Series 2006A Bonds may be changed, and certain actions may be taken, under the

circumstances and subject to the terms and conditions set forth in such documents, upon the advice or with the approving opinion of counsel nationally recognized in the area of tax-exempt obligations. Bond Counsel expresses no opinion as to the exclusion from gross income for federal income tax purposes of the interest on the Series 2006A Bonds on and after the date on which any such change occurs or action is taken upon the advice or approval of counsel other than Bond Counsel.

Original Issue Discount. The excess of the amount payable at maturity of any maturity of the Series 2006A Bonds over the initial public offering price to the public (excluding bond houses, brokers or similar persons acting in the capacity as underwriters or wholesalers) at which price a substantial amount of such maturity is sold constitutes original issue discount, which will be excludable from gross income to the same extent as interest with respect to the Series 2006A Bonds for federal income tax purposes. The Code provides that the amount of original issue discount accrues in accordance with a constant payment method based on the compounding of interest, and that a holder's adjusted basis for purposes of determining a holder's gain or loss on disposition of the Series 2006A Bonds with original issue discount (the "**OID Bonds**") will be increased by such amount. A portion of the original issue discount that accrues in each year to a holder of an OID Bond that is a corporation will be included in the calculation of the corporation's federal alternative minimum tax liability. In addition, original issue discount that accrues in each year to a holder of an OID Bond is included in the calculation of the distribution requirements of certain regulated investment companies and may result in some of the collateral federal income tax consequences discussed above. Consequently, holders of any OID Bonds should be aware that the accrual of original issue discount in each year may result in an alternative minimum tax liability, additional distribution requirements or other collateral federal income tax consequences although the holder of such OID Bonds has not received cash attributable to such original issue discount in such year. Holders of OID Bonds should consult their personal tax advisors with respect to the determination for federal income tax purposes of the amount of original issue discount or interest properly accruable with respect to such OID Bonds, other tax consequences of holding OID Bonds and other state and local tax consequences of holding such OID Bonds.

Original Issue Premium. The excess, if any of the tax basis of Series 2006A Bonds to a purchaser (other than a purchaser who holds such Series 2006A Bonds as inventory, stock in trade or for the sale to customers in the ordinary course of business) over the amount payable at maturity is "bond premium". Series 2006A Bond premium is amortized over the respective terms of such Series 2006A Bonds for federal income tax purposes (or in the case of a bond with bond premium callable prior to its stated maturity, the amortization period and yield may be required to be determined on the basis of an earlier call date that results in the lowest yield on such bond). Holders of such Series 2006A Bonds are required to decrease their adjusted basis in such obligations by the amount of amortizable bond premium attributable to each taxable year such Series 2006A Bonds are held. The amortizable bond premium on such Series 2006A Bonds attributable to a taxable year is not deductible for federal income tax purposes; however, bond premium is treated as an offset to qualified stated interest received on such Series 2006A Bonds. Holders of such Series 2006A Bonds should consult their tax advisors with respect to the determination for federal income tax purposes of the treatment of bond premiums upon sale or other disposition of such Series 2006A Bonds and with respect to the state and local tax consequences of owning and disposing of such Series 2006A Bonds.

Future Legislation. Legislation affecting municipal obligations is continually being considered by the United States Congress. There can be no assurance that legislation enacted after the date of issuance of the Series 2006A Bonds will not have an adverse effect on the tax-exempt status of the Series 2006A Bonds. Legislative or regulatory actions and proposals may also affect the economic value of the tax exemption or the market price of the Series 2006A Bonds.

State Tax Exemption

In the opinion of Bond Counsel, interest on the Series 2006A Bonds is exempt from personal income taxes imposed by the State of California.

RATINGS

It is a condition to the obligation of the Underwriters to purchase the Capital Appreciation Bonds that, at the date of delivery thereof to the Underwriters, the Capital Appreciation Bonds be assigned ratings of "____" by [Standard & Poor's Ratings Services, a division of the McGraw-Hill Companies, Inc. ("**S&P**"), and "___" by

Moody's Investors Service, Inc. ("**Moody's**," and together with S&P, the "**Rating Agencies**")]. It is a condition to the obligation of the Underwriters to purchase the Convertible Bonds that, at the date of delivery thereof to the Underwriters, the Convertible Bonds be assigned ratings of "____" by S&P and "___" by Moody's. The ratings by [S&P and Moody's] of the Series 2006A Bonds reflect only the views of such organizations and any desired explanation of the significance of such ratings and any outlooks or other statements given by such Rating Agencies with respect thereto should be obtained from the Rating Agency furnishing the same.

There is no assurance that the initial ratings assigned to the rated Series of Series 2006A Bonds will continue for any given period of time or that any of such ratings will not be revised downward, suspended or withdrawn entirely by any of the Rating Agencies. Any such downward revision, suspension or withdrawal of such ratings may have an adverse effect on the availability of a market for or the market price of the Series 2006A Bonds.

UNDERWRITING

The Underwriters listed on the cover page hereof have jointly and severally agreed, subject to certain conditions, to purchase all, but not less than all, of the Series 2006A Bonds from the Agency at an underwriters' discount of $_____. The Underwriters will be obligated to purchase all of the Series 2006A Bonds if any are purchased. The initial public offering prices of the Series 2006A Bonds may be changed from time to time by the Underwriters. Citigroup Global Markets Inc. is acting as representative on behalf of the Underwriters. The Series 2006A Bonds may be offered and sold to certain dealers (including the Underwriters and other dealers depositing Series 2006A Bonds into investment trusts) at prices lower than such public offering prices.

LEGAL MATTERS

The validity of the Series 2006A Bonds and certain other legal matters are subject to the approving opinion of Sidley Austin Brown & Wood LLP, as Bond Counsel to the Agency. A complete copy of the proposed form of Bond Counsel opinion is contained in Appendix D hereto. Certain legal matters with respect to the Agency, the Corporation and the County will be passed upon by County Counsel and Bond Counsel. Certain legal matters will be passed upon for the Agency by Hawkins Delafield & Wood LLP, Los Angeles, California, as Disclosure Counsel to the Agency, and for the Underwriters by their counsel, Nixon Peabody LLP, Los Angeles, California.

OTHER PARTIES

Global Insight

Global Insight has been retained as an independent econometric consultant. The Global Insight Cigarette Consumption Report attached as Appendix A hereto is included herein in reliance on Global Insight as experts in such matters. Global Insight's fees for acting as independent economic consultant are not contingent upon the issuance of the Series 2006A Bonds. The Global Insight Cigarette Consumption Report should be read in their entirety.

Financial Advisor

Public Resources Advisory Group, Los Angeles, California, has served as Financial Advisor to the Agency in connection with the issuance of the Series 2006A Bonds. The Financial Advisor has assisted the Agency in matters relating to the planning, structuring, execution and delivery of the Series 2006A Bonds. The Financial Advisor has not audited, authenticated or otherwise independently verified the information set forth in the Offering Circular, or any other related information available to the Agency, with respect to accuracy and completeness of disclosure of such information. The Financial Advisor makes no guaranty, warranty or other representation respecting accuracy and completeness of the Offering Circular.

APPENDIX A

Cigarette Consumption Report

APPENDIX B

MASTER SETTLEMENT AGREEMENT

APPENDIX C

MOU, ARIMOU, CONSENT DECREE
AND CALIFORNIA ESCROW AGREEMENT

APPENDIX D

PROPOSED FORM OF OPINION OF BOND COUNSEL

APPENDIX E

SUMMARY OF PRINCIPAL LEGAL DOCUMENTS

APPENDIX F

BOOK-ENTRY ONLY SYSTEM

The information in this Appendix F concerning The Depository Trust Company ("DTC"), New York, New York, and DTC's book-entry system has been obtained from DTC and the Agency, the Corporation, the County and the Underwriters take no responsibility for the completeness or accuracy thereof. The Agency, the Corporation, the County and the Underwriters cannot and do not give any assurances that DTC, DTC Participants or Indirect Participants will distribute to the Beneficial Owners (a) payments of principal of and interest on the Series 2006A Bonds, (b) certificates representing ownership interest in or other confirmation or ownership interest in the Series 2006A Bonds, or (c) redemption or other notices sent to DTC or Cede & Co., its nominee, as the registered owner of the Series 2006A Bonds, or that they will do so on a timely basis, or that DTC, DTC Participants or DTC Indirect Participants will act in the manner described in this Appendix F. The current "Rules" applicable to DTC are on file with the Securities and Exchange Commission and the current "Procedures" of DTC to be followed in dealing with DTC Participants are on file with DTC.

DTC will act as securities depository for the Series 2006A Bonds. The Series 2006A Bonds will be issued as fully registered securities registered in the name of Cede & Co. (DTC's partnership nominee) or such other name as may be requested by an authorized representative of DTC. One fully registered security certificate will be issued for the Series 2006A Bonds, in the aggregate principal amount of such Series 2006A Bonds, and will be deposited with DTC.

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

Purchases of the Series 2006A Bonds under the DTC system must be made by or through Direct Participants, which will receive a credit for the Series 2006A Bonds on DTC's records. The ownership interest of each actual purchaser of each Security ("Beneficial Owner") is in turn to be recorded on the Direct and Indirect Participants' records. Beneficial Owners will not receive written confirmation from DTC of their purchase. Beneficial Owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the Direct or Indirect Participant through which the Beneficial Owner entered into the transaction. Transfers of ownership interests in the Series 2006A Bonds are to be accomplished by entries made on the books of Direct and Indirect Participants acting on behalf of Beneficial Owners. Beneficial Owners will not receive certificates representing their ownership interests in the Series 2006A Bonds, except in the event that use of the book-entry system for the Series 2006A Bonds is discontinued.

To facilitate subsequent transfers, all Series 2006A Bonds deposited by Direct Participants with DTC are registered in the name of DTC's partnership nominee, Cede & Co., or such other name as may be requested by an authorized representative of DTC. The deposit of the Series 2006A Bonds with DTC and their registration in the name of Cede & Co. or such other DTC nominee do not effect any change in beneficial ownership. DTC has no knowledge of the actual Beneficial Owners of the Series 2006A Bonds; DTC's records reflect only the identity of the Direct Participants to whose accounts such Series 2006A Bonds are credited, which may or may not be the Beneficial Owners. The Direct and Indirect Participants will remain responsible for keeping account of their holdings on behalf of their customers.

Conveyance of notices and other communications by DTC to Direct Participants, by Direct Participants to Indirect Participants, and by Direct Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Beneficial Owners of the Series 2006A Bonds may wish to take certain steps to augment the transmission to them of notices of significant events with respect to the Series 2006A Bonds, such as redemptions, tenders, defaults, and proposed amendments to the Security documents. For example, Beneficial Owners of the Series 2006A Bonds may wish to ascertain that the nominee holding the Series 2006A Bonds for their benefit has agreed to obtain and transmit notices to Beneficial Owners. In the alternative, Beneficial Owners may wish to provide their names and addresses to the registrar and request that copies of notices be provided directly to them.

Redemption notices shall be sent to DTC. The conveyance of notices and other communications by DTC to DTC Participants, by DTC Participants to Indirect Participants and by DTC Participants and Indirect Participants to Beneficial Owners will be governed by arrangements among them, subject to any statutory or regulatory requirements as may be in effect from time to time. Any failure of DTC to advise any DTC Participant, or of any DTC Participant or Indirect Participant to notify a Beneficial Owner, of any such notice and its content or effect will not affect the validity of the redemption of the Series 2006A Bonds called for redemption or of any other action premised on such notice. Redemption of portions of the Series 2006A Bonds by the Agency will reduce the outstanding principal amount of Series 2006A Bonds held by DTC. In such event, DTC will implement, through its book-entry system, redemption by lot of interests in the Series 2006A Bonds held for the account of DTC Participants in accordance with its own rules or other agreements with DTC Participants and then DTC Participants and Indirect Participants will implement redemption of the Series 2006A Bonds for the Beneficial Owners.

Neither DTC nor Cede & Co. (nor any other DTC nominee) will consent or vote with respect to the Series 2006A Bonds unless authorized by a Direct Participant in accordance with DTC's Procedures. Under its usual procedures, DTC mails an Omnibus Proxy to the issuer as soon as possible after the record date. The Omnibus Proxy assigns Cede & Co.'s consenting or voting rights to those Direct Participants to whose accounts the Series 2006A Bonds are credited on the record date (identified in a listing attached to the Omnibus Proxy).

Payments of principal of and interest evidenced by the Series 2006A Bonds will be made to Cede & Co., or such other nominee as may be requested by an authorized representative of DTC. DTC's practice is to credit Direct Participants' accounts upon DTC's receipt of funds and corresponding detail information from the Agency or the Trustee, on payable date in accordance with their respective holdings shown on DTC's records. Payments by Participants to Beneficial Owners will be governed by standing instructions and customary practices, as is the case with securities held for the accounts of customers in bearer form or registered in "street name," and will be the responsibility of such Participant and not of DTC (nor its nominee), the Trustee, or the Agency, subject to any statutory or regulatory requirements as may be in effect from time to time. Payment of principal of and interest evidenced by the Series 2006A Bonds to Cede & Co. (or such other nominee as may be requested by an authorized representative of DTC) is the responsibility of the Agency or the Trustee, disbursement of such payments to Direct Participants will be the responsibility of DTC, and disbursement of such payments to the Beneficial Owners will be the responsibility of Direct and Indirect Participants.

NONE OF THE AGENCY, THE CORPORATION, THE COUNTY, THE UNDERWRITERS OR THE INDENTURE TRUSTEE WILL HAVE ANY RESPONSIBILITY OR OBLIGATION TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS WITH RESPECT TO THE PAYMENTS OR THE PROVIDING OF NOTICE TO DTC PARTICIPANTS, INDIRECT PARTICIPANTS OR BENEFICIAL OWNERS OR THE SELECTION OF SERIES 2006A BONDS FOR PREPAYMENT.

DTC may discontinue providing its services as depository with respect to the Series 2006A Bonds at any time by giving reasonable notice to the Agency or the Indenture Trustee. Under such circumstances, in the event that a successor depository is not obtained, Security certificates are required to be printed and delivered. The Agency may decide to discontinue use of the system of book-entry transfers through DTC (or a successor securities depository). In that event, bond certificates will be printed and delivered. In the event that the book-entry system is discontinued as described above, the requirements of the Indenture will apply.

APPENDIX G

TABLE OF ACCRETED VALUES

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