

**SETTLEMENT DISCUSSIONS ONLY – NOT APPROVED BY ANY PM OR STATE  
MEMORANDUM OF UNDERSTANDING**

The following is a Memorandum of Understanding (“MOU”) containing the principal terms of a comprehensive settlement of the NPM Adjustment dispute, including resolution of the 2003-2009 NPM Adjustments (the “Accrued Claims”) and revision of the NPM Adjustment for subsequent years. The MOU is binding on all signatories, provided that both the MOU and the settlement are conditioned on joinder by a critical mass of PMs, and by a critical mass of Settling States as provided in Section IV.C.4 below. The parties contemplate the prompt drafting and execution of a comprehensive final settlement agreement that will incorporate the terms of this MOU, as well as other customary terms and conditions acceptable to the parties.<sup>1</sup>

**I. ACCRUED CLAIMS AND 2010-11 NPM ADJUSTMENTS**

The 2003-2011 NPM Adjustments will be resolved with respect to all Settling States that join the Settlement (“Joining States”) as provided in Section IV.C.4 on the following basis:

**A. Refunds and Reductions**

The PMs that join the settlement (“PMs”) shall receive reductions of MSA payments as follows:

1. The OPMs shall receive a total amount, in the form of reductions and retained withheld payments as specified below, equal to (a) the aggregate Allocated Settlement Percentage of all Joining States multiplied by \$6.422 billion; and (b) the aggregate Allocated Settlement Percentage of all Joining States multiplied by the OPMs’ full 2010 and 2011 NPM Adjustments under the original formula. Each Joining State’s Allocated Settlement Percentage shall equal the product of its Allocable Share percentage and (x) 29.5% in the case of Joining States that sign this MOU by June \_\_, 2011, or (y) 59% in the case of Joining States that sign this MOU after June \_\_, 2011, but before execution of the final settlement agreement. **[Amounts to be updated to reflect another year of interest on the amounts in (a) and interest on the 2010 Adjustment.]**

2. The amount under Paragraph 1 will be provided to the OPMs by their receiving a credit against their MSA annual payment due in April 2012 in the total amount specified in Paragraph 1 less the Joining States’ aggregate Allocable Share percentage of the \$419.8 million withheld by R.J. Reynolds Tobacco Company with respect to the 2006 NPM Adjustment. The Joining States waive and release any claim or right to their aggregate Allocable Share percentage of the \$419.8 million withheld by R.J. Reynolds Tobacco Company with respect to the 2006 NPM Adjustment.

3. Each OPM that paid amounts attributed to the 2003, 2004, 2006, 2007 or 2008 NPM Adjustments into the Disputed Payments Account will, as of the date that the credit under Paragraph 2 is actually received, instruct the Escrow Agent and the Independent Auditor to

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<sup>1</sup> The PMs reserve all rights against any State that does not join the Settlement, and the settlement agreement will so provide.

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release to the Joining States from that Account an amount equal to the total amounts attributed to such NPM Adjustments (plus the accumulated earnings thereon) multiplied by the aggregate Allocable Share percentage of all Joining States, less amounts allocated pursuant to Paragraph 4(c). The parties will cooperate in taking available steps to allow the credit and release to occur as soon as possible following execution of the final settlement agreement, including in advance of April 16, 2012.

4. The Joining States and OPMs will jointly instruct the Escrow Agent and Independent Auditor:

(a) To recognize and apply the credits described in Paragraphs 1-2 and to allocate the credits solely among the Joining States pro rata, in proportion to their respective Allocated Settlement Percentages.

(b) To allocate the amount released from the Disputed Payments Account under Paragraph 3 solely among the Joining States pro rata, in proportion to their respective Allocable Shares.

(c) To allocate up to \$20 million of the accumulated earnings in the Disputed Payments Account on funds to be released from that Account pursuant to Paragraph 3 to a tax-exempt account to be identified by the Joining States to fund the Data Clearinghouse as provided in Section IV.A.

5. The OPMs and Joining States will jointly seek a ruling from the Panel that the Escrow Agent and Independent Auditor are to act in accordance with the instructions described in Paragraph 4. Obtaining such a ruling is a condition to the settlement.

6. There will be parallel provisions for SPMs that provide for each SPM that signs this MOU by June \_\_, 2011 to receive the same (*i.e.*, no greater) relative payment amounts, and for each SPM that signs this MOU after June \_\_, 2011 to receive 50% of the same (*i.e.*, no greater) relative payment amounts, in each case subject to the same conditions.<sup>2</sup> There will also be parallel provisions for SPMs to Paragraphs 4 and 5.

**B. Release or Reduction in the Case of Certain SPMs**

Notwithstanding the foregoing, any SPM that has expressly waived or assigned to the Settling States any claim to an NPM Adjustment for any year shall not be entitled to any release or reduction related to that year pursuant to Section A.

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<sup>2</sup> These conditions include release of funds and earnings in the Disputed Payments Account corresponding to Paragraph 3 and re-payment of withheld amounts on the 2003-2010 NPM Adjustments to the extent greater than the payment amount the SPM is to receive under this MOU, in each case as of the later of the date the payment amount corresponding to Paragraph 2 is actually received by the SPM or the date of the final settlement agreement. Where a PM is not current on its undisputed or adjudicated payment obligations under the MSA or any amendment to the MSA, any amounts to be received by it under this MOU will be applied to such unpaid obligations and will not otherwise be credited to that PM except to the extent such amounts exceed the Joining States' aggregate Allocable Share of such unpaid obligations.

## **II. NPM ADJUSTMENT FOR SUBSEQUENT YEARS**

The following revised NPM Adjustment will apply to the Joining States in lieu of the original NPM Adjustment.

### **A. Transition**

1. There will be a two-year transition period covering sales years 2012-2013 during which the revised NPM Adjustment will operate as follows.

2. The revised adjustment for stamped NPM sales described in Section B will apply.

3. The revised adjustment for unstamped NPM sales described in Section C will not apply until sales year 2014. Instead, the OPMs would receive for each of 2012 and 2013:

(a) 15% of the NPM Adjustment under the original formula up to the amount of the 2010 Market Share Loss multiplied by the aggregate Allocable Share percentage of all Joining States;

(b) 30% of any part of the NPM Adjustment under the original formula arising from NPM sales of 1 to 100 million cigarettes above the 2010 Market Share Loss, multiplied by the aggregate Allocable Share percentage of all Joining States;

(c) 40% of any part of the NPM Adjustment under the original formula arising from NPM sales of 100 million to 200 million cigarettes above the 2010 Market Share Loss, multiplied by the aggregate Allocable Share percentage of all Joining States; and

(d) 50% of any part of the NPM Adjustment under the original formula arising from NPM sales of more than 200 million cigarettes above the 2010 Market Share Loss, multiplied by the aggregate Allocable Share percentage of all Joining States.

Each SPM that joins the settlement would receive proportional adjustments in proportion to the size of its MSA payment for that year.

4. If a Joining State does not have the mandatory provisions of the model legislation (or their functional equivalent) in full force and effect throughout any year following 2013,<sup>3</sup> the PMs will designate for that year either (a) that the State will remain subject to the revised NPM Adjustment under this settlement or (b) that the State will be subject to the original NPM Adjustment formula and arbitration process. If the PMs designate a State for the second option for a year, the State and the PMs will cooperate in the prompt commencement and conduct of that arbitration process; the State may exempt itself from the original NPM Adjustment for that year if it demonstrates to the arbitration panel that it diligently enforced its Escrow Statute during

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<sup>3</sup> For a description of the model legislation and associated terms, see Section III below.

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that year, but the diligent enforcement requirement will be construed as including the obligations of licensing, stamping and reporting set forth in the mandatory provisions of the model legislation that the State was to have enacted under the settlement and the State may not contend that non-collection of state excise tax or absence of an excise tax stamp on NPM cigarettes removes those cigarettes from the diligent enforcement requirement.<sup>4</sup> For purposes of Section II.C.6, a Joining State that is subject to the original NPM Adjustment under the second option will be treated as a Non-Joining State.<sup>5</sup>

5. Except as provided in Paragraph 6 and Section IV.C.6, the PMs may not designate the second option under Paragraph 4 as to any Joining State for a year in which that State (a) has all of the mandatory provisions of the model legislation (or their functional equivalent) in full force and effect throughout that year except for one or more of the tribal provisions; and (b) represents to the PMs (i) that no federally or state-recognized Indian tribe within its geographic boundaries, no entity owned or operated by such a tribe or member of that tribe on Indian Country, and no entity that the State knows or reasonably should know claims sovereign immunity by virtue of tribal status, membership in such a tribe, ownership or operation by such a tribe or member of that tribe or relationship to such a tribe or member of that tribe participated in the manufacture, sale or distribution of cigarettes during that year, and (ii) that cigarettes were not manufactured, sold or distributed on or from such a tribe's Indian Country during that year. If the representation is inaccurate,<sup>6</sup> the OPMs will be entitled to receive from that State the excess of (x) what they would have received as to that State under the original NPM Adjustment for that year if that State did not diligently enforce a Qualifying Statute during that year and the significant factor issue for that year had been resolved in the PMs' favor over (y) the amount the OPMs received as to that State under the revised NPM Adjustment under settlement for that year, and each SPM will be entitled to the similar excess in proportion to the size of its MSA payment for that year.

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<sup>4</sup> If the PMs designate a State for the second option, the significant factor requirement for application of the NPM Adjustment will be applicable only if there are Non-Joining States that are contesting the significant factor issue for that year.

<sup>5</sup> Because of biennial legislative sessions, there will be a potential third transition-period year covering sales year 2014 for the following five States: Arkansas, Montana, Nevada, North Dakota and Oregon. As to any of these five States that does not believe that it has the mandatory provisions of the model legislation (or their functional equivalent) in full force and effect as of December 2013, for 2014: (1) the PMs may not designate the second option described in this Paragraph as to that State on the ground that it does not have the mandatory provisions of the model legislation (or their functional equivalent) in full force and effect throughout 2014; (2) the revised adjustment for stamped sales described in Section B will apply as to that State; (3) the PMs will receive such State's Allocable Share of the amounts detailed in Paragraph 3 for 2014; and (4) the revised adjustment for unstamped NPM sales described in Section C will not apply as to that State for 2014, but that revised adjustment will apply to all other Joining States for 2014 (with no reduction in any adjustment under Section II.C.4(e) reflecting the Section's inapplicability to one or more of the five States). If any of these five States believes on or before December 31, 2013 that it has the mandatory provisions of the model legislation (or their functional equivalent) in full force and effect, it shall promptly notify all parties of that belief. The third transition-period year will not apply as to any of the five States that provides such a notice.

<sup>6</sup> A State may not maintain that the representation was accurate on the ground that it did not know or should not reasonably have known that the entity at issue claimed sovereign immunity if either that is not true or the entity raises a sovereign immunity claim and the State does not contest that claim in court or the entity prevails with finality in whole or in part on it.

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6. In order to effectuate the MSA, this MOU and the final settlement agreement, a Joining State shall forbear from issuing any future bonds or similar instruments that are secured in whole or in part by a pledge of any MSA payments unless the documents with respect to such bonds or instruments clearly provide that they do not limit or impair the State's authority or discretion to amend, modify or resolve disputes under the MSA or this MOU or the final settlement agreement.

7. Each Joining State shall sign the PSS credit amendment at the same time it signs the MOU or the final settlement agreement, whichever is earlier.

**B. Adjustment for Stamped NPM Sales**

1. *Adjustment.* Except as provided in Section B.3, each year beginning for sales year 2012 an adjustment will be applied to a Joining State's share of the OPMs' MSA payment equal to the adjustment amount for each non-compliant NPM cigarette sold in a pack bearing a stamp of that State.<sup>7</sup> The adjustment amount will be three (3) times the per-cigarette escrow deposit rate in the Model Escrow Statute for the year of sale (including the inflation adjustment in the Statute). There will be a proportional adjustment for each SPM in proportion to the size of its MSA payment for that year.

2. *Meaning of non-compliant NPM cigarettes.* Non-compliant NPM cigarettes are stamped NPM cigarettes as to which escrow was not deposited at the Escrow Statute rate. Escrow is considered deposited on a cigarette only if (a) it was deposited at the Escrow Statute rate by the NPM or by entities other than the NPM that are liable for escrow payments on the cigarette at issue under the model legislation or (b) the State recovered on an escrow bond posted by the NPM in the amount of escrow due on the cigarette at issue; provided that the State did not release or refund any part of the deposit or the recovery on the bond except as provided in the Model Escrow Statute (as amended by Allocable Share Repeal) or as set forth in subparagraph (x) below (if applicable). In addition, the term non-compliant cigarettes does not include:

(x) As to States that have the tribal provisions of the model legislation (or their functional equivalent) in full force and effect, NPM cigarettes meeting the definition of the limited exempt NPM sales set forth in those provisions upon which escrow is deposited at the Escrow Statute rate, but as to which the State then properly refunded the escrow in accordance with the process set forth in those provisions.

(y) As to States that have Sections 16-18 of the model legislation (or their functional equivalent) in full force and effect, NPM cigarettes as to which the State is barred from requiring escrow deposits from all entities liable for escrow payments on those cigarettes under the model legislation, and from recovery on a remaining escrow bond posted by the NPM, by an automatic stay or subsequent order in a federal bankruptcy proceeding or by order of a court of competent jurisdiction that requiring escrow deposits is barred by federal or state constitutional law (other than state

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<sup>7</sup> The term "cigarette" has the meaning given in the MSA except as provided below. References to "stamps" include any of the stamps permitted under the model legislation.

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constitutional provisions added or to the extent amended after September 1, 2010 or state constitutional law as it may impact or be applied in relation to sovereign immunity or other Native American issues) or federal statutory or common law, so long as (i) the State opposes and appeals the stay or order, (ii) the State has not contended after execution of the final settlement agreement that the escrow requirement does not apply to or cannot be enforced with respect to any NPM cigarettes required to bear a stamp under the model legislation and has opposed any such contention by any other person or entity, and (iii) the NPM and brand at issue were properly on the State's approved directory, either in accordance with the terms of Complementary Legislation or pursuant to the order of a court of competent jurisdiction barring removal of the NPM or brand from that directory, within 30 days prior the time of sale.<sup>8</sup> This subparagraph does not apply with respect to the cigarettes of any NPM that the State in question has not required to post a bond in at least the amount set forth in Section 17(b) of the model legislation, including because the bond provision as enacted does not apply to that NPM.

Subparagraphs (x) and (y) do not apply to any State that does not have the mandatory provisions of the model legislation in full force and effect.

3. *Safe Harbor.* No adjustment under this Section B will be applied to a State for any year as to which the State demonstrates either (a) that escrow was deposited on at least 96% of all NPM cigarettes sold in the State during that year in packs bearing the State's stamps (other than packs meeting the conditions of Paragraph 2(y), if applicable to the State in question); or (b) that the number of NPM cigarettes sold in the State during that year in packs bearing the State's stamps on which escrow was not deposited does not exceed 2 million cigarettes.

4. *Timing.* The adjustment amount with respect to a State will be applied to that State's share of the PMs' next annual MSA payment. As to NPM cigarettes to which Paragraph 2(y) applies, if the stay or order is reversed or otherwise becomes no longer operative and escrow is not then deposited on the cigarettes at issue, the adjustment on those cigarettes will be applied to that State's share of the PMs' next annual MSA payment unless a further stay or order is entered meeting the provisions of Paragraph 2(y). Adjustment amounts applied to a State's share will be subject to appropriate repayments by the PMs if escrow is deposited on the cigarettes at issue after application of the adjustment.

5. *Data Clearinghouse.* Except as provided in Section IV.B below, the calculations and determinations required under this Section B will be made by the Data Clearinghouse as agreed to by the parties. The Data Clearinghouse will then communicate its calculations and determinations to the Independent Auditor for it to incorporate into its payment calculations.

**C. Adjustment for Unstamped NPM Sales**

1. Each year beginning for sales year 2014, the Data Clearinghouse will calculate the total number of unstamped NPM sales in the MSA States. This will be done by starting with

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<sup>8</sup> The requirements of clauses (i) and (ii) are subject to any limitation arising from Rule 11 or similar state ethical rules.

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the nationwide NPM FET-paid<sup>9</sup> sales and subtracting (a) the total number of NPM sales in the Previously Settled States and (b) the total number of stamped NPM sales in the MSA States. Nationwide NPM FET-paid sales will be the sum of NPM FET-paid sales reported by all NPMs (or their importers) to TTB or U.S. Customs, unless such sum is more than 5% different from the sum of all FET-paid sales minus the sum of PM FET-paid sales, in which case the Data Clearinghouse will determine the accurate amount of nationwide NPM FET-paid sales.<sup>10</sup> NPM sales in the Previously Settled States will be determined by the Data Clearinghouse on the basis of NPM reports, other data supplied by the parties and other data obtained by the Data Clearinghouse, but will presumptively be 6.5 billion unless the Data Clearinghouse finds that there is clear and convincing evidence that the sales are at a materially different level. The total number of stamped NPM sales in the MSA States will be the sum of stamped NPM sales in the Joining States and NPM sales bearing the excise tax stamp (or, with respect to a Non-Joining State that does not have excise tax stamps, the similar indicia used by that State) of a Non-Joining State.<sup>11</sup>

2. If the number of unstamped NPM sales in the MSA States as determined pursuant to Paragraph 1 does not exceed Threshold A, then no further action will be taken for that year under the following Paragraphs. Threshold A will be, for 2014, 10% of the number of total NPM sales in the MSA States (stamped plus unstamped) as determined pursuant to Paragraph 1, and will decline by a percentage point per year until it reaches 5%.

3. If the number of unstamped NPM sales in the MSA States exceeds Threshold A but is below Threshold B, the following will take place:

(a) The Data Clearinghouse will determine the nature of the sales at issue to the extent reliable information permits, including which NPM manufactured the cigarettes, in which MSA States they were sold and in what amounts in each such State. The Data Clearinghouse will take into account, but not be limited to, assessment of reports under the model legislation (including corrected reports generated by state enforcement measures and license revocations), PACT Act reports and any reports or information submitted by the PMs pursuant to the settlement.<sup>12</sup>

(b) After these determinations have been made, the Joining States and the PMs will negotiate in good faith to identify: (i) whether there are further measures that are not available under the model legislation that a Joining State could reasonably take to

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<sup>9</sup> References to “FET” include arbitrios de cigarillos in Puerto Rico.

<sup>10</sup> Beginning for 2016, the percentage used in this sentence will be reduced to 2.5%. If reports from all NPMs to TTB are not available, the sum of the available reports will be used unless such sum is more than the applicable percentage different from the sum of all FET-paid sales minus the sum of PM FET-paid sales.

<sup>11</sup> If a Non-Joining State does not cooperate in producing this information to the Data Clearinghouse in a timely manner, the Data Clearinghouse will estimate the stamped NPM volume in that State using the most recent information for stamped or SET-paid NPM sales produced by that State pursuant to the NPM Procedures Agreement and other data submitted by the parties.

<sup>12</sup> The Data Clearinghouse will not use any sources of information other than the listed sources in the first year of the other sources’ introduction absent agreement otherwise by the parties. Information considered by the Data Clearinghouse will be available to the parties in connection with arbitrations under Section IV.B, subject to appropriate confidentiality protections.

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prevent unstamped NPM sales in that State; and (ii) whether the PMs could reasonably report further data consistent with existing confidentiality laws and contract provisions that would assist the Joining States in preventing such sales.

(c) If the PMs or Joining States either dispute a determination pursuant to Paragraph 3(a) or cannot reach agreement pursuant to Paragraph 3(b), the disputes would be submitted to non-binding arbitration as described in Section IV.B. In resolving disputes under Paragraph 3(b), the arbitrators would identify any additional measures or reporting that meets the standard described in that Paragraph and recommend their adoption by the party involved. Each Joining State and each PM would have the option of implementing measures or reporting recommended to it going forward.

(d) A Joining State may offer evidence to the PMs, the Data Clearinghouse or the arbitrators that escrow was deposited within the meaning of Section II.B.2 on some or all of the unstamped NPM sales at issue.<sup>13</sup>

(e) The States would not be subject to any adjustment under this Section C unless Threshold B is exceeded.

4. If the number of unstamped NPM sales in the MSA States as determined pursuant to Paragraph 1 exceeds Threshold B, the following would apply. Threshold B will be, for 2014, 20% of the number of total NPM sales in the MSA States (stamped plus unstamped) as determined pursuant to Paragraph 1, and will decline by two percentage points per year until it reaches 10%.<sup>14</sup>

(a) The same determination described in Paragraph 3(a).

(b) The same good faith negotiations described in Paragraph 3(b). If the PMs and the Joining States cannot reach agreement on the matters described in Paragraph 3(b), the dispute will be submitted to non-binding arbitration as provided in Paragraph 3(c).

(c) If the PMs or the Joining States dispute a determination pursuant to Paragraph 4(a) or if there are disputes under Paragraph 1 or Paragraph 4(d)-(f), the disputes would be submitted to binding arbitration as described in Section IV.B.

(d) As to unstamped NPM sales in the MSA States identified by the Data Clearinghouse/arbitration as having been sold in a particular Joining State, if the arbitrators determine that the State could have prevented the sales either under the

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<sup>13</sup> For purposes of this subparagraph and Paragraph 4(g), escrow deposits for an NPM's sales in a State will be assigned first to stamped sales of that NPM's brands in the State except to the extent that the State proves that such deposits are properly assigned to unstamped sales of that NPM's brands in the State.

<sup>14</sup> Threshold B (and the threshold for unidentified NPM sales in the first sentence of Paragraph 4(e)) are the levels at which the applicable potential adjustments are triggered; where triggered, the adjustments apply to NPM cigarettes within the category at issue both above and below the thresholds. The thresholds for the safe harbors in Paragraph 4(d) and Section II.B.3 are the levels at which the applicable safe harbors are triggered; where the safe harbor is not triggered, the adjustments apply to NPM cigarettes within the category at issue both above and below the thresholds.



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mandatory/reciprocity provisions of the model legislation or if it had implemented measures previously recommended to it under prior agreements or arbitral rulings, a per-cigarette adjustment for the preventable sales would be applied to that State's share of the OPMs' MSA payment of three (3) times the per-cigarette escrow deposit rate in the Model Escrow Statute for the year of sale (including the inflation adjustment in the Statute) and there would be a further proportional adjustment for each SPM in proportion to the size of its MSA payment. No adjustment under this subparagraph (d) will be applied to a Joining State for any year as to which the number of unstamped NPM sales identified by the Data Clearinghouse/arbitration as having been sold in that State are less than the greater of (i) 1 million cigarettes or (ii) 3% of all NPM cigarettes sold during that year in the State (stamped and unstamped) so long as that is not more than 5 million cigarettes.

(e) If the Data Clearinghouse/arbitration does not identify the State of sale of more than 5% of all unstamped NPM sales in the MSA States or sale of more than 150 million unstamped NPM cigarettes ("Unidentified NPM sales"), whichever is less, the following would apply. For each of the Unidentified NPM sales, there would be a further per-cigarette adjustment for the OPMs of four (4) times the per-cigarette escrow deposit rate in the Model Escrow Statute (including the inflation adjustment in the Statute) and a proportional adjustment for each SPMs in proportion to the size of its MSA payment allocated among each Joining State that the arbitrators determine (i) did not have the mandatory/reciprocity provisions of the model legislation (or their functional equivalent) in full force and effect throughout the sales year, (ii) failed to implement measures previously recommended to it under prior agreements or arbitral rulings, or (iii) did not demonstrate to the arbitration panel that it took the steps and measures available under the model legislation and that there is no reason to believe that Unidentified NPM sales took place in the State during that year that it could have prevented either under the mandatory/reciprocity provisions of the model legislation or if it had implemented measures previously recommended to it under prior agreements or arbitral rulings ("additional amount"). All other Joining States would not share in this additional amount.

(f) If the arbitrators determine that a PM (i) failed to implement reporting previously recommended to it under prior agreements or arbitral rulings pursuant to Paragraph 3(b)-(c), or (ii) distributed more than 1 million of its cigarettes in a Joining State through direct sale to a contract distributor more than 21 days after receiving notice that the contract distributor's license was revoked by that State pursuant to the model legislation (or its functional equivalent), then the PM waives any adjustment under this Paragraph 4 for the year at issue.

(g) A Joining State that is subjected to an adjustment under Paragraph 4(d) may demonstrate that escrow was deposited within the meaning of Section II.B.2 on some or all of the unstamped NPM sales at issue and the adjustment would be reduced accordingly.

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5. The States and the PMs would continue to discuss in good faith on an ongoing basis whether there are other actions that they can reasonably take to prevent unstamped NPM sales.

6. If the OPMs receive an NPM Adjustment under the original NPM Adjustment provision against a Non-Joining State(s) with finality for any year after sales year 2013 and the sum of such Adjustment plus the total adjustments received with finality for that year by the OPMs under the revised NPM Adjustment set forth in Sections B and C above exceed the maximum NPM Adjustment for that year for the OPMs under the original NPM Adjustment provision, then the OPMs will refund the excess to the Joining States. If an SPM receives an NPM Adjustment under the original NPM Adjustment provision against a Non-Joining State(s) with finality for any year after sales year 2013 and the sum of such Adjustment plus the total adjustments received with finality for that year by that SPM under the revised NPM Adjustment set forth in Sections B and C above exceed the maximum NPM Adjustment for that year for that SPM under the original NPM Adjustment provision, then that SPM will refund the excess to the Joining States.

7. Except as provided in Section IV.B, the calculations and determinations required under this Section C will be made by the Data Clearinghouse as agreed to by the parties. The Data Clearinghouse will then communicate its calculations and determinations to the parties and the Independent Auditor for any further proceedings described above or for incorporation into the PMs' payment calculations.

### **III. LEGISLATION**

A. As used in this MOU, the mandatory provisions of the model legislation include: (1) the Model Escrow Statute, Complementary Legislation and Allocable Share Repeal; (2) the provisions of the model legislation attached hereto as Appendix A that are identified as mandatory; and (3) in the case of any Joining State that, in the year at issue, has a federally or state-recognized Indian tribe within its geographic boundaries or provides for a different level of taxation or has a different stamping requirement/policy for cigarettes based on their sale by or other connection with Native American tribes or tribal entities, the provisions of the model legislation that are identified as tribal.

B. A provision of the model legislation will be deemed to be in full force and effect if either (1) the State enacts that provision of model legislation without modification or addition except for particularized state procedural or technical requirements and not in conjunction with any other legislative or regulatory proposal (except for other model legislation provisions or additional legislation that the PMs may agree can be enacted in conjunction with the model legislation) and that provision remains in full force and effect, or (2) the State has or puts in place the functional equivalent of that provision through legislation or regulation and that legislation or regulation remains in full force and effect.

C. At each Joining State's option, the PMs will upon request discuss in good faith with a Joining State prior to enactment or promulgation of proposed legislation or regulation an

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agreement as to whether the proposal constitutes the functional equivalent of the provision of the model legislation at issue.

D. Disputes about whether a Joining State has a provision of the model legislation or its functional equivalent in full force and effect will be submitted to binding arbitration as described in Section IV.B.

E. The PMs will support the enactment of legislation described in Paragraph B.1 if introduced or proposed (1) without modification or addition (except for particularized procedural or technical requirements) and (2) not in conjunction with any other legislative proposal (except for other model legislation provisions or additional legislation that the PMs may agree can be enacted in conjunction with the model legislation).

F. Each Joining State will disclose to the PMs any modification of any provision of the model legislation or functional equivalent that is subsequently made, whether by amendment or separate legislation or regulation.

#### **IV. PROCESS**

##### **A. Data Clearinghouse**

The Data Clearinghouse will be a firm that has both forensic accounting and analytical qualifications that is jointly retained by the parties. The Clearinghouse, in consultation with the parties, will also employ or contract with a person with extensive legal qualifications, who will make the determinations concerning legal issues involved in application of Section II.B.2(x)-(y) (other than issues regarding whether a State has provisions of the model legislation or their functional equivalent in full force and effect). The final settlement agreement will set forth (1) detailed qualifications for the entity and its employees/contractors who will work on the matters described herein, (2) the process for retaining the entity, (3) the process for submission of information to and raising issues with the entity and for the entity's decisionmaking, and (4) the types of information to be submitted to and considered by the entity. The first \$5 million of funding for the Data Clearinghouse shall be paid from the earnings or principal of the amount allocated under Section I.A.4(c), and the reasonable costs will thereafter be paid 50% by the PMs and 50% by the Joining States.

##### **B. Arbitration**

1. Disputes specified in Sections II.C.3(c), II.C.(4)(b), II.C.4(c) and III.D will be submitted to arbitration as described in those Sections. In addition, disputes arising from calculations or determinations of the Data Clearinghouse that involve over \$10 million or 10% of the affected States' Allocated Payments for that year, whichever is less, and disputes regarding whether a representation described in this MOU was inaccurate will be submitted to binding arbitration. The parties will cooperate in the prompt commencement and conduct of the arbitrations, as set forth in Paragraph 3, and may agree to pursue mediation in lieu of arbitration. The foregoing is not intended to alter or amend Section XI(c) of the MSA.

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2. Any Joining State and any PM that is affected by the dispute may participate in the arbitration concerning that dispute and in the selection of the panel as provided in Paragraph 3. The arbitration will be before a single panel to address both common and state-specific issues. If a State has issues specific to that state, it may submit those to the panel for determination. The panel shall decide all issues necessary to resolve the dispute and shall not lack jurisdiction or the duty to do so because of the failure of a Joining State or PM to participate. Unless specified otherwise by the arbitration panel, the rulings of the panel in binding arbitrations will be binding on all parties to the settlement, whether or not they participated in the arbitration or in the selection of the panel. Unless specified otherwise by the arbitration panel, any additional measures or reporting recommended by the panel in non-binding arbitrations under Section II.C.3(c) will be treated as having been recommended to all Joining States (in the case of additional measures) and PMs (in the case of reporting), whether or not they participated in the arbitration or in the selection of the panel.

3. The arbitration panel will be selected as follows. The participating PMs (collectively) and the participating Joining States (collectively) will each select one neutral arbitrator chosen from JAMS (unless the parties agree to a substitute) within 90 days of the sending of the initial arbitration notice by a party under this Section. If the 90-day period expires without a side having selected its arbitrator, JAMS (unless the parties agree to a substitute) will choose the arbitrator for that side. Within 60 days of the selection of the two arbitrators, those two arbitrators will choose the third neutral arbitrator, who shall be a retired Article III federal judge. Once selected, the panel will establish a scheduling order either as agreed to by the parties or if not agreed, as determined by the panel. That panel shall hear all disputes to be submitted to arbitration under Paragraph 1 for the year in question.

**C. Other**

1. *Withholding/Disputed Payments Account.* The PMs will not withhold or pay into the Disputed Payments Account based on a dispute arising out of the revised NPM Adjustment except if the dispute was noticed for arbitration by the PM over one year prior to the payment date and the arbitration has not begun despite good faith efforts by the PM.

2. *Most Favored Nations.*

(a) If one or more PMs that join the settlement enter into a separate settlement agreement with a Settling State that resolves the 2003 NPM Adjustment as to that State prior to a determination in the current Arbitration as to whether that State diligently enforced a Qualifying Statute during 2003, and such settlement includes overall terms more favorable to such Settling State than the terms of this settlement applicable to Joining States that sign this MOU by June \_\_, 2011, then the overall terms of this settlement will be revised as to all Joining States that sign this MOU by June \_\_, 2011 so that they will obtain from the PM(s) party to such separate settlement agreement overall terms as favorable as those obtained by such Settling State;<sup>15</sup> provided, however, that

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<sup>15</sup> References to settling or resolving the 2003 NPM Adjustment as to a Settling State do not include determinations by a PM not to contest that State's diligent enforcement claim for 2003 unless the PM received consideration from that State in return for such determination.

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revision will not be required by virtue of an agreement by a PM to accept a compact described in Paragraph 6 as to a State or by virtue of the provisions of footnote 5.

(b) If one or more Joining States enter into a separate settlement agreement with a PM (whether a signatory to this settlement or not) that resolves the 2003 NPM Adjustment as to that State prior to a determination in the current Arbitration as to whether that State diligently enforced a Qualifying Statute during 2003, and such settlement includes overall terms more favorable to such PM than the terms of this settlement, then the overall terms of this settlement will be revised as to all PMs that sign this MOU by June \_\_, 2011 so that they will obtain from the Joining State(s) party to such separate settlement agreement overall terms as relatively favorable as those obtained by such PM.

3. *RYO.* The settlement agreement will contain the provisions necessary to implement the terms and intent of this MOU fully as to RYO. These provisions will include: (a) provisions that make the provisions of Section II.B applicable to SET (or equivalent tax) paid RYO in the case of Joining States that do not require that RYO containers be stamped; (b) that, for any Joining State that does not require that RYO containers be stamped, the mandatory provisions of the model legislation include provisions sufficient to require NPMs to make escrow deposits at the Escrow Statute rate on RYO sales in the State; and (c) provisions for non-binding arbitration as described in Section IV.B in the event that non-SET (or equivalent tax) paid NPM RYO sales exceed 4 million pounds in a year; in such an arbitration, the arbitrators would identify any further measures that are not available under the model legislation that a Joining State could reasonably take to prevent non-SET (or equivalent tax) paid NPM RYO sales in that State and recommend their adoption, and any such recommended measures would be treated as recommended measures under Section II.C.3(c) and Section II.C.4(b).

4. *Joinder.* This MOU and the settlement are conditioned on joinder by a critical mass of PMs and by a critical mass of Settling States by June \_\_, 2011. By June \_\_, 2011, the Joining States will inform the PM negotiating team of the identity of the Settling States that have signed this MOU. By June \_\_, 2011, the PMs will inform the State negotiating team of the identity of the PMs that have signed this MOU. On June \_\_, 2011, the parties who have signed this MOU by June \_\_, 2011 will determine, in each party's sole discretion, whether a critical mass of Settling States (in the case of a PM) and PMs (in the case of a State) have signed this MOU such that the settlement will proceed. Any Settling State or Participating Manufacturer may sign this MOU by June \_\_, 2011, and if the settlement proceeds after that date, up until execution of the final settlement agreement by delivering a copy signed by its authorized representative to the following persons: Elli Leibenstein, Esq., Jones Day, 77 West Wacker, Chicago, IL 60601; Bradford Phelps, Esq., Office of the Attorney General, State of Arkansas, 323 Center St., Suite 200, Little Rock, AR 72201. After execution of the final settlement agreement, the parties agree to cooperate in the addition of further parties to the agreement. If the PMs enter into an agreement with a Settling State that has not signed this MOU under which such Settling State agrees to a revised NPM Adjustment that contains no material deviation of substance as to the applicable years from the provisions of Sections II.B, II.C, III, IV.A, IV.B and IV.C.3 of this MOU (as those Sections are reflected in the final settlement agreement), the Joining States will not object to such Settling State being considered a Joining State for purposes of those Sections

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for such years, although such agreement may give rise to a revision under Paragraph 2(a) if its terms and timing are as described in that Paragraph.

5. *Office.* Each Joining State shall identify or establish an office, department or other point of contact to which information regarding potential violations of the provisions of the model legislation (or its functional equivalent), the Model Escrow Statute, Complementary Legislation and Allocable Share Repeal, as enacted in each such Joining State, can be reported by consumers, retailers, wholesalers, jobbers, manufacturers or others involved with the manufacture, distribution or sale of cigarettes. Each Joining State shall report publicly, to the extent permissible under any applicable confidentiality restrictions, the reports made and the actions, if any, taken to address each such report.

6. *Compacts.* Each Joining States represents that it has no compacts or treaties with Indian tribes or tribal entities or tribal members that are inconsistent with any of the provisions of this MOU or the mandatory or tribal provisions of the model legislation, except as may have been disclosed to and accepted by the PMs, and that it will not enter into any such compacts or treaties after signing this MOU. A Joining State will be treated under Section II.A.4 for each year beginning with sales year 2014 in which the representation is inaccurate.

7. *Adjustment.* The Joining States and OPMs agree that the proper interpretation of the MSA is that the OPMs may exclude amounts received or retained pursuant to Section I from operating income for purposes of Section B(ii) of Exhibit E to the MSA, irrespective of how the OPMs account for such amounts in their financial statements. The Joining States and OPMs further agree to jointly urge the Independent Auditor not to treat amounts received or retained pursuant to Section I as operating income for purposes of Section B(ii) of Exhibit E to the MSA. Should the Independent Auditor nonetheless calculate an increase in MSA payments for the OPMs pursuant to Section B(ii) of Exhibit E to the MSA despite this paragraph, the Joining States agree to waive the right to receive their portion of any such increase in MSA payments and, if necessary, provide an affected OPM an additional credit against its April 2012 annual MSA payment to offset the Joining States' portion of any such increase in MSA payments.

8. *Sales “in” a State; “Original” NPM Adjustment.* As used in this MOU, cigarettes are sold in the State in or into which they are sold for consumption. References to the “original” NPM Adjustment or the “original” NPM Adjustment formula mean the NPM Adjustment under MSA §§ IX(d)(1)(A)-(B) (as to OPMs), IX(d)(4) (as to SPMs) and IX(j) as they existed immediately prior to this MOU on the assumption (unless stated otherwise) that the NPM Adjustment applies under MSA § IX(d)(1)(C)-(D) and that the full amount of such Adjustment can be allocated under MSA § IX(d)(2).

9. *Independent Auditor.* The parties will instruct the Independent Auditor to act in conformity with the settlement agreement as to the Joining States and PMs.

10. *Settlement Agreement.* The parties will cooperate in the drafting and execution of a comprehensive final settlement agreement incorporating the terms of this MOU, as well as other customary terms and conditions acceptable to the parties, by August 1, 2011 or as soon as possible thereafter. The documentation process will be subject to the oversight of the Panel.

11. *Existing MSA Bonds.*<sup>16</sup>

(a) A Joining State that has issued outstanding MSA bonds (“Securitized Joining State”) shall be subject to the provisions of this MOU, including all downward adjustments. Except as provided below, such adjustments shall be applied with respect to the Securitized Joining State at the time otherwise provided in this MOU.

(b) A Securitized Joining State wishing to be eligible for the deferral provisions of this Paragraph 11 shall, promptly after signing this MOU, provide and represent to be accurate to the PMs and the other Joining States the following information and any further information related to the Securitized Joining State’s MSA bonds that the PMs reasonably request, including a copy of any documents associated with the bonds: (i) the maturity date of each of its MSA bonds, (ii) the interest payments (in rate and dollar amount) required to be paid to bondholders in each respective Fiscal Year under each such bond, (iii) the total amount of principal required to be paid in each respective Fiscal Year arising from the maturity of such bonds in such Fiscal Year, (iv) the total operating expenses required to be paid in each respective Fiscal Year under such bonds, (v) the amount or amounts that have been deposited or otherwise held in reserve under each such bond that will be available for interest or principal payments and (vi) the percentage of such Securitized Joining State’s share of MSA payments that are pledged to secure each such bond (or, in the case of a Securitized Joining State that pledged an amount of MSA payments to secure a bond instead of a percentage of such payments, the amount pledged). The information provided initially shall be based on the circumstances as of that time, but the Securitized Joining State shall have a continuing obligation to update such information in the event of any changes.

(c) A Securitized Joining State shall be eligible for the deferral provisions of this Paragraph 11 if it meets the following conditions: (i) it signs this MOU by June \_\_, 2011, (ii) it has fully complied with subparagraph (b), (iii) it had the mandatory and optional provisions of the model legislation (or their functional equivalent) in full force and effect throughout the year for which the revised NPM Adjustment for which deferral is sought is being applied, (iv) its representation under Section IV.C.6 is accurate and (v) it has signed the PSS credit amendment.<sup>17</sup>

(d) If a Securitized Joining State (i) is eligible under subparagraph (c) and (ii) application of the portion of the revised NPM Adjustment under Section II.C.4(e) for a sales year from 2014-2015 inclusive would leave the State’s bond issuing entity with inadequate funds to meet its total minimum payment obligation to bondholders for the corresponding Fiscal Year (or increase the inadequacy of such funds), the following shall apply. The Securitized Joining State, at its election, may defer that portion of the revised

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<sup>16</sup> This paragraph 11 is a preliminary concept that is subject to further review. It has been prepared for the purpose of seeing whether the general structure warrants further consideration, provision of information and analysis. It is subject to modification.

<sup>17</sup> Revision under Section IV.C.2(a) will not be required by virtue of an agreement by a PM to waive the condition of clause (i).

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NPM Adjustment under Section II.C.4(e) allocated to its share of the MSA payment for that sales year that meets the condition of clause (ii) above. If the Securitized Joining State elects such deferral, the deferred amounts shall bear interest at the rate provided in § IX(h) of the MSA. The deferred amounts and interest shall be applied as credits to the Securitized Joining State's share of the MSA payment for subsequent sales year(s) (after application of all adjustments, including any NPM Adjustment, for that year) until fully paid, in the case of a subsequent sales year prior to 2016 to the extent consistent with clause (ii) above for such year. If deferred amounts and/or interest remain upon the maturity of all of the Securitized Joining State's MSA bonds, they shall be retired as credits against that State's share of the next MSA payment (after application of all adjustments, including any NPM Adjustment, to that payment) or, if any such amounts cannot be credited against such share of the next MSA payment, by direct payment by the State.<sup>18</sup>

(e) In determining whether and the extent to which the condition of subparagraph (d)(ii) is met, the following shall apply. The revised NPM Adjustment under Section II.C.4(e) allocated to a Securitized Joining State for a sales year shall first be applied to the portion (if any) of the State's share of the MSA payment for that sales year that is not pledged to secure any of the State's MSA bonds that remain outstanding as of the corresponding Fiscal Year. If there is any remaining amount of such Adjustment that cannot be applied under the preceding sentence, the condition of subparagraph (d)(ii) is met if (but only to the extent that) such remaining amount is greater than the amount (if any) by which the State's share of the MSA payment for that sales year that is pledged to secure the State's MSA bonds on which payments to bondholders are required during the corresponding Fiscal Year exceeds the total minimum payment obligation to bondholders under those bonds for that Fiscal Year.<sup>19</sup>

(f) As used in this Paragraph 11:

(i) "MSA bonds" means bonds or similar instruments that are secured in whole or in part by a pledge of any MSA payments.

(ii) MSA bonds are considered to be a State's bonds or to have been "issued" by that State if they are secured in whole or in part by a pledge of any or all of that State's share of any MSA payments.

(iii) Fiscal Year means the period from April 15 of one calendar year (or the next Business Day if April 15 is not a Business Day) to April 14 of the

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<sup>18</sup> Note: In the final settlement agreement, it may be necessary as a drafting matter to break this out into parallel OPM and SPM provisions as is done in other places in the MOU.

<sup>19</sup> In applying the second and third sentences of subparagraph (e), if a further adjustment is applied to the Securitized Joining State for the sales year at issue under provisions of the revised NPM Adjustment other than Section II.C.4(e), the revised NPM Adjustment under Section II.C.4(e) and the revised NPM Adjustment under the other provisions shall be applied in proportion to their respective dollar amounts to the unpledged portion of the State's MSA payment (as described in the second sentence) and to the excess of the pledged amount over the total minimum payment obligation to bondholders (as described in the third sentence).



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next calendar year (or the next Business Day if April 15 of that next calendar year is not a Business Day). References to the Fiscal Year “corresponding” to a sales year mean the Fiscal Year beginning on April 15 of the calendar year after that sales year. E.g., the NPM Adjustment for sales year 2014 refers to the NPM Adjustment applied to the MSA payment due on April 15, 2015, and the Fiscal Year corresponding to that sales year runs from April 15, 2015 to April 16, 2016.

(iv) A State’s “total minimum payment obligation” to bondholders for a Fiscal Year is the sum of (x) the total interest payments required to be paid to bondholders in that Fiscal Year under its MSA bonds, (y) the total amount of principal required to be paid to bondholders in that Fiscal Year arising from the maturity of its MSA bonds in that Fiscal Year, and (z) the total operating expenses required to be paid in that Fiscal Year under its MSA bonds. The “total minimum payment obligation” to bondholders for a Fiscal Year does not include any payments that are not required to be made directly to bondholders during that Fiscal Year (e.g., payments into a reserve or sinking fund, or accrual of interest to be paid in a subsequent Fiscal Year) or potential payments of principal on bonds prior to their scheduled maturity.

(g) A Joining State shall not be eligible for deferral under this Paragraph 11 if, after January 15, 2011, any of its MSA bonds were amended or modified in a way that increases the total minimum payment obligation to bondholders in any of the Fiscal Years corresponding to sales years 2014-2015 or otherwise increases the likelihood that the condition in subparagraph (d)(ii) will be met or the extent to which it may be met.

Agreed and accepted

Party: \_\_\_\_\_

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

Title: \_\_\_\_\_

Date: \_\_\_\_\_

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**Appendix A – Model Legislation**

**MANDATORY**

**Sec. [1]. Restrictions on Transactions in Unstamped Cigarettes.**

(a) Cigarettes may be sold in, into or from the State only in packages.

(b) Except as provided in this Section, all packages of cigarettes sold in or into the State shall bear a stamp permitted under Section [4] and no person may sell, transport or cause to be transported unstamped cigarettes in, into or from, or possess unstamped cigarettes in, the State.

(c) No person other than a stamping agent may affix a stamp listed in Section [4] to any package. A stamping agent must affix the appropriate stamp under Section [4] to the package containing any unstamped cigarettes it acquires prior to selling those cigarettes in or into the State. Stamping agents may sell cigarettes in or into the State, may purchase cigarettes for re-sale in or into the State, and may affix a stamp listed in Section [4] to a package only if (i) the manufacturer and brand family of the cigarettes are listed on the state directory at the time of stamping and (ii) the stamping agent is the manufacturer or importer of the cigarettes or purchased the cigarettes directly from the manufacturer or importer of the cigarettes.

(d) A manufacturer or importer may possess, transport or cause to be transported unstamped cigarettes that it manufactures or imports. A manufacturer or importer may sell its unstamped cigarettes in or into the State to a stamping agent under the following circumstances: (i) the manufacturer and brand family of the cigarettes are at the time of sale listed on the state directory; or (ii) if the manufacturer and brand family of the cigarettes are not at the time of sale listed on the state directory, only if (A) the stamping agent is authorized to affix the stamp of or, where permitted under subsection (e) pay the taxes imposed by, another State on whose directory the manufacturer and brand family of the cigarettes are listed at the time of sale, (B) the stamping agent would be permitted to re-sell the cigarettes from this State into that other State under subsection (e) and (C) the stamping agent receiving the cigarettes holds a directory license from [name of State agency] pursuant to Section [2(c)] and has given at least 5 days notice to [name of State agency] before the cigarettes are transferred.

(e) A manufacturer or importer may sell its cigarettes from this State into another State only if the sale is to a person authorized by the law of the other State to affix the stamp required by the other State prior to re-sale or the manufacturer or importer first affixes the stamp required by the other State to the package containing the cigarettes. Any other stamping agent may sell cigarettes from this State into another State only if it first affixes the stamp required by the other State to the package containing the cigarettes. If the law of the other State permits the sale of the cigarettes to consumers in a package not bearing a stamp, a manufacturer, importer or stamping agent may sell cigarettes into

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the other State without a stamp only if (i) it first pays any excise, use or similar tax imposed on the cigarettes by the other State or (ii) in the case of sale by a manufacturer or importer, the sale is to a person authorized by the law of the other State to pay such tax and the manufacturer or importer reports the name and address of the recipient and the quantity and brand of the cigarettes to the taxing authority of the other State by 15 days following the end of the month in which the sale was made. Notwithstanding the above, a person may not sell cigarettes from this State into another State if the sale would violate the law of the other State, or affix the stamp required by the other State or pay the excise, use or similar tax imposed by the other State if doing so would violate the law of the other State.

(f) A manufacturer or importer may sell unstamped cigarettes as permitted under subsection (d) or (e) through its sales entity affiliate. If the manufacturer or importer does so: (i) it may sell or otherwise transfer the unstamped cigarettes to its sales entity affiliate in connection with the sale; (ii) the sales entity affiliate may sell, possess, transport or cause to be transported the unstamped cigarettes in connection with the sale to the same extent as the manufacturer or importer could under this Section if it were making the sale directly; (iii) in the case of sales permitted under subsection (d), the stamping agent will be deemed to have purchased the cigarettes directly from the manufacturer or importer; and (iv) in the case of sales permitted under subsection (e), the sales entity affiliate may act for the manufacturer or importer in affixing the stamp required by the other State or paying the taxes imposed by the other State prior to the sale, in lieu of the manufacturer or importer doing so itself, to the same extent as the manufacturer or importer could do so. A manufacturer or importer shall notify [name of State agency] prior to beginning selling cigarettes through its sales entity affiliate under this subsection. Such notification shall identify the sales entity affiliate, certify the facts that the manufacturer or importer believes qualify it as a sales entity affiliate as defined in this Act, and be updated promptly in the event of any changes.

(g) A stamping agent may possess unstamped cigarettes for sale in or into the State provided that (i) it is permitted to purchase, sell and affix a stamp to the package containing such cigarettes under subsection (b) and (ii) it affixes the appropriate stamp under Section [4] to the package containing such cigarettes within 15 days of receipt of the cigarettes and prior to selling the cigarettes in or into the State. This requirement shall not apply to a manufacturer, importer or sales entity affiliate that is a stamping agent to the extent it is selling, transferring, transporting, causing to be transported or possessing unstamped cigarettes as permitted under this Section.

(h) Except as provided below, a stamping agent may possess unstamped cigarettes for sale from this State into another State provided that (i) it affixes the stamp required by the other State to the package containing the cigarettes, or if permitted under subsection (e), pays any excise or similar tax imposed on the cigarettes by the other State, within 15 days of receipt of the cigarettes and prior to selling the cigarettes in or into the other State; and (ii) neither the sale nor the affixing of the stamp or payment of taxes would violate the law of the other State. A stamping agent may not purchase or possess

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unstamped cigarettes in this State for sale into another State where the manufacturer and brand family of the cigarettes are not at the time of sale listed on this State's directory unless it holds a directory license pursuant to Section 2(c). The requirements of this subsection shall not apply to a manufacturer, importer or sales entity affiliate that is a stamping agent to the extent it is selling, transferring, transporting, causing to be transported or possessing unstamped cigarettes as permitted under this Section.

(i) A stamping agent may transfer, transport or cause to be transported unstamped cigarettes that it owns and is permitted to possess under subsections (g) or (h) from one of its facilities in this State to another of its facilities. If the facility to which the cigarettes are transferred is located in this State or the cigarettes are to be re-sold in this State, the applicable time period for affixing a stamp or payment of tax under those subsections shall remain in effect and shall continue to run from the date of the stamping agent's original receipt of the cigarettes. If the facility to which the cigarettes are transferred is located outside of this State, the stamping agent shall report the quantity and brand of the cigarettes to the [name of State agency] and the taxing authority of the other State by 15 days following the end of the month in which the transfer was made. Notwithstanding the above, a stamping agent may not transfer cigarettes from this State into another State if the transfer would violate the law of the other State.

(j) A common carrier or contract carrier may possess and transport unstamped cigarettes in connection with a sale or other transfer permitted under subsections (d)-(f) or (i), if the common carrier or contract carrier has in its possession documents establishing that title to the unstamped cigarettes remains with the manufacturer, importer or stamping agent or bills of lading or other shipping documents establishing that it is delivering the cigarettes on behalf of a person authorized to sell or transfer the unstamped cigarettes under subsections (d)-(f) or (i) and, in each case, such documents list the name and address of the person to whom the cigarettes are being delivered. A public warehouse may possess unstamped cigarettes on behalf of a manufacturer, importer or stamping agent if the public warehouse maintains records to show receipt from a person authorized to sell or transfer the unstamped cigarettes under subsections (d)-(f), provided that in the case of a stamping agent this shall not extend the 15-day period for affixing of stamps or payment of taxes under subsections (g) or (h).

(k) Manufacturers and importers and their contractors, agents, common carriers or contract carriers may possess, transport or cause to be transported unstamped cigarettes in, into or from this State for use in connection with consumer testing permitted under the law of the State in which the testing is to be done, provided that (i) such cigarettes are not currently commercially marketed in the United States, (ii) the manufacturer pays applicable State excise taxes on such cigarettes by return, (iii) in the case of a non-participating manufacturer, the non-participating manufacturer makes escrow payments on such cigarettes under [cross-reference State's escrow statute] and Section [5], or, in the case of a participating manufacturer, such cigarettes are included in its volume for purposes of the Master Settlement Agreement (as defined in [cross-reference to complementary law]); (iv) the cigarettes are provided at no cost to the

consumer testing participants; and (v) and the quantity of cigarettes so used by a manufacturer or importer for consumer testing shall not exceed a reasonable quantity.

(l) A person shall not be subject to penalty under this Act for possession of up to 600 cigarettes bearing the stamp of another State for consumption by that person or that person's family if the cigarettes are physically brought into the State by such person or a member of that person's family. *[Note: States may reduce the number below 600.]*

(m) No person may sell cigarettes or cigarette inputs to, or purchase cigarettes from, any person in another State if the sale or purchase would violate the law of the other State.

**Sec. [2]. Stamping Agent Licenses**

(a) Any manufacturer, importer, sales entity affiliate, wholesaler or retailer that engages in the business of selling cigarettes may apply to be licensed as a stamping agent, in accordance with this Section [2]. A license shall be issued by [name of State agency] to an applicant upon the applicant's (i) meeting all requirements in [cross-reference existing requirements for its particular license]; (ii) certifying on a form prescribed by [name of State agency] that it will comply with the requirements in Section [3]; (iii) consenting to the jurisdiction of the State to enforce the requirements of this Act, and waiving any claim of sovereign immunity to the contrary; (iv) waiving any confidentiality laws as necessary to permit the [name of State agency] to create and make available the list described in subsection (b) and to share information reported under this Act and [cross-reference other State reporting requirements] with the taxing or law enforcement authorities of other States or with [insert reference to Data Clearinghouse]; and (v) in the case of an applicant located outside of the State, designating an agent in the State for service of process in connection with enforcement of this Act.

(b) The [name of State agency] shall list on its website the names of all persons licensed as stamping agents under this Section [2]. Manufacturers, importers and sales entity affiliates shall be entitled to rely upon the list in selling cigarettes as provided in Section [1].

(c) A manufacturer, importer, sales entity affiliate, wholesaler or retailer that engages in the business of selling cigarettes that holds a valid stamping agent license under subsection (a) may apply for a directory license allowing it to purchase or possess in the State cigarettes of a manufacturer or brand family not at the time of purchase listed on the state directory for sale into another State where permitted under Section 1. A directory license shall be issued by [name of State agency] to an applicant upon the applicant's (i) demonstrating that it holds a valid license under subsection (a), (ii) providing a certification by an officer thereof on a form prescribed by [name of State agency] that any cigarettes of a manufacturer or brand family not listed on the state directory will be purchased or possessed solely for sale or transfer into another State as permitted by Section 1; and (iii) waiving any confidentiality laws as necessary to permit

the [name of State agency] to create and make available the list described in subsection (e). The directory license shall remain in effect for a period of one year.

(d) No directory license may be issued to a person that acted inconsistently with a certification it previously made under subsection (c).

(e) The [name of State agency] shall list on its website the names of all persons holding a directory license. Manufacturers, importers, sales entity affiliates and stamping agents shall be entitled to rely upon the list in selling cigarettes as provided in Section [1].

**Sec. [3]. Licensed stamping agents; requirements.**

Each stamping agent shall:

- (a) Comply with Section [1] with regard to affixing stamps;
- (b) Comply with Section [4] and [cross-reference applicable tax law provisions] with regard to which stamp to affix;
- (c) Pay to the State all taxes applicable under [cross-reference applicable tax law provisions] to cigarettes it sells or present documentation demonstrating that such taxes were paid prior to the sale;
- (d) Provide complete and accurate reports as required under Sections [6], [6A] and [8]; and
- (e) Certify quarterly that it has complied with all requirements of this Act.

**Sec. [4]. Required stamps.**

[This section will need to be customized for each State depending upon its tax policy. States will be permitted to include (i) a regular excise tax stamp, (ii) a tax-exempt stamp, (iii) a tribal tax stamp or (iv) another type of stamp representing a specified level of tax different from the regular excise tax; provided that, in the case of stamps within (ii), (iii) or (iv), the State sets forth specific requirements regarding the circumstances when the stamps are permitted and those requirements are the same as to all manufacturers' cigarettes.]

**Sec. [5]. Relationship with escrow and complementary laws.**

(a) The definition of “units sold” under Section [ ] of [cross-reference State’s escrow statute] shall include all non-participating manufacturer cigarettes that are required to be sold in a package bearing a stamp permitted under Section [4] or are described in Section [1(k)].

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(b) All escrow deposits under [cross-reference State’s escrow statute] shall be made on a quarterly basis, no later than 30 days after the end of each calendar quarter in which the sales are made. Each failure to make a full quarterly installment deposit shall constitute a separate violation of [cross-reference State’s escrow statute].

(c) The [name of State agency] shall promptly review the amount deposited by each non-participating manufacturer for each calendar quarter against the reports received under Sections [6-8] and other information, and shall invoice each non-participating manufacturer for which it concludes that an additional deposit was owed.

(d) The [name of State agency] shall promptly remove from the state directory any non-participating manufacturer and its brand families where that non-participating manufacturer fails to make or have made on its behalf deposits equal to the full amount owed for a quarter as of the date due under subsection (b). [Cross-reference existing state complementary legislation regarding process protections.]

(e) An importer shall be jointly and severally liable for escrow deposits due from a non-participating manufacturer with respect to non-participating manufacturer cigarettes that it imports.

(f) As a condition to being listed and having its brand families listed on the state directory, a manufacturer must certify annually that it holds a valid permit under 26 U.S.C. § 5713 and provide a copy of such permit to [name of State agency];

(g) The [name of State agency] shall promulgate rules and regulations necessary to implement subsections (a)-(f).

**Sec. [6]. Stamping Agent Reports.**

Each stamping agent shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate. The report shall contain, in addition to any further information that the [name of State agency] may reasonably require to assist in enforcing this Act and [cross-reference State’s escrow statute, contraband law and tax law], the following information:

(a) the total number of cigarettes acquired by the stamping agent during that month for sale in or into the State or for sale from this State into another State, sold in or into the State by the stamping agent during that month, and held in inventory in the State or for sale into the State by the stamping agent as of [the last Friday of that month/the end of the month], in each case identifying by name and number of cigarettes (i) the manufacturers of those cigarettes and (ii) the brand families of those cigarettes; and  
*[Note: State may choose the inventory date.]*

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(b) the total number of stamps under Section [4] it affixed during that month, and identifying (i) how many of each type of stamp it affixed by number and total dollar amount of tax paid, (ii) the total number of cigarettes contained in the packages to which it affixed each respective type of tax stamp and (iii) by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective type of tax stamp.

(c) In the case of a stamping agent that is a manufacturer or importer, reports under subsection (a) shall not include cigarettes it sold to a stamping agent as permitted under Section [1(d)(i)] and that it separately reports pursuant to Section [7]. In the case of a stamping agent that is a retailer, reports under subsection (a) do not have to include cigarettes contained in packages that bore a stamp permitted under Section [4] at the time the stamping agent received them and that the stamping agent then sold at retail.

(d) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

**Sec. [6A]. Reports of Cigarettes not on State Directory.**

Any person that during a month acquired, purchased, sold, possessed, transferred, transported or caused to be transported in or into this State cigarettes of a manufacturer or brand family that were not on the State directory at the time shall, within 15 days following the end of that month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate. The report shall contain, in addition to any further information that the [name of State agency] may reasonably require to assist it in enforcing this Act and [cross-reference State's escrow statute, contraband law and tax law], the following information:

(a) the total number of those cigarettes, in each case identifying by name and number of cigarettes (i) the manufacturers of those cigarettes, (ii) the brand families of those cigarettes, (iii) in the case of a sale or transfer, the name and address of the recipient of those cigarettes, (iv) in the case of an acquisition or purchase, the name and address of the seller or sender of those cigarettes, and (v) the other State(s) on whose directory the manufacturer and brand family of those cigarettes were listed at the time and whose stamps the person is authorized to affix, or where permitted under Section [1(e)] whose taxes the person is authorized to pay; and

(b) in the case of acquisition, purchase or possession, the details of the person's subsequent sale or transfer of those cigarettes, identifying by name and number of cigarettes (i) the brand families of those cigarettes, (ii) the date of the sale or transfer, (iii) the name and address of the recipient, (iii) the number of stamps of each other State that the person affixed to the packages containing those cigarettes during that month, (iv) the total number of cigarettes contained in the packages to which it affixed each



respective other State's stamp, (v) by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective other State's stamp and (vi) a certification that it reported each sale or transfer to the taxing authority of the other State by 15 days following the end of the month in which the sale or transfer was made and attaching a copy of all such reports. If the subsequent sale or transfer were from this State into another State in packages not bearing a stamp of the other State, the report shall also contain the information described in Section [8(b)(iii).]

(c) Reports under this Section shall be in addition to reports under Sections 6, 7 or 8.

(d) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

**Sec. [7]. Manufacturer and Importer Reports.**

(a) Each manufacturer and importer that sells cigarettes in or into the State shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate.

(b) The report shall contain the following information: the total number of cigarettes sold by that manufacturer or importer in or into the State during that month, and identifying by name and number of cigarettes (i) the manufacturers of those cigarettes, (ii) the brand families of those cigarettes and (iii) the purchasers of those cigarettes. A manufacturer's or importer's report shall include cigarettes sold in or into the State through its sales entity affiliate.

(c) The requirements of subsection (a) shall be satisfied and no further report shall be required under this Section with respect to cigarettes if the manufacturer or importer timely submits to [name of State agency already receiving reports under 15 U.S.C. § 376] the report or reports required to be submitted by it with respect to those cigarettes under 15 U.S.C. § 376 to [State agency] and certifies to the State that the reports are complete and accurate.

(d) Upon request by [name of State agency] a manufacturer or importer will subject to this Section will provide copies of similar reports that it filed in other States.

(e) Each manufacturer and importer that sells cigarettes in or into the State shall either: (i) submit its federal returns, as defined below, to [name of State agency] by 60 days after the close of the quarter in which the returns were filed or (ii) submit to the United States Treasury a request or consent under Internal Revenue Code Section 6103(c) authorizing the Alcohol and Tobacco Tax and Trade Bureau and, in the case of a foreign

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manufacturer or importer, the U.S. Customs Service to disclose the manufacturer's or importer's federal returns, as defined below, to [name of State agency] as of 60 days after the close of the quarter in which the returns were filed.

(f) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

**Sec. [8]. Out of State Sales Reports.**

(a) Any person that sells cigarettes from this State into another State shall, within 15 days following the end of each month, file a report on a form to be prescribed by the [name of State agency] and certify to the State that the report is complete and accurate.

(b) The report shall contain the following information:

(i) the total number of cigarettes sold from this State into another State by the person during that month, identifying by name and number of cigarettes (A) the manufacturers of those cigarettes, (B) the brand families of those cigarettes and (C) the name and address of the each recipient of those cigarettes;

(ii) the number of stamps of each other State the person affixed to the packages containing those cigarettes during that month, the total number of cigarettes contained in the packages to which it affixed each respective other State's stamp and by name and number of cigarettes, the manufacturers and brand families of the packages to which it affixed each respective other State's stamp; and

(iii) if the person sold cigarettes during that month from this State into another State in packages not bearing a stamp of the other State, (A) the total number of cigarettes contained in such packages, identifying by name and number of cigarettes, the manufacturers of those cigarettes, the brand families of those cigarettes and the name and address of each recipient of those cigarettes; and (B) the person's basis for belief that such State permits the sale of the cigarettes to consumers in a package not bearing a stamp, and the amount of excise, use or similar tax imposed on the cigarettes by paid by the person to such State on the cigarettes, provided that manufacturers and importers need include the information described in this clause (B) only as to cigarettes not sold to a person authorized by the law of the other State to affix the stamp required by the other State or, where permitted under Section [1(e)], to a person authorized by the law of the other State to pay the excise, use or similar tax imposed on the cigarettes by

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the other State.

(c) In the case of a manufacturer or importer, the report shall include cigarettes sold from this State into another State through its sales entity affiliate. A sales entity affiliate shall file a separate report under this Section only to the extent that it sold cigarettes from this State into another State not separately reported under this Section by its affiliated manufacturer or importer.

(d) The report shall also attach reports filed under Sections 1(e) and 1(i) with [name of State agency] or the taxing authority of another State.

(e) The [name of State agency] may share the information reported under this section with the taxing or law enforcement authorities of this State or other States or with [insert reference to Data Clearinghouse] as provided in [insert reference to settlement agreement and related documents regarding Data Clearinghouse].

**Sec. [9]. Revocation of License and Removal from State Directory; penalties.**

*[Note: the penalties for violation of an Optional or Tribal provision are to be included only where the State has enacted the corresponding Optional or Tribal provision.]*

- (a) The license of a stamping agent shall be subject to termination if it
- (i) fails to provide a report required under Section [6], [6A] or [8] or a certification as provided in Section 3(e);
  - (ii) files an incomplete or inaccurate report or files an inaccurate certification;
  - (iii) fails to pay taxes as provided in Section 3(c) or deposit escrow as provided in Section 16;
  - (iv) sells cigarettes in or into the State in a package that bears a stamp permitted under Section [4] that is not the correct stamp under [cross-reference applicable tax law provisions] and provides for a lower level of tax than the correct stamp;
  - (v) sells unstamped cigarettes in, into or from the State or possesses unstamped cigarettes in the State except as provided in Section [1];
  - (vi) purchases, sells in or into the State, or affixes a tax stamp to a package containing, cigarettes of a manufacturer or brand family that is not at the time listed on the State directory, or possesses such cigarettes more than [10-20]

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days after receiving notice that the manufacturer or brand family is not on the State directory, except as expressly permitted under this Act; or

(vii) purchases or sells cigarettes in violation of Sections [1, 9(d) or 20].

(b) In the case of a failure under subsection (a)(i)-(iv) that was not knowing or intentional, the stamping agent shall be entitled to cure the failure during the period set forth in Section [10(a)]. The license of a stamping agent that fully cures the failure during that period shall not be terminated on account of that failure. *[Note: A State may use a different cure period or mechanism if not more favorable to the stamping agent.]*

(c) In the case of a knowing or intentional failure under subsection (a)(i)-(iv), or of any violation described in subsection (a)(v)-(vi), the stamping agent shall for a first violation be subject to a civil penalty of up to \$1,000 and be guilty of a [Class IV] misdemeanor and for a second or subsequent violation be subject to a civil penalty of up to \$5,000 per violation and be guilty of a [Class II] misdemeanor. In the case of violations described in subsection (a)(iv)-(vi), each sale constitutes a separate offense. *[Note: criminal penalties are optional.]*

(d) The [name of State agency] shall promptly remove any stamping agent whose license is terminated from the list required by Section [4(b)] and shall publish a notice of the termination on [State agency's] website and send notice of the termination to all stamping agents and to all persons listed on the state directory. Beginning 10 days following the publication and sending of such notice, no person may sell cigarettes to, or purchase cigarettes from, the stamping agent whose license has been terminated.

(e) If a stamping agent whose license has been terminated is a manufacturer of cigarettes, it and its brand families shall be removed from the State directory.

(f) A stamping agent whose license is terminated shall eligible for reinstatement:

(i) 90 days following the termination, in the case of a first failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(ii) 180 days following the termination, in the case of a second failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(iii) one year following the termination, in the case of a third or subsequent failure under subsection (a)(i)-(iv) that was not knowing or intentional;

(iv) one year following the termination, in the case of a first knowing or intentional failure under subsection (a)(i)-(iv) or violation described in subsection (a)(v)-(vii); and

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(v) three years following the termination, in the case of a second of subsequent knowing or intentional failure under subsection (a)(i)-(iv) or violation described in subsection (a)(v)-(vii).

*[Note: A State may use different reinstatement periods if not more favorable to the stamping agent.]*

(g) A manufacturer that fails to file a complete and accurate report required under Section 7 or 8 shall be entitled to cure the failure during the period set forth in Section [10(g)]. If the manufacturer fails to fully cure the failure during that period, it and its brand families shall be removed from the State directory.

(h) A manufacturer that knowingly or intentionally sells cigarettes in violation of Section [1, 9(d) or 20] and its brand families shall be removed from the State directory.

(i) A non-participating manufacturer whose total nationwide reported sales on which federal excise tax [or, in the case of sales in Puerto Rico, arbitrios de cigarillos] is paid exceed the sum of its nationwide reports under [cross-reference PACT Act] and any intrastate sales reports by more than 5 percent of its total sales or [1] million cigarettes, whichever is less, shall be subject to removal from the State directory unless it cures or satisfactorily explains the discrepancy within the time period set forth in Section [10(g)].

(j) Any person that is not a stamping agent or manufacturer that fails to file a complete and accurate report required under Section 7 or 8 shall be entitled to cure the failure during the period set forth in Section [10(j)]. If the person fails to fully cure the failure during that period, it shall be subject to a civil penalty of up to \$1,000 per violation and shall be ineligible to hold any license of the State regarding cigarette sales until the date specified by subsection (f) for violations of subsection (a)(i).

(k) A directory license shall be subject to termination if the licensee acts inconsistently with its certification under Section [2(c)] or violates any provision of this Act

(l) Any person that knowingly or intentionally sells cigarettes in violation of Section [1, 9(d) or 20], or that knowingly or intentionally sells cigarettes in or into the State in a package that bears a stamp permitted under Section [4] that is not the correct stamp under [cross-reference applicable tax law provisions] and provides for a lower level of tax than the correct stamp, shall for a first violation be subject to a civil penalty of up to \$1,000 and be guilty of a [Class IV] misdemeanor and for a second or subsequent violation be subject to a civil penalty of up to \$5,000 per violation and be guilty of a [Class II] misdemeanor. Each sale constitutes a separate violation. *[Note: criminal penalties are optional.]*

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**Sec. [10]. Procedure.**

*[Note: States may use provisions of their existing administrative procedure act or similar process laws or regulations so long as they are comparable to, and not substantially more favorable to the stamping agent, manufacturer or other person than, the corresponding provision below. States may use provisions of their Complementary Legislation instead of subsections (f)-(i) if those provisions are fully applicable to the grounds for removal in this model legislation. The procedures for violations of, or termination or removal under, Optional or Tribal provision are to be included only where the State has enacted the corresponding Optional or Tribal provision.]*

(a) The [name of State agency] shall provide a notice of termination to any stamping agent whose license it determines is subject to termination under Sections [9] or [18]. The notice shall state the grounds for the termination and inform the stamping agent that, except as provided in subsection (b), its license will be terminated 30 days following the date of the notice.

(b) During the [30] days following the date of the notice, the stamping agent may (i) in the case of a failure under Section [9(a)(i)-(iv)] that was not knowing or intentional, fully cure the failure or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the stamping agent has satisfied either (i) or (ii), the license of such stamping agent shall be terminated 30 days following the date of the notice.

(c) A stamping agent whose license is terminated shall have an opportunity for a hearing before [name of State agency] within 30 days following the license termination. The [name of State agency] shall reverse the termination if it determines that the stamping agent has demonstrated that its license was not subject to termination.

(d) A stamping agent that unsuccessfully challenges a license termination either in a hearing under subsection (c) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(e) If for any reason during the period from 30 days after the date of the notice until a final judgment, the termination is stayed or suspended, then the [name of State agency] shall promptly reinstate that stamping agent to the list required by Section [2(b)] during the time of the stay or suspension, but shall note the fact of the stay on that list and shall send notice of the stay to all persons described in Section [9(d)]. Any person that sells cigarettes to, or purchases cigarettes from, that stamping agent after the earlier of receiving notice of the stay of termination or 10 days after the fact of the stay was noted on the list under Section [2(b)], shall be jointly and severally liable for any taxes applicable to such cigarettes under [cross-reference applicable tax law provisions] and for any escrow due on such cigarettes under [cross-reference State's escrow statute]

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during the period of the stay if the stay is subsequently lifted and the termination reinstated. The periods of time for reinstatement under Section [9(f)] shall be tolled during the period in which a stay of termination is in effect.

(f) The [name of State agency] shall provide a notice of removal to any manufacturer that it determines should be removed or have any of its brand families removed from the State directory under Sections [9] or [18]. The notice shall state the grounds for the removal and inform the manufacturer that, except as provided in subsection (g), it or its brand families will be removed from the State directory 30 days following the date of the notice.

(g) During the 30 days following the date of the notice, the manufacturer may (i) fully cure the failure or violation or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the manufacturer has satisfied either (i) or (ii), it or its brand families will be removed from the State directory 30 days following the date of the notice.

(h) A manufacturer that is removed or has any of its brand families removed from the State directory shall have an opportunity for a hearing before [name of State agency] within 30 days following the removal. The [name of State agency] shall reinstate the manufacturer and its brand families to the State directory if it determines that the manufacturer has demonstrated that it and its brand families were not subject to removal from the State directory.

(i) A manufacturer that unsuccessfully challenges a removal either in a hearing under subsection (h) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(j) [Parallel provisions to (a)-(d) for importers or other persons subject to penalty under Section 9(j).]

(k) [Parallel provisions to (a)-(d) for directory licensees.]

(l) Each person may provide a name and address to which notices under this Section and Sections [9], [18] and [20(j)] are to be sent. Notice periods under this Section run from the date of notice sent to such name and address or, in the case of a person that does not provide a name and address, the last known company address.

**Sec. [11]. Contraband Product.**

Any cigarettes or cigarette inputs sold, possessed, transported, caused to be transported or purchased in violation of this Act shall be deemed to be contraband and shall be subject to seizure and forfeiture to the State. Any cigarettes or cigarette inputs forfeited to the State under this Section shall be destroyed or used for law enforcement

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purposes and then destroyed. *[Note: If the state has a general statutory provision on contraband cigarettes, include the following: “Any cigarettes that are contraband under this Section shall also be contraband within the meaning of [cross-reference general state cigarette contraband statute].”]*

**Sec. [12]. Roll Your Own Tobacco.**

[This will need to be customized for each State depending on how it taxes RYO. The provisions will need to be sufficient to provide for the application and transposition of all provisions of this Act other than the stamping requirement to RYO, including the requirement that NPMs make escrow payments on all RYO sales in the State. and, in the case of States that tax RYO but do not require stamping of RYO containers, provisions that transpose the provisions of this Act to RYO on which tax is due.]

**Sec. [13]. Regulations.**

The [name of State agency] may promulgate rules and regulations necessary and proper to effect the purposes of or enforce this Act.

**Sec. [14]. Severability.**

The provisions of this Act shall be severable.

**Sec. [15]. Definitions.**

*[Note: Definitions used only in Optional or Tribal provisions are mandatory only where the State has enacted the corresponding Optional or Tribal provision.]*

“Brand family” has the meaning set forth in [cross-reference State complementary legislation definition].

“Cigarette” means a cigarette within the meaning set forth in [cross-reference State escrow statute definition] that is subject to federal excise tax.<sup>1</sup> The term “cigarette” as used in this Act and [cross-reference State escrow statute definition] shall follow the interpretation of the term “cigarette” and “roll your own” used by the Alcohol and Tobacco Tax and Trade Bureau.

“Cigarette inputs” means any machinery or other component parts typically used in the manufacture of cigarettes, including, without limitation, tobacco whether processed or unprocessed, cigarette papers and tubes, cigarette filters or any component parts intended for use in the making of cigarette filters, and any machinery typically used in the making of cigarettes.

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<sup>1</sup> Note: this definition would need to be revised in Puerto Rico and the territories as FET is not due on sales in those jurisdictions.



- References to “days” refer to calendar days unless specified otherwise.
- “Federal returns” mean all federal excise tax returns and all monthly operational reports on Alcohol and Tobacco Tax and Trade Bureau Form 5210.5, and all adjustments, changes and amendments to the foregoing.
- “Importer” means any person in the United States to whom non-tax-paid cigarettes manufactured in a foreign country are shipped or consigned; any person who removes cigarettes for sale or consumption in the United States from a customs bonded manufacturing warehouse; and any person who smuggles or otherwise unlawfully brings cigarettes into the United States.
- “Indian tribe” means any Indian tribe, band, nation, Alaska Native village or other organized group or community that is recognized as eligible for the special programs and services provided by the United States to Indians because of their status as Indians under the laws of the United States.
- A “knowing or intentional” violation or failure is one where the person knowingly or intentionally engaged in conduct without a good faith belief that the conduct was consistent with the provision of this Act at issue. *[Note: State may use an existing definition of these terms if the definition is similar.]*
- “Manufacturer” means a person that manufactures, fabricates, or assembles cigarettes.
- “Non-participating manufacturer” means a manufacturer that is not a participating manufacturer.
- “Non-participating manufacturer cigarettes” means cigarettes (i) of a brand family that is not included in the certification of a participating manufacturer under [cross-reference State complementary legislation] or (ii) that are subject to the escrow requirement under [cross-reference State escrow statute] because the participating manufacturer in whose certification the brand family is included is not generally performing its financial obligations under the Master Settlement Agreement.
- “Package” means any pack or other container on which a stamp could be applied consistent with and as required by this Act that contains one or more individual cigarettes for sale. Nothing in this Act shall alter any other applicable requirement with respect to the minimum number of cigarettes that may be contained in a pack or other container of cigarettes. References to “package” do not include a container of multiple packages.
- “Participating manufacturer” has the meaning set forth in [cross-reference State complementary legislation].

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( ) “Person” means any natural person, trustee, company, partnership, corporation or other legal entity, including any Indian tribe or instrumentality thereof or any member of an Indian tribe.

( ) “Purchase” means any acquisition in any manner or by means for any consideration. The term includes transporting or receiving product in connection with a purchase.

( ) “Qualified Tribal Lands” means any lands both (i) title to which is either in trust by the United States for the benefit of any Indian tribe or individual or held by any Indian tribe or individual subject to restriction by the United States against alienation and (ii) over which an Indian tribe exercises governmental power.

( ) “Retailer” means a person that sells cigarettes for consumption or use by the purchaser.

( ) “Sale” or “sell” means any transfer, exchange or barter in any manner or by any means for any consideration. The term includes distributing or shipping product in connection with a sale.

( ) References to a sale “in” or “into” a State refer to the State of the destination point of the product in the sale, without regard to where title was transferred. References to a sale “from” a State refer to the sale of cigarettes that are located in that State to the destination in question, without regard to where title was transferred.

( ) “Sales Entity Affiliate” means an entity that (1) sells cigarettes that it acquires directly from a manufacturer or importer and (2) is affiliated with that manufacturer or importer. Entities are affiliated with each other if one directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the other. Unless provided otherwise, references to “manufacturer” or “importer” include any sales entity affiliate of that manufacturer or importer.

( ) “Shortfall Amount” means the difference between (1) the full amount of the deposit required to be made by a non-participating manufacturer for a calendar quarter under Section [5(b)] and (2) the sum of (i) any amounts pre-collected by a stamping agent and deposited into escrow for that calendar quarter on behalf of the non-participating manufacturer under Section [16(c)], (ii) the amount deposited into escrow by the non-participating manufacturer for that calendar quarter under Section [5(b)], (iii) any amounts deposited into escrow for that calendar quarter under Section [5(e)] by an importer on such non-participating manufacturer’s cigarettes, and (iv) any amounts collected by the State for that calendar quarter under the bond posted by the non-participating manufacturer under Section [17]. The Shortfall Amount, if any, for a non-participating manufacturer for a calendar quarter shall be calculated by [State agency] within 15 days following the date on which the State determines the amount it will collect

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on the bond posted by the non-participating manufacturer as provided in Section [17].  
*[Note: This definition concerns two optional provisions. If a State enacts one of these provisions, but not the other, the definition will need to be modified.]*

“Stamping agent” means a manufacturer, importer or wholesaler that holds a valid license under Section [2] of this Act.

References to a “State” or this “State” includes all land that is within the borders of the State, including all Qualified Tribal Lands and any other lands held by or on behalf of an Indian tribe within that State’s borders. References to sales in, into or from a State include any sales in, into or from Qualified Tribal Lands or any other lands held by or on behalf of an Indian tribe within that State’s borders. References to possession in a State include possession on Qualified Tribal Lands or any other lands held by or on behalf of an Indian tribe within that State’s borders. Reference to another “State” or other “States” include the District of Columbia, Puerto Rico and the territories of the United States.

“State directory” or “directory” means the directory compiled by the [name of State agency] under [cross-reference State complementary legislation] or, in the case of references to another State’s directory, the directory compiled under the similar law in that other State.

“Unstamped cigarettes” means any cigarettes that are not contained in a package bearing a stamp permitted under Section [4].

“Wholesaler” means a person that purchases cigarettes for sale or resale but does not include any person when and to the extent such person is acting as a manufacturer, importer, or retailer.

**OPTIONAL**

**Sec. [16]. Additional responsibility for escrow deposits.**

(a) A stamping agent shall be responsible for escrow deposits required under [cross-reference State’s escrow statute] and Section [5] in the event it receives notice from [State agency] that there is a Shortfall Amount with respect to non-participating manufacturer cigarettes stamped by it.

(b) The liability of a stamping agent for escrow deposits shall be calculated as follows: If there is a Shortfall Amount for a non-participating manufacturer for a calendar quarter, each stamping agent that sold cigarettes of that non-participating manufacturer during the calendar quarter shall deposit into such escrow account as shall be designated by the State an amount equal to the applicable Shortfall Amount multiplied by a fraction, the numerator of which is the number of cigarettes of that non-participating

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manufacturer sold in or into the State by the stamping agent during that calendar quarter and the denominator of which is the total number of cigarettes of that non-participating manufacturer sold by all stamping agents in or into the State during that calendar quarter. Provided, that any non-participating manufacturer cigarettes sold in or into the State by a stamping agent during the calendar quarter on which the stamping agent collected and deposited the required escrow deposit amount on or before the due date for deposits for that quarter under Section [5(b)] shall be excluded from both the numerator and the denominator of the fraction in the immediately preceding sentence. To the extent a stamping agent makes payments with respect to a Shortfall Amount under this subsection, such stamping agent shall have a claim against the non-participating manufacturer for such amount.

(c) A stamping agent is authorized to require a non-participating manufacturer to pre-pay the escrow deposit amount to the stamping agent, for deposit by the stamping agent on behalf of the non-participating manufacturer into an escrow account designated by the State, as a condition of the stamping agent's agreement to purchase cigarettes of that non-participating manufacturer.

**Sec. [17]. Bond.**

*[Note: A State may also enact a bond requirement that is broader than the following if it wants broader application of Section II.B.2(y) of the MOU.]*

(a) A non-participating manufacturer shall post a bond for the benefit of the State if (i) its cigarettes were not sold in the State during any one of the four preceding calendar quarters, (ii) it or any person affiliated with it failed to make a full and timely escrow deposit due under [cross-reference State's escrow statute] or Section [5] during any of the five preceding calendar years, unless the failure was not knowing or reckless and was promptly cured upon notice, or (iii) it or any person affiliated with it, or any of its brands or brands of a person affiliated with it, were removed from the state directory of any State during any of the five preceding calendar years, unless the removal were determined to have been erroneous or illegal. Entities are affiliated with each other if one directly, or indirectly through one or more intermediaries, controls or is controlled by or is under common control with the other.

(b) The bond shall be posted at least 10 days in advance of each calendar quarter as a condition to the non-participating manufacturer and its brand families being included in the state directory for that quarter. The amount of the bond shall be the greater of (i) the greatest required escrow amount due from the non-participating manufacturer or its predecessor for any of the 12 preceding calendar quarters or (ii) \$25,000.

(c) If a non-participating manufacturer that posted a bond has failed to make or have made on its behalf deposits equal to the full amount owed for a quarter within 15 days following the due date for the quarter under Section [5(b)], the State may execute

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upon the bond in the amount equal to any remaining amount of the escrow due. Amounts the State collects on a bond shall be deposited into the State treasury and shall reduce the amount of escrow due from that non-participating manufacturer in the dollar amount collected. Escrow obligations above the amount collected on the bond remain due from that non-participating manufacturer and, as provided in Sections [5(e)] and [16], from the importers and stamping agents that sold its cigarettes during that calendar quarter.

(d) The [name of State agency] shall promulgate rules and regulations necessary to implement subsections (a)-(c).

**Sec. [18]. Reciprocity.**

(a) The license of a stamping agent may be subject to termination if its similar license is terminated in any other state based on acts or omissions that would, if done in this State, be grounds for license termination under this Section, unless the stamping agent demonstrates that its termination in the other State was effected without due process. A stamping agent whose license is terminated under this subsection shall be eligible for reinstatement upon the earlier of the date specified by Section 9(f) for the act or omission in question or reinstatement of its license by the other State.

(b) A manufacturer and its brand families may be removed from the State directory if it is removed from the directory of another State based on acts or omissions that would, if done in this State, be grounds for removal from the State directory under this Section or [cross-reference State complementary legislation], unless the manufacturer demonstrates that its removal from the other State's directory was effected without due process. A manufacturer that is removed from the State directory under this subsection shall be eligible for reinstatement upon the earlier of the date on which it cures the violation or is reinstated to the directory in the other State.

(c) The applicable procedures under Section 10 shall apply to terminations and removals under this Section.

**TRIBAL**

**Sec. [19]. Refunds of State Excise Taxes and Escrow Deposits.**

(a) A person that paid taxes applicable under [cross-reference applicable tax law provisions] on cigarettes sold in an exempt transaction shall be eligible for a refund of the taxes paid on those cigarettes. A person that deposited escrow due under [cross-reference State's escrow statute] on cigarettes sold in an exempt transaction shall be eligible for a release of the escrow deposited on those cigarettes.

(b) Only the following cigarette sales are exempt transactions:

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(i) Cigarette sales on a federal installation in a transaction that is exempt from state taxation under federal law.

(ii) Cigarette sales on an Indian tribe's Qualified Tribal Lands by a retail outlet or other entity owned and operated by that tribe or a tribal member for official tribal use or to a consumer who is an adult enrolled member of that tribe domiciled on that tribe's Qualified Tribal Lands.

(c) Except as provided in subsection (f), the person seeking a refund of taxes or release of escrow must submit an application to [name of State agency] providing documentation sufficient to demonstrate (i) that the cigarettes were sold in a package bearing the correct stamp permitted under Section [4] and, as to refund of taxes, that the stamp was one that required payment of tax, (ii) that the person paid the applicable taxes or deposited the escrow in question, (iii) that the cigarettes were sold in an exempt transaction, (iv) as to release of escrow, that the cigarettes were non-participating manufacturer cigarettes, and (v) that the person has not obtained the refund or release on the cigarettes previously. The documentation shall include, in addition to information necessary to meet the requirements listed above and any other information that the [name of State agency] may reasonably require, documents showing the identity of the seller and purchaser and the places of shipment and delivery of the cigarettes. The [name of State agency] shall verify the accuracy and completeness of the required documentation and information before granting the requested refund.

(d) If a meritorious refund claim under subsection (c) is not paid within 60 days of submission of the required documentation, the refund shall include interest at the prime rate from the date of submission of the required documentation.

(e) The total number of cigarettes found to be sold in exempt transactions under subsection (b)(ii) in any year on an Indian tribe's Qualified Tribal Lands shall not exceed 14,600 cigarettes times the number of enrolled adult members of that tribe domiciled on its Qualified Tribal Lands during the preceding calendar year. The [name of State agency] shall not permit (i) refunds of taxes paid on cigarettes claimed to be sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands in excess of that total number; or (ii) release of escrow deposited on a non-participating manufacturer's cigarettes claimed to be sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands in excess of that total number times the market share percentage of that non-participating manufacturer on that tribe's Qualified Tribal Lands during that year.

(f) As to refunds of taxes, the [name of State agency] and an Indian tribe may agree upon a refund formula to operate in lieu of application for refunds under subsection (c). The aggregate refund provided to an Indian tribe under a formula for a year shall not exceed the lesser of (i) the aggregate tax paid by entities owned and operated by that tribe or member of that tribe on cigarettes sold in exempt transactions under subsection (b)(ii) on that tribe's Qualified Tribal Lands during that year or (ii) the aggregate tax due under

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[cross-reference tax law provision applicable to tribal sales on Qualified Tribal Lands] on the number of cigarettes that would be used during that year by enrolled adult members of that tribe domiciled on that tribe's Qualified Tribal Lands during the preceding calendar year based on the national average smoking incidence for all adults and the national average annual cigarettes used by an adult smoker, in each case as published most recently by the Centers for Disease Control. Refunds of taxes under subsection (c) shall not be available for cigarettes sold in exempt transactions on the Qualified Tribal Lands of an Indian tribe that agrees upon a refund formula under this subsection.

(g) As to release of escrow, the [name of State agency] and an Indian tribe may agree upon a refund formula to operate in lieu of application for releases under subsection (c) if the formula meets the requirements of this subsection. The formula shall assign to the tribe credits for release of escrow that the tribe may allocate among non-participating manufacturers that sold cigarettes on that tribe's Qualified Tribal Lands during that year. The aggregate credits provided to an Indian tribe under a formula for a year shall not exceed the aggregate escrow deposit due under [cross-reference State's escrow statute] on the number of non-participating manufacturer cigarettes represented by the product of (i) the number of cigarettes that would be used during that year by enrolled adult members of that tribe domiciled on that tribe's Qualified Tribal Lands during the prior calendar year based on the national average smoking incidence for all adults and the national average annual cigarettes used by an adult smoker, in each case as published most recently by the Centers for Disease Control, times (ii) the aggregate national market share percentage of non-participating manufacturers for the preceding calendar year, as determined by the [independent auditor under the master settlement agreement/Data Clearinghouse]. A non-participating manufacturer allocated a credit by an Indian tribe under a formula shall be entitled to a release of escrow deposited by it or on its behalf for cigarette sales in or into the State during that year in the amount of the credit, provided that no non-participating manufacturer shall be entitled to a release in excess of the total escrow deposited by it or on its behalf for cigarette sales in or into the State during that year. Releases of escrow under subsection (c) shall not be available for cigarettes sold in exempt transactions on the Qualified Tribal Lands of an Indian tribe that agrees upon a refund formula under this subsection.

(h) In order for an Indian tribe, entities owned and operated by that tribe or a member of that tribe, or persons doing business with that tribe or such entities to be entitled to a refund of taxes or release of escrow under this Section for cigarettes sold on that tribe's Qualified Tribal Lands during a year, the tribe shall provide documentation to the [name of State agency] by April 15 of that year sufficient to demonstrate the number of enrolled adult members of that tribe domiciled on its Qualified Tribal Lands during the preceding calendar year. The [name of State agency] shall verify the accuracy and completeness of the required documentation and information before granting the refunds or releases. For purposes of this subsection and subsections (e)-(g), a tribal member domiciled on Qualified Tribal Lands for part of a year counts as a fraction reflecting the portion of the year domiciled on those Lands. A formula under subsection (f) or (g) shall incorporate and be subject to the provisions of this subsection.

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(i) Amounts the State collects on a bond under [cross-reference bond section] shall not be subject to release under this Section. References in this section to escrow deposited by a non-participating manufacturer or other person shall not include amounts collected by the State on a bond.

(j) The [name of State agency] shall promulgate rules and regulations necessary to implement this Section.

**Sec. [20]. Effect of certain violations.**

(a) The [name of State agency] shall list on its website any person that both (i) claims not to be subject, or holds itself out as not subject, to enforcement of any provision of this Act by reason of lack of jurisdiction of the State or sovereign immunity and (ii) the [name of State agency] has a reasonable basis to believe has not fully complied with any provision of this Act. The [name of State agency] shall promptly publish and regularly update the list of such persons on its website.

(b) The [name of State agency] shall not include on the list any person described in subsection (a) that submits an enforceable certification in accordance with rules or regulations to be promulgated by [name of State agency] that such person will not assert that it is not subject to enforcement of any provision of this Act based on an asserted lack of State jurisdiction or claim of sovereign immunity.

(c) Except as provided in subsection (d), it shall be unlawful for any person to sell cigarettes or cigarette inputs to, or purchase cigarettes from, any person that is on the list described in subsection (a). A supplier of cigarette inputs may obtain advance approval from [name of State agency] to sell inputs to a person on the list if the supplier demonstrates that the input will not be used for the manufacturing of cigarettes.

(d) Notwithstanding subsection (c), a person may sell cigarettes to, or purchase cigarettes from, persons on the list if the manufacturer and brand of such cigarettes is on the State directory and, prior to the sale or purchase, a stamping agent that is not on the list affixed a tax stamp permitted under Section [4] to the package containing such cigarettes.

(e) It shall be unlawful for any person that is on the list described in subsection (a) to sell, transport or cause to be transported cigarettes in or into this State unless (i) the manufacturer and brand of such cigarettes is on the State directory and (ii) prior to the sale or transport, a stamping agent that is not on the list affixed a tax stamp permitted under Section [4] to the package containing such cigarettes.

(f) The [name of State agency] shall provide a notice to any person that it determines should be placed on the list described in subsection (a). The notice shall state the grounds for the listing and inform the person that, except as provided in subsection



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(g), it will be placed on the list 30 days following the date of the notice.

*[Note: As to subsections (f)-(h), States may use provisions of their existing administrative procedure act or similar process laws or regulations so long as they are comparable to, and not substantially more favorable to the listed person than, the corresponding provision in subsections (f)-(h).]*

(g) During the 30 days following the date of the notice, the person may (i) submit the certification described in subsection (b) or (ii) submit documentation to the [name of State agency] demonstrating that its determination described in the notice was incorrect. Unless the [name of State agency] determines that the person has satisfied either (i) or (ii), it shall be placed on the list 30 days following the date of the notice.

(h) A person that is placed on the list shall have an opportunity for a hearing before [name of State agency] within 30 days. The [name of State agency] shall remove the person from the list if it determines that the person has demonstrated that its inclusion on the list was not proper under this Section.

(i) A person that unsuccessfully challenges being placed on the list either in a hearing under subsection (h) or in court shall pay the State's reasonable costs and attorney's fees incurred in contesting the challenge. *[Note: This provision is optional.]*

(j) If for any reason during the period from 30 days after the date of the notice until a final judgment, a person's placement on the list described in subsection (a) is stayed or suspended, then the [name of State agency] shall promptly remove that person from the list during the time of the stay or suspension, but shall note the fact of the stay on that list and shall send notice of the stay to all persons described in Section [9(d)]. Any person that sells cigarettes or cigarette inputs to, or purchases cigarettes from, that person after the earlier of receiving notice of the stay of listing or 10 days after the fact of the stay was noted on the list, shall be jointly and severally liable for any taxes applicable to such cigarettes under [cross-reference applicable tax law provisions] and for any escrow due on such cigarettes under [cross-reference State's escrow statute] during the period of the stay if the stay is subsequently lifted and the placement on the list reinstated.

**Sec. [21]. Compacts.**

Neither the State nor any agency or department thereof shall enter into any future agreement, compact or treaty with any Indian tribe that is inconsistent with the provisions of this Act.