SETTLEMENT AGREEMENT

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

2. On June 8, 2001, California filed a Complaint captioned *People of the State of California v. R. J. Reynolds Tobacco Company*, Los Angeles Superior Court No. KC 036109 ("the Litigation"), alleging that Reynolds had violated Health & Safety Code Section 118950 by distributing cigarettes and coupons for cigarettes on public grounds.

3. The parties made cross-motions for summary judgment. The trial court granted California's motion in part and denied it in part, and entered judgment in the amount of $14,826,200 in civil penalties for California. Reynolds appealed, and the judgment was affirmed on appeal. The California Supreme Court granted review, affirmed the finding of liability but reversed and remanded on the issue of the amount of the civil penalties. The decision is reported at *People v. R. J. Reynolds Tobacco Company*, 37 Cal.4th 707 (2005).

4. The provisions of this Agreement shall be binding upon Reynolds and its directors, predecessors, subsidiaries, employees, officers, attorneys, representatives, agents, successors, and assigns.

5. Reynolds agrees to make payments totaling $5,000,000, to settle all claims in the Litigation, including California's claims for civil penalties, attorneys' fees and costs. Promptly after the issuance of the remittitur to the Superior Court, California will submit this Agreement to the California Superior Court for approval of its terms. California Superior Court approval of this Agreement is a material consideration for Reynolds' entering into this Agreement, and any failure of the Superior Court to approve the Agreement (other than the identity or amount of the payment to Public Health Institute (PHI)) will constitute grounds for termination by Reynolds of this Agreement, at its discretion. Within 10 days of receiving notice of entry of a court order approving this settlement, Reynolds will pay California, by check, the sum of $4,000,000 (constituting $3,100,000 in civil penalties and $900,000 in attorneys' fees and costs), and Reynolds will pay $1,000,000 directly to PHI, a nonprofit organization, which oversees the Public Health Trust. The Public Health Trust manages litigation settlements and will use the amount made available from this settlement to fund tobacco control advocacy and education. Upon confirmation of receipt of such payments, California will promptly file a request for dismissal with prejudice of the Litigation. Upon the signing of this Agreement, California will execute the documents attached as Exhibit A to release the Escrow Account established to secure the judgment in this matter. Reynolds agrees not to file a petition for certiorari in United States Supreme Court to review the December 22, 2005, decision of the California Supreme Court. In the event that the Superior Court does not approve the settlement, the parties agree to negotiate an alternative disposition

of the Litigation, but in no event shall Reynolds be required to pay any civil penalties in addition to those agreed to in this Agreement.

6. In consideration of the obligations set out in this Agreement, California now and forever releases and discharges Reynolds and its past and present directors, predecessors, subsidiaries, partnerships, funds, employees, officers, shareholders, members, partners, attorneys, representatives, agents, subcontractors, trust, trustees, heirs, family, successors, assigns and insurers, of and from any and all claims (including without limitation, claims for attorneys' fees, costs, damages or restitution), debts, liabilities, demands, obligations, costs, fees, expenses, charges, grievances, damages, actions and causes of action whatsoever, known, unknown, discovered, undiscovered, suspected or unsuspected, which California owns, holds or has owned or held, with respect to the Litigation.

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

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

8. This Agreement shall be governed by and construed in accordance with the laws of the State of California, without reference to conflict of law rules.

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

10. This Agreement constitutes the entire agreement between the Parties pertaining to its subject matter and supersedes any and all prior and/or contemporaneous oral or written negotiations, agreements, representations, and undertakings. The Parties, and each of them, understand that this Agreement is made without reliance upon any inducement, statement, promise, or representation other than those contained within this Agreement. In particular, the parties have not entered into this Agreement in reliance on any representations, statements, or promises with respect to the tax consequences of the Agreement. This Agreement may not be altered, amended, modified or otherwise changed in any respect or particular whatsoever, except, by a writing duly executed by the Parties to this Agreement or their authorized representatives.

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

Dated: March 22, 2006

R. J. REYNOLDS TOBACCO COMPANY

By: _____
Name: DANIEL A. FAWLEY
Title: SVP + TREASURER

Dated: March 22, 2006

THE PEOPLE OF THE STATE OF CALIFORNIA

By: _____
Name: Dennis Eckhart
Title: Senior Deputy Attorney General

APPROVED AS TO FORM:

Dennis Eckhart, Esq.
State of California
Department of Justice
1300 I Street, Suite 125
P.O. Box 944255
Sacramento, CA 94244-2550

By: _____

Attorneys for PEOPLE OF THE STATE OF CALIFORNIA, ex rel. BILL LOCKYER, Attorney General

H. Joseph Escher III
Dechert LLP
One Market, Steuart Street Tower
Suite 2500
San Francisco, CA 94105

By: _____

Attorneys for R. J. REYNOLDS TOBACCO COMPANY

EXHIBIT A

AGREEMENT RE TERMINATION OF ESCROW ACCOUNT AGREEMENT

The judgment in favor of the People of the State of California in litigation styled People of the State of California v. R.J. Reynolds Tobacco Corporation, Action No. 036109 (erroneously referred to in the Escrow Account Agreement as No. KC 396109) (the "Free Samples Action"), was affirmed in part and reversed in part and remanded on appeal. 37 Cal. 4th 707 (2005). The matter having been finally resolved by settlement and R.J. Reynolds Tobacco Company and the People of the State of California, as parties to the Escrow Account Agreement, hereby agree that the Escrow Account Agreement is terminated pursuant to Section 4.01 thereof. The Deposit pursuant to the Escrow Account Agreement can now be released to R.J. Reynolds Tobacco Company.

Dated: March 22 2006

Dennis Eckhart, Esq.
State of California
Department of Justice

By: _____
Attorneys for PEOPLE OF THE STATE OF CALIFORNIA, ex rel. BILL LOCKYER, Attorney General

H. Joseph Escher III
Dechert LLP

By: _____
Attorneys for R. J. REYNOLDS TOBACCO COMPANY