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09:05am EST 3-Nov-99 Bernstein (BILL PECORIELLO 212-756-4196) MO RJR  
 MO & RJR- USING THEIR SURPLUS TO BUY BACK STOCK, PERSONAL LIABILITY PREVENTS...

Stock	Price	SCB Rating	YTD Perf.	1998	EPS 1999E	2000E	P/E 1999E	2000E	Yield 1999
MO	\$24	O	(52)%	\$3.17	\$3.31	\$3.65	7.3x	6.6x	8.0%
RJR	\$20	M	(38)%		\$3.71	\$3.93	5.4x	5.1x	15.5%
SPX	\$1347		9.6%	\$44.25	\$49.00	\$52.50	27.5x	25.7x	1.3%

O - Outperform, M - Marketperform, U - Underperform

1. RJR announced a \$125 million share repurchase after the close yesterday. The approximate size and fact of the share repurchase have been expected for some time and its effects have been included in our projections.

2. Funded out of surplus. As one might expect, virtually every corporate activity of the tobacco manufacturers may be the subject of future legal action or speculation. Share repurchase programs are no exception and the relevant case law is *Nakano v. Nakano* (1975). The ruling in the case states that a corporation may only purchase or redeem its stock out of surplus and that directors could be held liable for improper purchases of stock (see Details).

3. Based on our projections, RJR could fund a more aggressive buyback over the next 5 years. Our projections have RJR generating approximately \$200 million in free cash flow after dividends each of the next five years, so the company could buyback that amount of its stock on an annual basis without concerns regarding the liability of its directors. However, as we have pointed out previously, our projections regarding RJR's operating profits (and cash flow) are sensitive to changes in market share (see Details). Currently we have RJR ceding « share point each year, with operating profits growing 2-3% per year. Given this uncertainty surrounding the company's fundamentals, a more conservative stance on share repurchases is appropriate.

4. Implications for MO? Philip Morris is currently repurchasing \$3-3.5 billion of its own stock each year, which is in line with its free cash flow after dividends. Neither company is likely to increase the pace of repurchase beyond its free cash flow, nor are they likely to borrow in order to increase the rate of share repurchase due to worries over fraudulent conveyance (see details)

5. HMO Lesson. The situation currently facing the HMO's is different than that facing the tobacco companies. While both industries are the targets of litigation, the litigation facing the HMO's is for disgorgement of profits and is not potentially bankrupting. Therefore, aggressive share repurchase programs do not represent personal liability to the directors.

#### Investment Conclusion.

The announcement by RJR was a positive (albeit completely expected) move by the company. Many investors ask why MO and RJR don't significantly step up and repurchase shares given their depressed valuations. The reason is that the pending tobacco litigation threatens insolvency and the directors would be personally liable for authorizing a share repurchase program in excess of surplus free cash flow post dividends. We expect MO to finish its current \$8B share repurchase program early and to replace it with a larger one, but still using surplus free cash flow post dividends and not taking on debt to fund the repurchase. We believe tobacco valuations will remain depressed over the next 12-20 months until the Federal and Engle suits are resolved favorably with some valuation relief possible in Q1 when the issue of the Engle bond is resolved.

#### Details

*Nakano v. Nakano* (New York - 1975)

The law is well settled that a corporation may only purchase or redeem its stock out of surplus. Corporate directors may be held jointly and severally liable to the corporation for the benefit of creditors or shareholders for improper purchases. The redemption of stock where there is an undisputed deficit in the corporate surplus account would violate both civil and criminal law. The rule is designed to protect creditors who extend credit in reliance upon the corporation's capital structure. Accordingly, where creditors became such with notice of the purchase, and the

52932 2614

redemption is in good faith; the purchase does not infringe upon or prejudice creditor's rights. Thus, an agreement by a corporation to purchase or redeem its stock is both valid and legal, subject to the stated limitations on its enforceability, requiring the existence of a corporate surplus from which the purchase must be made. If a surplus that existed at the time of the agreement disappears, or shrinks to a deficit, the agreement is rendered unenforceable.

NY CLS Bus Corp \_513

\_513. Purchase, redemption and certain other transactions by a corporation with respect to, its own shares. Notwithstanding any authority contained in the certificate of incorporation, the shares of a corporation may not be purchased by the corporation, or, if redeemable, convertible or exchangeable shares, may not be redeemed, converted or exchanged, in each case for or into cash, other property, indebtedness or other securities of the corporation (other than shares of the corporation and rights to acquire such shares) if the corporation is then insolvent or would thereby be made insolvent. Shares may be purchased or redeemed only out of surplus. When its redeemable, convertible or exchangeable shares are purchased by the corporation within the period during which such shares may be redeemed, converted or exchanged at the option of the corporation, the purchase price thereof shall not exceed the applicable redemption, conversion or exchange price stated in the certificate of incorporation. Upon a redemption, conversion or exchange, the amount payable by the corporation for shares having a cumulative preference on dividends may include the stated redemption, conversion or exchange price plus accrued dividends to the next dividend date following the date of redemption, conversion or exchange of such shares. No domestic corporation which is subject to the provisions of section nine hundred twelve of this chapter shall purchase or agree to purchase more than 10 percent of the stock of the corporation from a shareholder for more than the market value thereof unless such purchase or agreement to purchase is approved by the affirmative vote of the board of directors and a majority of the votes of all outstanding shares entitled to vote thereon at a meeting of shareholders unless the certificate of incorporation requires a greater percentage of the votes of the outstanding shares to approve. The provisions of this paragraph shall not apply when the corporation offers to purchase shares from all holders of stock or for stock which the holder has been the beneficial owner for more than two years. The term "stock", "beneficial owner", and "market value" shall be as defined in section nine hundred twelve of this chapter.

Call For Exhibit  
Bill Pecoriello (212)756-4196  
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09:17am EST 3-Nov-99 Goldman Sachs (COHEN\*\*,HONG) RJR  
R.J. Reynolds Tobacco Inc. : Raising Estimates Slightly on Buyback Announcement

GS  
Goldman, Sachs & Co. Investment Research

R.J. Reynolds Tobacco Inc.

\* \* Raising Estimates Slightly on Buyback Announcement \* \*

\*\*\*\*\*

\* RJR announced a share repurchase program of up to \$125 million \*  
\* yesterday. We are raising our estimate for 2000 by 5c to \$3.45, \*  
\* reflecting a commitment that is larger in size, earlier in timing, and \*  
\* one that can be done at a more attractive stock price than we previously \*  
\* expected. We believe that this is not only a sound financial decision \*  
\* but also an expression of strong confidence by company management about \*  
\* the future outlook of the business. We reiterate our MO rating due to \*  
\* low valuation and a strong dividend yield. \*

\*\*\*\*\*

Marc Cohen (New York) 1 212-902-0004 - Investment Research  
Judy E. Hong (New York) 1 212-902-0490 - Investment Research

===== NOTE 9:08 AM November 03, 1999 =====

		Stk	Latest	52 Week	Mkt Cap	YTD Pr	Cur
		Rtg	Close	Range	(mm \$)	Change	Yield
		MO	20.06	34-19	2199.3	%	15.5%
R.J. Reynolds Tobacco Inc.							
-----Earnings Per Share-----							
RJR		Mar	Jun	Sep	Dec	FY	CY
	2000 FY					3.45	
	1999 FY	0.70A	0.90A	1.01A	0.79	3.40	
	1998 FY(A)	0.79	0.82	0.83	0.72	5.79	
-----							
		-Abs P/E on-		-Rel P/E on-		EV/NxtFY	LT EPS
		Cur	Nxt	Cur	Nxt	EBITDA	Growth
RJR	FY	5.9X	5.8X	0.2X	0.2X	NA	NA%

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\* Share repurchases should not only be additive to EPS, but will also enhance company free cash flow due to the high yield on this stock.

\* Based on our own research, we believe that rating agencies will be comfortable with the size of this commitment and that it is not likely to have any consequences with respect to the company's bond rating.

\* RJR is currently trading at less than 6 times our revised 2000 EPS estimate and offers a more than 15% dividend yield. We believe that this combination should be attractive to value and income-oriented investors.

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ADDITIONAL DETAILS:

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1. SHARE REPURCHASE AN EXCELLENT FINANCIAL DECISION - RJR announced that its board authorized the share repurchase of up to \$125 million effective immediately and without any expiration date. We view this as a prudent financial decision on the part of management for a couple of reasons. First, the share repurchase should be significantly additive to the company's EPS if completed anywhere near the current stock price. If the entire amount were to be done at today's price of around \$20 per share, it would add about 15c to EPS in 2000. We have raised our 2000 EPS estimate by only 5c to \$3.45 because we had already incorporated a \$100 million share repurchase in 2000 into our model. The 5c upside stems from a buyback that is larger, likely to be done earlier and one that can be completed at a lower average stock price than what was embedded in our earlier projections. This repurchase should also enhance the company's free cash flow generation, as total dividend payments could be reduced. The company currently pays out a \$3.10 per share dividend. By repurchasing around 6.2 million shares (at the current price), RJR could save about \$19.5 million, far greater than the estimated financing cost of \$3.8 million after-taxes.

2. THE SIZE SEEMS TO BE RIGHT - We believe that this level of commitment is appropriate for RJR based upon both our cash flow analysis and on our conversations with GS Fixed Income Research. First, we estimate that RJR could generate about \$220 million in free cash flow after paying out dividends in 2000. The size established here is only about half of that free cash flow. This appears reasonable especially given that the company will still maintain net debt of less than \$1 billion. Second, we had already explored how the rating agencies would react to some type of share repurchase program on the part of RJR before today's announcement with our Fixed Income Research analysts. Based on those conversations, we believe that the rating agencies will be comfortable with the indicated level and that it will not trigger any negative rating changes.

3. REITERATE MARKET OUTPERFORMER RATING - We believe that the company's commitment to buy back its own stock portrays strong confidence by management in RJR's future. At a time when many investors appear to be avoiding RJR's shares, management has made a decision that the current stock price level presents an attractive opportunity for it to invest its excess cash flow back into the business on behalf of long-term shareholders. While we expect RJR's EPS growth to be modest because the company still faces competitive challenges for its premium brands, there could be upside to our 2000 EPS estimate if premium brands start to stabilize or even grow market share. Even with only modest EPS growth expectations, we rate RJR a Market Outperformer based on a compelling dividend yield of 15%.

4

Important Disclosures (code definitions attached or available upon request)  
RJR : No Disclosures

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**\* \* Engle Update: FL Supr. Ct. Bid a Well Put Together Longshot \* \***

\*\*\*\*\*

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**Judy E. Hong (New York) 1 212-902-0490 - Investment Research**

NOTE 9:08 AM November 03, 1999 =====

MO		-----Earnings Per Share-----				CY
		Mar	Jun	Sep	Dec	
	2000 FY					3.65
	1999 FY	0.80A	0.85A	0.87A	0.77	3.30
	1998 FY(A)	0.79	0.82	0.83	0.72	3.17
LTR		Mar	Jun	Sep	Dec	
					9.45	
					8.50	
					6.98	

		-Abs P/E on-		-Rel P/E on--		EV/NxtIFY	LT EPS
		Cur	Nxt	Cur	Nxt	EBITDA	Growth
MO	FY	7.3X	6.6X	0.3X	0.3X	NA	13%
LTR	FY	7.8X	7.0X	0.3X	0.3X	NA	13

**This document also contains comments on MO, BTI, RJR, UST.**

52932 2618

\* We continue to believe that recent tobacco stock price declines are too extreme given our strong conviction that no bond will be necessary to appeal an adverse punitive damage award and that this case will eventually be resolved on an individual case by case basis.

\* We rate RJR, BTI and UST (not involved in this litigation) as Market Outperformers. Our preference for MO and LTR reflects significant negative valuation now assigned to their U.S. cigarette operations.

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#### ADDITIONAL DETAILS:

1. FL SUPREME COURT BID A LONGSHOT - We have now had an opportunity to rigorously examine the tobacco industry motions to the FL Supreme Court. The purpose of these motions is to persuade the court to intercede by either prohibiting Judge Kaye from allowing the jury to consider classwide punitive damages in Phase II or by mandating that the DCA direct him to follow its original order which clearly specified that damages be tried on an individual case by case basis. We believe that the tobacco companies have crafted a strong argument that the trial court is misinterpreting the DCA directive with its current trial plan. However, there is a tension in arguments raised in the document, and it is unclear that the companies have painted a persuasive enough situation to compel the FL Supreme Court to act now. It would be unusual for it to do so at such an early juncture in a case absent extraordinary circumstances.

2. TENSION IN THE INDUSTRY POSITION - The key issue we see with the appeal is that tobacco companies are walking a delicate, though skillfully drawn, line. On one hand, they maintain that Judge Kaye can not enter a final judgment on any lump sum punitive damage award that is set by the jury after Phase II. On the other, they argue that the Supreme Court needs to act now, because not doing so would allow Judge Kaye to put the companies in a devastating position, significantly impairing their ability to conduct business. What makes their argument something of a longshot, in our view, is the very strength of their position with respect to the punitive damage issue. As previously written, we feel strongly that Judge Kaye can NOT under FL or federal law declare any punitive damage award a FINAL and COLLECTIBLE judgment in the event of a Phase II mini-trial loss by the defendants. Because this is the case, the companies will have recourse to appeal this entire matter in the event of a loss WITHOUT posting a significant bond. So there may be no reason for the Supreme Court to act now. Perhaps the only reason for it to do so now would be if it considers the possibility of an outstanding, but not final, punitive damage award a burden that will preclude it from reviewing substantive appeals at a later, more appropriate point. We believe there is an outside chance that the justices could see things this way.

3. MOTIONS SET A POSITIVE GROUND IN ANY EVENT - At the very least, however, we believe that these motions set positive ground for industry appeals if plaintiffs eventually win the Engle Phase II trials. For one thing, tobacco companies are giving the court a preview of all of the issues. In the event that Judge Kaye does declare a punitive damage as final and collectible (which our contacts strongly believe would be incorrect interpretation of FL and federal law), the appellate courts will already have background to consider an accelerated industry appeal of that ruling. That appeal itself could be heard without posting a bond. Before that, there is an outside chance that the court will realize that these proceedings are already breaking down under this class action treatment and intercede to end the matter entirely. At the very least, though, there is an opportunity for the court to make clear its thinking about the constitutionality of how punitive damages are intended to be treated in this trial in a written opinion, which could inject a great deal more certainty into the situation.

4. UPDATE ON DAY 2 PROCEEDINGS - The second day of Engle Phase II concluded with each of the defendants' making their opening arguments. As expected, each defense lawyer essentially focused on the central platforms of awareness, ability to quit and questioning individual medical causation issues. On awareness, the industry argued that plaintiffs must have known about the risks of smoking given the great body of information publicly available concerning health risks associated with smoking, and that these plaintiffs were responsible for their own actions. Second, the defense contended that cigarettes were not addictive, since one of the plaintiffs, Ms. Farnan, did in fact stop smoking on her own without professional help. Third, on the issue of causation, the tobacco industry lawyers outlined individual medical issues that could have also contributed to each plaintiff's alleged injury. For example, Ms. Farnan had cancer in her family, and Mr. Amodeo was exposed to sawdust at work. Each company counsel also focused on whether plaintiffs actually smoked cigarette brands manufactured by his client.

52932 2619

We have also learned that Mr. Amodio is seeking \$2 million in compensatory damages. The trial appears to be progressing quickly, and testimony is expected to begin when jurors reconvene at 10am today.

5. REITERATE BUY ON LTR AND MO - Tobacco stocks are currently trading at 6-8 times our 2000 EPS estimates, except for UST who is not a party in this lawsuit. We think that market participants have placed an unduly large litigation discount on these stocks, even if we assume that legal issues are not likely to go away any time soon. Both MO and LTR appear particularly attractive based on our sum-of-parts analysis. We estimate that the current prices of these two stocks embed a -\$20 per share value for PM USA and a -\$30 per share value for Lorillard. Even if we attach a 50% tobacco discount to non-US tobacco assets for these companies, the stock prices imply that the market is valuing PM USA and Lorillard at only 2x EBITDA. We think, at the very least, that these multiples should be around 4x EBITDA given the fundamental strength of both PM USA and Lorillard compared with other tobacco stocks. Moreover, we believe that placing a 50% discount to these non-US tobacco assets is too severe. Attaching a more reasonable, albeit still conservative, 35% discount to non tobacco assets and valuing U.S. tobacco operations at 4x EBITDA for these companies could lead to a potential upside of nearly 50% for both MO and LTR, even if legal landscape remains status quo.

6

Important Disclosures (code definitions attached or available upon request)

MO : CF, CP, M  
LTR : No Disclosures  
BTI : ADR, CF, CP, OS  
RJR : No Disclosures  
UST : No Disclosures

===== Further Information =====

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10:48am EST 3-Nov-99 Credit Suisse First Boston (Herzog, Bonnie (212) 325-679

RJR: Authorizes a Share Buy-Back Program

FBC

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Equity Research Americas

U.S./Tobacco

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HOLD

LARGE CAP

RJ Reynolds (RJR)

RJR Authorizes a Share Buy-Back Program

Summary

RJ Reynolds' Board, in a special meeting, authorized a share buyback program of up to \$125 million earlier than we had expected. Because there is no specific time frame, the company could authorize an additional program once this one is complete.

If completed today, this \$125 million share buy-back program would represent approximately 6% of RJR's current shares outstanding.

Overall, we believe this program is very positive and creates shareholder value. Also we believe the announcement of this program yesterday is especially timely given all of the market concerns regarding the Engle trial.

Although we are not changing our EPS estimates today, this program will have a positive impact on EPS growth. We maintain our Hold recommendation on RJR.

Price 11/2/991	Target (12mo.)	Div.	Yield	Mkt.Value (MM)	52-Week Price Range	
20.06	\$0	\$3.10	15.5%	\$2,166.5	\$34-19	
	Annual EPS	Prev. EPS	Abs. P/E	Rel. P/E	EV/ EBITDA	EBITDA/ Share
12/00E	\$3.40		5.9X	24%	2.3	\$12.96
12/99E	\$3.38		5.9	22%	2.3	\$12.79
12/98A	N/A		N/A	N/A		
	March	June	Sept.	Dec.		FY End
2000E	0.62	0.90	\$1.05	0.83		Dec. 31
1999E	0.70A	0.90A	\$1.01A	0.77		
1998A						
ROIC (12/98)				6%		
Total Debt (12/98)						
Book Value/Share (12/98)						
WACC (12/98)						
Debt/Total Capital (12/98)						
Common Shares				108 mil		
EP Trend2				down		
Est. 5-Yr. EPS Growth				10%		
Est. 5-Yr. Div. Growth				10%		

52932 2621

1 On 11/2/99 DJIA closed at 10,581.84 and S&P 500 at 1347.74.  
2 Economic profit trend.

RJ Reynolds holds the number two position in the U.S. cigarette industry. Top brands include: Winston, Camel, Salem, and Doral.

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Analyst: Herzog, B Telephone: (212) 325-6793 bonnie.herzog@csfb.com

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BON

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12:24pm EST 3-Nov-99 Brown Brothers Harriman (Burry, R.D., CFA) RJR  
RJR: SHARE-REPURCHASE PROGRAM ANNOUNCED

BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH BBH

BROWN BROTHERS HARRIMAN & CO.

-----  
RJ REYNOLDS TOBACCO HOLDING (L-T BUY/S-T BUY)  
-----

ROY BURRY, CFA (212) 493-8276

RJR: SHARE-REPURCHASE PROGRAM ANNOUNCED

Price	12/98	EPS ANNUAL		12/99	P/E	Rate	Dividend		3-Yr. Grwth	52-Wk Range
		12/99E	12/00E				Yld			
11/2		*	*							
-----	-----	-----	-----	-----	-----	-----	-----	-----	-----	-----
\$20 3/4	\$5.15	\$3.40	\$3.60	6.1	5.8	\$3.10	14.9%	N.A.		\$19-34

#### PROGRAM PARAMETERS

As the final element of a broad-based restructuring program-entailing the sale of international tobacco operations, separation of tobacco and food businesses, and the establishment of the initial common dividend-the R.J. Reynolds Tobacco board has announced its initial share repurchase program. Share repurchase represents, by far, the most attractive use of excess liquidity generated internally, after payment of dividends and capital expenditures. Not only is the implied shareholders' return associated with share repurchase extremely high, but the company faces severe limitations with regard to acquisition activity within either tobacco or non-tobacco fields.

The company's initial announcement was limited to a definition of the budget for the first share-repurchase program-\$125 million. A targeted time frame was not announced.

#### A LIMITED DOLLAR AMOUNT-POSSIBLE REASONS WHY

The dollar amount established for the initial share repurchase program is extremely modest. At current prices, shares to be purchased approximate only eight days' trading volume. Further, \$125 million represents only about one quarter of excess cash flow generated annually. The reasons for this limited beginning could encompass some combination of the following eight points:

\* The company wishes to avoid stirring up anti-tobacco political and legal factions by beginning with a more substantial program;

\* Multiple programs can be established annually with any desired frequency. Thus, no upside limitation on per-year expenditure for share purchase has been set;

\* As was the case with the initial dividend declaration, the board has left room for future upward movement when the initial program is exhausted;

\* Legal advice given the board indicates some limitation on the amount spent with regard to possible fraudulent conveyance charges and a resulting possible court-imposed injunction;

\* R.J. Reynolds Tobacco, within the current legal and political environment, is establishing a conservative stand in light of the ongoing Engel class-action case and the recently-filed federal civil suit;

52932 2623

\* The company is attempting to establish a definable, total investor return by combining the initial dividend with rising earnings per share and dividend per-share levels caused by a reduction in shares outstanding. If such a total return could be defined within a more certain investment environment, valuation could be maximized. With tobacco shares now extremely depressed, and the R.J. Reynolds Tobacco stock therefore yielding an excessive level, a more than adequate total return is supported by below-average share repurchase. The level of share retirement can be varied in the future based upon possible substantial changes in the dividend yield. In this manner, total returns could be maintained within a defined range;

\* Over the longer term, shareholder return may be maximized by gradual reductions in the shares outstanding, as opposed to a sudden recapitalization. In other words, common shares could be retired at a lower cost if purchased over an extended interval; and

\* Management's strategy includes maximum flexibility with regard to acquisitions of either tobacco or non-tobacco operations. We hope this is not the case.

#### FINANCIAL IMPACT

At the current stock price, the budgeted share repurchase program, as just announced, would result in retirement of six million shares. If in effect for a full 12-month period, earnings and dividends per-share would be increased by 6% without shifts in either income or aggregate dividend payment levels. Substantial cash would be accumulated if share repurchase activity were limited to the announced level each year.

In addition, the capitalization of R.J. Reynolds Tobacco under-utilizes financial leverage given an inadequate debt level. This adds even further to potential returns available to shareholders based upon complete utilization of the firm's substantial financial resources. (For a complete discussion of the combined financial dynamics of the stock's current valuation level, internal excess cash flow generation, and current capitalization as regards to investor returns, please see our R.J. Reynolds Tobacco report of October 5, 1999.)

#### Additional Information Available Upon Request

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Engle Trial

Positive Event in the Engle Trial

Summary

On November 3, the Florida Supreme Court decided to review just the lump-sum punitive damage issue in the Engle trial which we believe is positive for the industry.

The Florida Supreme Court has the authority to stay (i.e. delay) Phase two of the Engle Trial while it reviews the lump-sum punitive damage issue, depending on how long it takes to review the decision. Presumably, the trial would be stayed before it entered the lump-sum punitive damage portion of Phase Two. As of now, the Supreme Court has indicated that the trial is not stayed.

We believe this is positive for the industry because there is no possible downside risk with this review. However, we believe the chances of the Florida Supreme Court ruling in favor of the industry is relatively small.

On October 29, the industry filed a petition for a writ of prohibition asking the Florida Supreme Court to review the Third District Court's ruling regarding the lump-sum punitive damage issue. The plaintiff's response to the petition for Writ of Prohibition must be received by November 15, and the industry's reply may be filed on or before November 22.

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