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**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-Q**

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**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
For The Quarterly Period Ended March 31, 2005**

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**VECTOR GROUP LTD.**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**1-5759**  
Commission File Number

**65-0949535**  
(I.R.S. Employer Identification No.)

**100 S.E. Second Street  
Miami, Florida 33131  
305/579-8000**

(Address, including zip code and telephone number, including area code, of the principal executive offices)

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Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the Registrant is an accelerated filer as defined in Rule 12b-2 of the Exchange Act. Yes  No

At May 9, 2005, Vector Group Ltd. had 41,837,553 shares of common stock outstanding.

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VECTOR GROUP LTD.

FORM 10-Q

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**PART I. FINANCIAL INFORMATION**

Item 1. Financial Statements

**VECTOR GROUP LTD. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**(Dollars in Thousands, Except Per Share Amounts)**  
**Unaudited**

	<u>March 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$ 140,509	\$ 110,004
Investment securities available for sale	20,446	14,927
Accounts receivable — trade	12,421	2,464
Other receivables	567	653
Inventories	73,831	78,941
Restricted assets	—	606
Deferred income taxes	9,220	22,695
Other current assets	9,582	11,834
Total current assets	<u>266,576</u>	<u>242,124</u>
Property, plant and equipment, net	63,750	65,357
Assets held for sale	2,213	54,077
Long-term investments, net	2,456	2,410
Investments in non-consolidated real estate businesses	26,620	27,160
Restricted assets	4,224	4,374
Deferred income taxes	18,121	18,119
Intangible asset	107,511	107,511
Other assets	13,427	14,763
Total assets	<u>\$ 504,898</u>	<u>\$ 535,895</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT):</b>		
Current liabilities:		
Current portion of notes payable and long-term debt	\$ 5,466	\$ 6,043
Accounts payable	8,146	10,549
Accrued promotional expenses	15,238	17,579
Accrued taxes payable, net	24,983	28,859
Settlement accruals	36,154	28,200
Deferred income taxes	4,175	4,175
Accrued interest	3,134	4,931
Other accrued liabilities	17,203	19,499
Total current liabilities	<u>114,499</u>	<u>119,835</u>
Notes payable, long-term debt and other obligations, less current portion	222,559	254,603
Fair value of derivatives embedded within convertible debt	30,379	25,686
Noncurrent employee benefits	16,965	15,727
Deferred income taxes	147,033	146,284
Other liabilities	4,847	5,134
Minority interests	59,787	53,429
Commitments and contingencies	—	—
Stockholders' equity (deficit):		
Preferred stock, par value \$1.00 per share, authorized 10,000,000 shares	—	—
Common stock, par value \$0.10 per share, authorized 100,000,000 shares, issued 45,227,348 and 45,163,386 shares and outstanding 41,837,553 and 41,733,591 shares	4,183	4,177
Additional paid-in capital	227,031	241,775
Unearned compensation	(3,579)	(656)
Deficit	(292,228)	(303,538)
Accumulated other comprehensive loss	(10,426)	(10,409)
Less: 3,389,795 and 3,389,795 shares of common stock in treasury, at cost	(16,152)	(16,152)
Total stockholders' equity (deficit)	<u>(91,171)</u>	<u>(84,803)</u>
Total liabilities and stockholders' equity (deficit)	<u>\$ 504,898</u>	<u>\$ 535,895</u>

The accompanying notes are an integral part  
of the consolidated financial statements.



**VECTOR GROUP LTD. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Dollars in Thousands, Except Per Share Amounts)**  
**Unaudited**

	Three Months Ended	
	March 31, 2005	March 31, 2004
Revenues*	\$ 104,173	\$ 126,573
Expenses:		
Cost of goods sold*	58,998	74,100
Operating, selling, administrative and general expenses	26,527	38,979
Restructuring and impairment charges	—	653
Operating income	18,648	12,841
Other income (expenses):		
Interest and dividend income	710	695
Interest expense	(6,647)	(6,101)
Gain on investments, net	1,430	251
Gain on LTS conversion	9,461	—
Equity (loss) income from non-consolidated real estate businesses	(306)	646
Equity loss from LTS	(299)	—
Other, net	(1)	(5)
Income from continuing operations before provision for income taxes and minority interests	22,996	8,327
Provision for income taxes	12,704	4,370
Minority interests	(2,016)	536
Income from continuing operations	8,276	4,493
Discontinued operations:		
Income from discontinued operations, net of minority interest and taxes	82	134
Gain on disposal of discontinued operations, net of minority interest and taxes	2,952	—
Gain from discontinued operations	3,034	134
Net income	\$ 11,310	\$ 4,627
Per basic common share:		
Income from continuing operations	\$ 0.20	\$ 0.11
Income from discontinued operations	\$ 0.07	\$ —
Net income applicable to common shares	\$ 0.27	\$ 0.11
Basic weighted average common shares outstanding	41,793,658	41,016,149
Per diluted common share:		
Income from continuing operations	\$ 0.19	\$ 0.10
Income from discontinued operations	\$ 0.07	\$ —
Net income applicable to common shares	\$ 0.26	\$ 0.11
Diluted weighted average common shares outstanding	43,554,881	43,322,966

\*Revenues and Cost of goods sold include excise taxes of \$33,432 and \$46,170 for the three months ended March 31, 2005 and 2004, respectively.

The accompanying notes are an integral part  
of the consolidated financial statements.

**VECTOR GROUP LTD. AND SUBSIDIARIES**

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)**

**(Dollars in Thousands, Except Per Share Amounts)**

**Unaudited**

	Common Stock		Additional Paid-In Capital	Unearned Compensation	Deficit	Treasury Stock	Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount						
Balance, December 31, 2004	41,773,591	\$ 4,177	\$ 241,775	\$ (656)	\$ (303,538)	\$ (16,152)	\$ (10,409)	\$ (84,803)
Net income	—	—	—	—	11,310	—	—	11,310
Foreign currency adjustments, net	—	—	—	—	—	—	(112)	(112)
Unrealized gain on investment securities, net	—	—	—	—	—	—	95	95
Total other comprehensive loss	—	—	—	—	—	—	—	(17)
Total comprehensive income	—	—	—	—	—	—	—	11,293
Distributions on common stock	—	—	(19,721)	—	—	—	—	(19,721)
Issuance of New Valley's restricted stock	—	—	583	(3,152)	—	—	—	(2,569)
Exercise of options	63,962	6	773	—	—	—	—	779
Tax benefit of options exercised	—	—	81	—	—	—	—	81
Amortization of deferred compensation, net	—	—	—	229	—	—	—	229
Beneficial conversion feature of notes payable	—	—	3,406	—	—	—	—	3,406
Other, net	—	—	134	—	—	—	—	134
Balance, March 31, 2005	<u>41,837,553</u>	<u>\$ 4,183</u>	<u>\$ 227,031</u>	<u>\$ (3,579)</u>	<u>\$ (292,228)</u>	<u>\$ (16,152)</u>	<u>\$ (10,426)</u>	<u>\$ (91,171)</u>

The accompanying notes are an integral part  
of the consolidated financial statements.

**VECTOR GROUP LTD. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Dollars in Thousands, Except Per Share Amounts)**  
**Unaudited**

	Three Months Ended	
	March 31, 2005	March 31, 2004
Net cash provided by operating activities:	\$ 6,390	\$ 1,343
Cash flows from investing activities:		
Sale or maturity of investment securities	5,420	29,950
Purchase of investment securities	(2,724)	(10,317)
Sale or liquidation of long-term investments	—	149
Purchase of long-term investments	(46)	(230)
Investment in non-consolidated real estate businesses	—	(1,500)
New Valley purchase of LTS common stock	(1,500)	—
Issuance of note receivable	(1,750)	—
Capital expenditures	(968)	(581)
Net cash (used in) provided by investing activities	(1,568)	17,471
Cash flows from financing activities:		
Proceeds from debt	14,959	—
Repayments of debt	(1,434)	(4,949)
Deferred financing charges	(678)	—
Borrowings under revolver	91,615	129,243
Repayments on revolver	(91,268)	(129,231)
Distributions on common stock	(16,735)	(15,635)
Proceeds from exercise of options	779	667
Other, net	11	—
Net cash used in financing activities	(2,751)	(19,905)
Net cash provided by discontinued operations	28,434	606
Net increase (decrease) in cash and cash equivalents	30,505	(485)
Cash and cash equivalents, beginning of period	110,004	74,808
Cash and cash equivalents, end of period	\$ 140,509	\$ 74,323

The accompanying notes are an integral part  
of the consolidated financial statements.



**VECTOR GROUP LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands, Except Per Share Amounts)**  
**(Unaudited)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

(a) Basis of Presentation:

The consolidated financial statements of Vector Group Ltd. (the "Company" or "Vector") include the accounts of VGR Holding Inc. ("VGR Holding"), Liggett Group Inc. ("Liggett"), Vector Tobacco Inc. ("Vector Tobacco"), Liggett Vector Brands Inc. ("Liggett Vector Brands"), New Valley Corporation ("New Valley") and other less significant subsidiaries. The Company owned 55.1% of the common shares of New Valley at March 31, 2005. All significant intercompany balances and transactions have been eliminated. Certain amounts in the 2004 consolidated financial statements have been reclassified to conform to the current year's presentation.

Liggett is engaged in the manufacture and sale of cigarettes in the United States. Vector Tobacco is engaged in the development and marketing of low nicotine and nicotine-free cigarette products and the development of reduced risk cigarette products. New Valley is currently engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties.

The interim consolidated financial statements of the Company are unaudited and, in the opinion of management, reflect all adjustments necessary (which are normal and recurring) to state fairly the Company's consolidated financial position, results of operations and cash flows. These consolidated financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K, as amended, for the year ended December 31, 2004, as filed with the Securities and Exchange Commission. The consolidated results of operations for interim periods should not be regarded as necessarily indicative of the results that may be expected for the entire year.

(b) Estimates and Assumptions:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Significant estimates subject to material changes in the near term include restructuring and impairment charges, inventory valuation, deferred tax assets, allowance for doubtful accounts, promotional accruals, sales returns and allowances, actuarial assumptions of pension plans, embedded derivative liability, the tobacco quota buy-out, settlement accruals and litigation and defense costs. Actual results could differ from those estimates.

(c) Earnings Per Share:

Information concerning the Company's common stock has been adjusted to give effect to the 5% stock dividend paid to Company stockholders on September 29, 2004. In connection with the 5% stock dividend, the Company increased the number of

VECTOR GROUP LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in Thousands, Except Per Share Amounts) — (Continued)  
(Unaudited)

outstanding stock options by 5% and reduced the exercise prices accordingly. All share amounts have been presented as if the stock dividends had occurred on January 1, 2004.

Basic net income per share is computed by dividing net income by the weighted-average number of shares outstanding. Diluted net income per share includes the dilutive effect of stock options and vested restricted stock grants. Basic and diluted EPS were calculated using the following shares for the three months ended March 31, 2005 and 2004:

	Three Months Ended March 31,	
	2005	2004
Weighted-average shares for basic EPS	41,793,658	41,016,149
Plus incremental shares related to stock options	1,761,223	2,306,817
Weighted-average shares for diluted EPS	43,554,881	43,322,966

(d) Comprehensive Income:

Other comprehensive income is a component of stockholders' equity (deficit) and includes such items as the unrealized gains and losses on investment securities available for sale, forward foreign contracts and minimum pension liability adjustments. Total comprehensive income was \$11,293 for the three months ended March 31, 2005 and \$6,108 for the three months ended March 31, 2004.

(e) Financial Instruments:

The Company uses forward foreign exchange contracts to mitigate its exposure to changes in exchange rates relating to purchases of equipment from third parties. The primary currency to which the Company is exposed is the euro. A substantial portion of the Company's foreign exchange contracts is effective as hedges. The fair value of forward foreign exchange contracts designated as hedges is reported in other current assets or current liabilities and is recorded in other comprehensive income. The fair value of the hedge at March 31, 2005 was a liability of approximately \$190.

(f) Change in Stock Ownership of Subsidiary:

The Company recognizes changes in its ownership percentage in a subsidiary caused by issuances of a subsidiary's stock as an adjustment to additional paid-in capital and unearned compensation. During the three month period ended March 31, 2005, the Company recorded \$2,569 in connection with the decrease in the Company's ownership of New Valley from 58.2% to 55.1%.

VECTOR GROUP LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in Thousands, Except Per Share Amounts) — (Continued)  
(Unaudited)

(g) New Accounting Pronouncements:

In 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS No. 123R"). SFAS No. 123R requires companies to measure compensation cost for share-based payments at fair value. The Company will adopt this new standard prospectively, on January 1, 2006, and has not yet determined whether the adoption of SFAS No. 123R will have a material impact on its consolidated financial position, results of operations or cash flows.

In 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 requires that abnormal idle facility expense and spoilage, freight and handling costs be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overhead costs to inventories be based on the normal capacity of the production facility. The Company is required to adopt the provisions of SFAS No. 151 prospectively after January 1, 2006, but the effect of adoption is not expected to have a material impact on its consolidated financial position, results of operations or cash flows.

**2. RESTRUCTURING**

*Liggett Vector Brands Restructurings.* During April 2004, Liggett Vector Brands adopted a restructuring plan in its continuing effort to adjust the cost structure of the Company's tobacco business and improve operating efficiency. As part of the plan, Liggett Vector Brands eliminated 83 positions and consolidated operations, subletting its New York office space and relocating several employees. As a result of these actions, the Company recognized pre-tax restructuring charges of \$2,735 in 2004 (\$432 in the first quarter of 2004), including \$798 relating to employee severance and benefit costs and \$1,937 for contract termination and other associated costs. Approximately \$503 of these charges represent non-cash items.

On October 6, 2004, the Company announced an additional plan to further restructure the operations of Liggett Vector Brands, its sales, marketing and distribution agent for its Liggett and Vector Tobacco subsidiaries. Liggett Vector Brands has realigned its sales force and adjusted its business model to more efficiently serve its chain and independent accounts nationwide. Liggett Vector Brands is seeking to expand the portfolio of private and control label partner brands by utilizing a pricing strategy that offers long-term list price stability for customers. In connection with the restructuring, the Company eliminated approximately 330 full-time positions and 135 part-time positions as of December 15, 2004.

The Company recognized pre-tax restructuring charges of \$10,583 in 2004, with approximately \$5,659 of the charges related to employee severance and benefit costs and approximately \$4,924 to contract termination and other associated costs. Approximately \$2,503 of these charges

**VECTOR GROUP LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands, Except Per Share Amounts) — (Continued)**  
**(Unaudited)**

represented non-cash items. Additionally, the Company incurred other charges in 2004 for various compensation and related payments to employees which are related to the restructuring. These charges of \$1,670 were included in selling, general and administrative expenses.

The components of the combined pre-tax restructuring charges relating to the 2004 Liggett Vector Brands restructurings for the three months ended March 31, 2005 are as follows:

	Employee Severance and Benefits	Non-Cash Asset Impairment	Contract Termination/ Exit Costs	Total
Balance, December 31, 2004	\$ 3,614	\$ 186	\$ 3,285	\$ 7,085
Utilized	(1,685)	—	(1,138)	(2,823)
Balance, March 31, 2005	<u>\$ 1,929</u>	<u>\$ 186</u>	<u>\$ 2,147</u>	<u>\$ 4,262</u>

*Timberlake Restructuring.* In October 2003, the Company announced that it would close Vector Tobacco's Timberlake, North Carolina cigarette manufacturing facility in order to reduce excess tobacco production capacity and improve operating efficiencies company-wide. Production of the QUEST line of low nicotine and nicotine-free cigarettes, as well as production of Vector Tobacco's other cigarette brands, was moved to Liggett's state-of-the-art manufacturing facility in Mebane, North Carolina. As a result of these actions, the Company recognized restructuring and impairment charges of \$21,696, of which \$21,300 was recognized in 2003 and the remaining \$221 was taken in the first quarter of 2004.

The components of the pre-tax restructuring charge relating to the closing of Vector Tobacco's Timberlake, North Carolina cigarette manufacturing facility for the three months ended March 31, 2005 are as follows:

	Employee Severance and Benefits	Non-Cash Asset Impairment	Contract Termination/ Exit Costs	Total
Balance, December 31, 2004	\$ 467	\$ —	\$ 52	\$ 519
Utilized	(115)	—	(22)	(137)
Balance, March 31, 2005	<u>\$ 352</u>	<u>\$ —</u>	<u>\$ 30</u>	<u>\$ 382</u>

**VECTOR GROUP LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands, Except Per Share Amounts) — (Continued)**  
**(Unaudited)**

**3. INVENTORIES**

Inventories consist of:

	March 31, 2005	December 31, 2004
Leaf tobacco	\$35,242	\$ 35,416
Other raw materials	4,241	3,400
Work-in-process	2,727	1,610
Finished goods	36,782	42,003
Inventories at current cost	78,992	82,429
LIFO adjustments	(5,161)	(3,488)
	<u>\$73,831</u>	<u>\$ 78,941</u>

The Company has a leaf inventory management program whereby, among other things, it is committed to purchase certain quantities of leaf tobacco. The purchase commitments are for quantities not in excess of anticipated requirements and are at prices, including carrying costs, established at the date of the commitment. At March 31, 2005, Liggett had leaf tobacco purchase commitments of approximately \$15,494. There were no leaf tobacco purchase commitments at Vector Tobacco at that date.

Included in the above table was approximately \$1,488 at March 31, 2005 and \$1,595 at December 31, 2004 of leaf inventory associated with Vector Tobacco's QUEST product.

LIFO inventories represent approximately 93% and 85% of total inventories at March 31, 2005 and December 31, 2004, respectively.

**4. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consist of:

	March 31, 2005	December 31, 2004
Land and improvements	\$ 1,418	\$ 1,418
Buildings	13,391	13,431
Machinery and equipment	94,276	93,700
Leasehold improvements	2,828	3,045
Construction-in-progress	3,694	3,240
	115,607	114,834
Less accumulated depreciation	(51,857)	(49,477)
	<u>\$ 63,750</u>	<u>\$ 65,357</u>

Depreciation and amortization expense for the three months ended March 31, 2005 was \$2,552. Future machinery and equipment purchase commitments at Liggett were \$5,504 at March 31, 2005.

**VECTOR GROUP LTD.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Dollars in Thousands, Except Per Share Amounts) — (Continued)**  
**(Unaudited)**

In February 2005, New Valley completed the sale of its two office buildings in Princeton, New Jersey for \$71,500. (Refer to Notes 5 and 11). The buildings were classified as assets held for sale on the balance sheet at December 31, 2004.

In July 2003, Liggett granted an unaffiliated third party an option to purchase Liggett's former manufacturing facility and other excess real estate in Durham, North Carolina with a net book value at March 31, 2005 of approximately \$2,213. The option agreement permits the purchaser to acquire the property during a two-year period expiring July 15, 2005, at a purchase price of \$15,250. At March 31, 2005, Liggett has received non-refundable option fees of \$1,250, creditable against the purchase price, which are recorded as deferred income in other current liabilities. The purchaser is currently seeking financing for the transaction, and there can be no assurance the sale of the property will occur.

**5. NOTES PAYABLE, LONG-TERM DEBT AND OTHER OBLIGATIONS**

Notes payable, long-term debt and other obligations consist of:

	<u>March 31,</u> <u>2005</u>	<u>December 31,</u> <u>2004</u>
<b>Vector:</b>		
5% Variable Interest Senior Convertible Notes due 2011, net of unamortized discount of \$45,596 and \$38,259*	\$ 36,268	\$ 28,646
6.25% Convertible Subordinated Notes due 2008	132,492	132,492
<b>Liggett:</b>		
Revolving credit facility	364	17
Term loan under credit facility	4,179	4,411
Equipment loans	5,520	6,341
<b>Vector Tobacco:</b>		
Notes payable — Medallion acquisition	35,000	35,000
<b>V.T. Aviation:</b>		
Note payable	9,168	9,436
<b>VGR Aviation:</b>		
Note payable	5,034	5,090
<b>New Valley:</b>		
Note payable — operating real estate	—	39,213
<b>Total notes payable, long-term debt and other obligations</b>	<u>228,025</u>	<u>260,646</u>
<b>Less:</b>		
Current maturities	(5,466)	(6,043)
<b>Amount due after one year</b>	<u>\$222,559</u>	<u>\$ 254,603</u>

\* The fair value of the derivatives embedded within these notes (\$30,379 at March 31, 2005 and \$25,686 at December 31, 2004) is separately classified as a derivatives liability in the consolidated balance sheet and the beneficial conversion feature (\$17,031 at March 31, 2005 and \$13,625 at December 31, 2004) is recorded as additional paid-in capital.

VECTOR GROUP LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in Thousands, Except Per Share Amounts) — (Continued)  
(Unaudited)

5% Variable Interest Senior Convertible Notes Due November 2011 — Vector:

In November 2004, the Company sold \$65,500 of its 5% variable interest senior convertible notes due November 15, 2011 in a private offering to qualified institutional investors in accordance with Rule 144A under the Securities Act of 1933. The buyers of the notes had the right, for a 120-day period ending March 18, 2005, to purchase up to an additional \$16,375 of the notes. At December 31, 2004, buyers had exercised their rights to purchase an additional \$1,405 of the notes, and the remaining \$14,959 principal amount of notes were purchased during the first quarter of 2005. In April 2005, Vector issued an additional \$30,000 principal amount of 5% variable interest senior convertible notes due November 15, 2011 in a separate private offering to qualified institutional investors in accordance with Rule 144A. These notes, which were issued under a new indenture at a price of 103.5%, were on the same terms as the \$81,864 principal amount of notes previously issued in connection with the November 2004 placement.

The notes pay interest on a quarterly basis at a rate of 5% per year with an additional amount of interest payable on the notes on each interest payment date. This additional amount is based on the amount of cash dividends actually paid by the Company per share on its common stock during the prior three-month period ending on the record date for such interest payment multiplied by the number of shares of its common stock into which the notes are convertible on such record date (together, the "Total Interest"). Notwithstanding the foregoing, however, during the period prior to November 15, 2006, the interest payable on each interest payment date will be the higher of (i) the Total Interest and (ii) 6 3/4% per year. The notes are convertible into the Company's common stock, at the holder's option. The conversion price of \$19.40 per share is subject to adjustment for various events, including the issuance of stock dividends.

The notes will mature on November 15, 2011. The Company must redeem 12.5% of the total aggregate principal amount of the notes outstanding on November 15, 2009. In addition to such redemption amount, the Company will also redeem on November 15, 2009 and on each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an "Applicable High Yield Discount Obligation" under the Internal Revenue Code. The holders of the notes will have the option on November 15, 2009 to require the Company to repurchase some or all of their remaining notes. The redemption price for such redemptions will equal 100% of the principal amount of the notes plus accrued interest. If a fundamental change occurs, the Company will be required to offer to repurchase the notes at 100% of their principal amount, plus accrued interest and, under certain circumstances, a "make-whole premium".

*Embedded Derivatives.* The portion of the Total Interest on the notes which is computed by reference to the cash dividends paid on the Company's common stock is considered an embedded derivative. Pursuant to SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended by SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities", the Company has bifurcated this dividend portion of the interest on the notes and, based on a valuation by an independent third party, estimated the fair value of the embedded derivative liability. At issuance of the notes, the estimated initial fair value was \$24,738, which was recorded as a discount to the notes and is classified as a derivative liability on the consolidated balance sheet. At December 31, 2004, with the issuance of \$1,405 of additional notes, the derivative liability was estimated at \$25,686. At March 31, 2005, with the issuance of \$14,959 of additional notes in connection with the November 2004 placement, the derivative liability was estimated at \$30,379. Changes to the fair value of this embedded derivative are

VECTOR GROUP LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Dollars in Thousands, Except Per Share Amounts) — (Continued)  
(Unaudited)

reflected quarterly as an adjustment to interest expense. The Company recognized in the first quarter of 2005 a gain of \$828, due to changes in the fair value of the embedded derivative, which was reported as an adjustment to interest expense.

*Beneficial Conversion Feature.* After giving effect to the recording of the embedded derivative liability as a discount to the notes, the Company's common stock had a fair value at the issuance date of the notes in excess of the conversion price resulting in a beneficial conversion feature. Emerging Issues Task Force (EITF) No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Convertible Ratios", requires that the intrinsic value of the beneficial conversion feature (\$17,031 at March 31, 2005) be recorded to additional paid-in capital and as a discount on the notes. The discount is then amortized to interest expense over the term of the notes using the effective interest rate method. The Company recognized non-cash interest expense in the first quarter of 2005 of \$524 due to the amortization of the debt discount attributable to the beneficial conversion feature.

6.25% Convertible Subordinated Notes Due July 15, 2008 — Vector:

In July 2001, Vector completed the sale of \$172,500 (net proceeds of approximately \$166,400) of its 6.25% convertible subordinated notes due July 15, 2008 through a private offering to qualified institutional investors in accordance with Rule 144A under the Securities Act of 1933. The notes pay interest at 6.25% per annum and are convertible into Vector's common stock, at the option of the holder. The conversion price, which was \$24.03 per share at March 31, 2005, is subject to adjustment for various events, and any cash distribution on Vector's common stock will result in a corresponding decrease in the conversion price. In December 2001, \$40,000 of the notes were converted into Vector's common stock and, in October 2004, an additional \$8 of the notes were converted. A total \$132,492 of the notes were outstanding at March 31, 2005.

Vector may redeem the notes, in whole or in part, at a price of 103.125% in the year beginning July 15, 2004, 102.083% in the year beginning July 15, 2005, 101.042% in the year beginning July 15, 2006 and 100% in the year beginning July 15, 2007, together with accrued interest. If a change of control occurs, Vector will be required to offer to repurchase the notes at 101% of their principal amount, plus accrued interest and, under certain circumstances, a "make whole" payment.

Revolving Credit Facility — Liggett:

Liggett has a \$50,000 credit facility with Wachovia Bank, N.A. ("Wachovia"). A total of \$364 was outstanding under the facility at March 31, 2005. Availability as determined under the facility was approximately \$29,793 based on eligible collateral at March 31, 2005. The facility is collateralized by all inventories and receivables of Liggett and a mortgage on its manufacturing facility. Borrowings under the facility bear interest at a rate equal to 1.0% above the prime rate of Wachovia. The facility requires Liggett's compliance with certain financial and other covenants including a restriction on Liggett's ability to pay cash dividends unless Liggett's borrowing availability under the facility for the 30-day period prior to the payment of the dividend, and after giving effect to the dividend, is at least \$5,000 and no event of default has occurred under the agreement, including Liggett's compliance with the covenants in the credit facility, including an adjusted net worth and working capital requirement. In addition, the facility imposes requirements with



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respect to Liggett's adjusted net worth (not to fall below \$8,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of \$17,000 as computed in accordance with the agreement). At March 31, 2005, Liggett was in compliance with all covenants under the credit facility; Liggett's adjusted net worth was \$49,290 and net working capital was \$23,223, as computed in accordance with the agreement.

100 Maple LLC, a company formed by Liggett in 1999 to purchase its Mebane, North Carolina manufacturing plant, has a term loan of \$4,179 outstanding under Liggett's credit facility at March 31, 2005. The remaining balance of the term loan is payable in 14 monthly installments of \$77 with a final payment on June 1, 2006 of \$3,095. Interest is charged at the same rate as applicable to Liggett's credit facility, and the outstanding balance of the term loan reduces the maximum availability under the credit facility. Liggett has guaranteed the term loan, and a first mortgage on the Mebane property and manufacturing equipment collateralizes the term loan and Liggett's credit facility.

Equipment Loans — Liggett:

In March 2000, Liggett purchased equipment for \$1,000 through the issuance of a note, payable in 60 monthly installments of \$21 with an effective annual interest rate of 10.14%. The note was paid in full during the first quarter of 2005. In April 2000, Liggett purchased equipment for \$1,071 through the issuance of notes, payable in 60 monthly installments through April 2005 of \$22 with an effective interest rate of 10.20%.

In October and December 2001, Liggett purchased equipment for \$3,204 and \$3,200, respectively, through the issuance of notes guaranteed by the Company, each payable in 60 monthly installments of \$53 with interest calculated at the prime rate.

In March 2002, Liggett purchased equipment for \$3,023 through the issuance of a note, payable in 30 monthly installments of \$62 and then 30 monthly installments of \$51. Interest is calculated at LIBOR plus 2.8%.

In May 2002, Liggett purchased equipment for \$2,871 through the issuance of a note, payable in 30 monthly installments of \$59 and then 30 monthly installments of \$48. Interest is calculated at LIBOR plus 2.8%.

In September 2002, Liggett purchased equipment for \$1,573 through the issuance of a note guaranteed by the Company, payable in 60 monthly installments of \$26 plus interest calculated at LIBOR plus 4.31%.

Each of these equipment loans is secured by the purchased equipment.

Notes for Medallion Acquisition — Vector Tobacco:

The purchase price for the acquisition of Medallion included \$60,000 in notes of Vector Tobacco, guaranteed by the Company and Liggett. Of the notes, \$25,000 have been repaid with the final quarterly principal payment of \$3,125 made on March 31, 2004. The remaining \$35,000 of notes bear interest at 6.5% per year, payable semiannually, and mature on April 1, 2007.

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Notes Payable — V.T. Aviation:

In February 2001, V.T. Aviation LLC, a subsidiary of Vector Research Ltd., purchased an airplane for \$15,500 and borrowed \$13,175 to fund the purchase. The loan, which is collateralized by the airplane and a letter of credit from the Company for \$775, is guaranteed by Vector Research, VGR Holding and the Company. The loan is payable in 119 monthly installments of \$125, including annual interest of 2.31% above the 30-day commercial paper rate, with a final payment of \$1,927 based on current interest rates.

Notes Payable — VGR Aviation:

In February 2002, V.T. Aviation purchased an airplane for \$6,575 and borrowed \$5,800 to fund the purchase. The loan is guaranteed by the Company. The loan is payable in 119 monthly installments of \$40, including annual interest of 2.75% above the 30-day average commercial paper rate, with a final payment of \$3,233 based on current interest rates. During the fourth quarter of 2003, this airplane was transferred to the Company's direct subsidiary, VGR Aviation LLC, which has assumed the debt.

Note Payable — New Valley:

In December 2002, New Valley financed a portion of its purchase of two office buildings in Princeton, New Jersey with a mortgage loan of \$40,500 from HSBC Realty Credit Corporation (USA). The loan had a term of four years, bore interest at a floating rate of 2% above LIBOR, and was secured by a first mortgage on the office buildings, as well as by an assignment of leases and rents. Principal was amortized to the extent of \$54 per month during the term of the loan. The loan was prepayable without penalty and was non-recourse against New Valley, except for various specified environmental and related matters, misapplications of tenant security deposits and insurance and condemnation proceeds, and fraud or misrepresentation by New Valley in connection with the indebtedness.

In February 2005, New Valley completed the sale of the office buildings. The mortgage loan on the properties was retired at closing with the proceeds of the sale.

**6. EMPLOYEE BENEFIT PLANS**

Net periodic benefit cost for the Company's pension and other postretirement benefit plans for the three months ended March 31, 2005 and 2004 consists of the following:

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	Pension Benefits Three Months Ended		Other Postretirement Benefits Three Months Ended	
	March 31, 2005	March 31, 2004	March 31, 2005	March 31, 2004
Service cost — benefits earned during the period	\$ 1,321	\$ 1,248	\$ 7	\$ 8
Interest cost on projected benefit obligation	2,172	2,240	153	157
Expected return on plan assets	(3,069)	(3,027)	—	—
Amortization of net loss	468	506	11	5
Net expense	<u>\$ 892</u>	<u>\$ 967</u>	<u>\$ 171</u>	<u>\$ 170</u>

The Company did not make contributions to its pension benefits plans for the three months ended March 31, 2005 and does not anticipate making any contributions to such plans in 2005. The Company anticipates paying approximately \$550 in other postretirement benefits in 2005.

**7. CONTINGENCIES**

**Smoking-Related Litigation:**

*Overview.* Since 1954, Liggett and other United States cigarette manufacturers have been named as defendants in numerous direct and third-party actions predicated on the theory that cigarette manufacturers should be liable for damages alleged to have been caused by cigarette smoking or by exposure to secondary smoke from cigarettes. These cases are reported here as though having been commenced against Liggett (without regard to whether such cases were actually commenced against Brooke Group Holding Inc., the Company's predecessor and a wholly-owned subsidiary of VGR Holding, or Liggett). There has been a noteworthy increase in the number of cases commenced against Liggett and the other cigarette manufacturers in recent years. The cases generally fall into the following categories: (i) smoking and health cases alleging injury brought on behalf of individual plaintiffs ("Individual Actions"); (ii) smoking and health cases alleging injury and purporting to be brought on behalf of a class of individual plaintiffs ("Class Actions"); (iii) health care cost recovery actions brought by various foreign and domestic governmental entities ("Governmental Actions"); and (iv) health care cost recovery actions brought by third-party payors including insurance companies, union health and welfare trust funds, asbestos manufacturers and others ("Third-Party Payor Actions"). As new cases are commenced, defense costs and the risks attendant to the inherent unpredictability of litigation continue to increase. The future financial impact of the risks and expenses of litigation and the effects of the tobacco litigation settlements discussed below are not quantifiable at this time. For the three months ended March 31, 2005, Liggett incurred legal fees and other litigation costs totaling approximately \$1,229 compared to \$1,738 for the three months ended March 31, 2004.

*Individual Actions.* As of March 31, 2005, there were approximately 340 cases pending against Liggett, and in most cases the other tobacco companies, where one or more individual plaintiffs allege injury resulting from cigarette smoking, addiction to cigarette smoking or

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exposure to secondary smoke and seek compensatory and, in some cases, punitive damages. Of these, 115 were pending in Maryland, 98 in Florida, 43 in Mississippi, 19 in New York and 16 in Puerto Rico. The balance of the individual cases were pending in 16 states. In one of these cases, an action against cigarette manufacturers involving approximately 1,000 named individual plaintiffs has been consolidated before a single West Virginia state court. Liggett is a defendant in most of the cases pending in West Virginia. In January 2002, the court severed Liggett from the trial of the consolidated action.

There are six individual cases pending where Liggett is the only named defendant. In April 2004, in the *Beverly Davis v. Liggett Group Inc.* case, a Florida state court jury awarded compensatory damages of \$540 against Liggett. In addition, plaintiff's counsel was awarded legal fees of \$752. Liggett has appealed the verdict. In February 2005, in the *Angel Martinez v. Liggett Group Inc.* case, a Florida state court jury returned a verdict in favor of Liggett. The plaintiff's post-trial motion seeking a new trial is pending. In March 2005, in another case in Florida state court where Liggett is the only defendant, *Ferlanti v. Liggett Group Inc.*, the court granted Liggett's motion for summary judgment disposing of the case in its entirety. The plaintiff has appealed.

The plaintiffs' allegations of liability in those cases in which individuals seek recovery for injuries allegedly caused by cigarette smoking are based on various theories of recovery, including negligence, gross negligence, breach of special duty, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of express and implied warranties, conspiracy, aiding and abetting, concert of action, unjust enrichment, common law public nuisance, property damage, invasion of privacy, mental anguish, emotional distress, disability, shock, indemnity and violations of deceptive trade practice laws, the Federal Racketeer Influenced and Corrupt Organizations Act ("RICO"), state RICO statutes and antitrust statutes. In many of these cases, in addition to compensatory damages, plaintiffs also seek other forms of relief including treble/multiple damages, medical monitoring, disgorgement of profits and punitive damages. Defenses raised by defendants in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, lack of design defect, statute of limitations, equitable defenses such as "unclean hands" and lack of benefit, failure to state a claim and federal preemption.

Jury awards in various states have been entered against other cigarette manufacturers. The awards in these individual actions are for both compensatory and punitive damages and represent a material amount of damages. Liggett is not a party to these actions. The following is a brief description of various of these matters:

- In February, 1999, in *Henley v. Philip Morris*, a California state court jury awarded \$1,500 in compensatory damages and \$50,000 in punitive damages. The trial court reduced the punitive damages award to \$25,000. In September 2003, the California Court of Appeals reduced the punitive damages award to \$9,000 based on the United States Supreme Court's 2003 opinion in *State Farm*, limiting punitive damages. In September 2004, the California Supreme Court upheld the \$9,000 punitive damages award. In March 2005, the United States Supreme Court denied review and the defendant has paid the amount of the judgment plus accrued interest of \$6,400.

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- In March 1999, an Oregon state court jury found in favor of the plaintiff in *Williams-Branch v. Philip Morris*. The jury awarded \$800 in compensatory damages and \$79,500 in punitive damages. The trial court reduced the punitive damages award to \$32,000. In June 2002, the Oregon Court of Appeals reinstated the \$79,500 punitive damages award. In October 2003, the United States Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of the *State Farm* decision. In June 2004, the Oregon appellate court reinstated the original jury verdict. The Oregon Supreme Court has agreed to review the case.
- In 2001, as a result of a Florida Supreme Court decision upholding the award, in *Carter v. Brown and Williamson Tobacco Corp.*, the defendant paid \$1,100 in compensatory damages and interest to a former smoker and his spouse for injuries they allegedly incurred as a result of smoking.
- In June 2001, a California state court jury found in favor of the plaintiff in *Boeken v. Philip Morris* and awarded \$5,500 in compensatory damages and \$3,000,000 in punitive damages. In August 2001, the trial court reduced the punitive damages award to \$100,000. In September 2004, the California Court of Appeals affirmed the compensatory damages award, but reduced the punitive damages award to \$50,000. In April 2005, the California Court of Appeals reaffirmed its decision. The defendant has appealed to the California Supreme Court.
- In December 2001, in *Kenyon v. R.J. Reynolds Tobacco Co.*, a Florida state court jury awarded the plaintiff \$165 in compensatory damages, but no punitive damages. In May 2003, the Florida Court of Appeals affirmed per curiam (that is, without an opinion) the trial court's final judgment in favor of the plaintiffs. The defendant paid the amount of the judgment plus accrued interest (\$196) after exhausting all appeals.
- In February 2002, in *Burton v. R.J. Reynolds Tobacco Co., et al*, a federal district court jury in Kansas awarded the plaintiff \$198 in compensatory damages, and determined that the plaintiff was entitled to punitive damages. In June 2002, the trial court awarded the plaintiff \$15,000 in punitive damages. In February 2005, the United States Court of Appeals for the Tenth Circuit overturned the punitive damages award, while upholding the compensatory damages award. The defendant has filed a petition for rehearing.
- In March 2002, an Oregon state court jury found in favor of the plaintiff in *Schwarz v. Philip Morris* and awarded \$169 in compensatory damages and \$150,000 in punitive damages. In May 2002, the trial court reduced the punitive damages award to \$100,000. The parties have appealed to the Oregon Court of Appeals.
- In October 2002, a California state court jury found in favor of the plaintiff in *Bullock v. Philip Morris* and awarded \$850 in compensatory damages and \$28,000,000 in punitive damages. In December 2002, the trial court reduced the punitive damages award to \$28,000. The parties have appealed to the California Court of Appeals.
- In April 2003, in *Eastman v. Brown & Williamson Tobacco Corp., et al*, a Florida state court jury awarded \$6,540 in compensatory damages. In May 2004, the Florida Court of Appeals affirmed the verdict in a per curiam opinion. The defendants' motion for rehearing was denied, and the judgment was paid in October 2004.

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- In May 2003, in *Boerner v. Brown & Williamson Tobacco Corp.*, a federal district court jury in Arkansas awarded \$4,000 in compensatory damages and \$15,000 in punitive damages. In January 2005, the United States Court of Appeals for the Eighth Circuit affirmed the compensatory damages award, but reduced the punitive damages award to \$5,000. The judgment was paid in February 2005.
- In November 2003, in *Thompson v. Brown & Williamson Tobacco Corp., et al.*, a Missouri state court jury awarded \$2,100 in compensatory damages. The defendants have appealed to the Missouri Court of Appeals.
- In December 2003, in *Frankson v. Brown & Williamson Tobacco Corp., et al.*, a New York state court jury awarded \$350 in compensatory damages. In January 2004, the jury awarded \$20,000 in punitive damages. The deceased smoker was found to be 50% at fault. In June 2004, the court increased the compensatory damages to \$500 and decreased the punitive damages to \$5,000. The defendants have appealed.
- In October 2004, in *Arnitz v. Philip Morris*, a Florida state court jury awarded \$600 in damages but found that the plaintiff was 60% at fault, thereby reducing the verdict against Philip Morris to \$240. Philip Morris has appealed to the Florida Second District Court of Appeals.
- In February 2005, in *Smith v. Brown & Williamson Tobacco Corp.*, a Missouri state court jury awarded \$2,000 in compensatory damages and \$20,000 in punitive damages. The defendants intend to appeal.
- In March 2005, in *Rose v. Philip Morris*, a New York state court jury awarded \$3,400 in compensatory damages and \$17,100 in punitive damages. The defendants intend to appeal.

In 2003, the Mississippi Supreme Court ruled that the Mississippi Product Liability Act “precludes all tobacco cases that are based on product liability.” Based on this ruling, Liggett is seeking, or intends to seek, dismissal of each of the 43 cases pending against it in Mississippi.

*Class Actions.* As March 31, 2005, there were approximately 16 actions pending, for which either a class has been certified or plaintiffs are seeking class certification, where Liggett, among others, was a named defendant. Many of these actions purport to constitute statewide class actions and were filed after May 1996 when the Fifth Circuit Court of Appeals, in the *Castano* case, reversed a Federal district court’s certification of a purported nationwide class action on behalf of persons who were allegedly “addicted” to tobacco products.

The extent of the impact of the *Castano* decision on smoking-related class action litigation is still uncertain. The *Castano* decision has had a limited effect with respect to courts’ decisions regarding narrower smoking-related classes or class actions brought in state rather than federal court. For example, since the Fifth Circuit’s ruling, a court in Louisiana (Liggett is not a defendant in this proceeding) certified an “addiction-as-injury” class action, in the *Scott v. American Tobacco Co., Inc.* case, that covered only citizens in the state. In May 2004, the *Scott* jury returned a verdict in the amount of \$591,000, plus prejudgment interest, on the

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class' claim for a smoking cessation program. The case is on appeal. Two other class actions, *Broin, et al., v. Philip Morris Companies Inc., et al.*, and *Engle, et al., v. R.J. Reynolds Tobacco Company, et al.*, were certified in state court in Florida prior to the Fifth Circuit's decision.

In May 1994, the *Engle* case was filed against Liggett and others in the Circuit Court, Eleventh Judicial Circuit, Miami-Dade County, Florida. The class consists of all Florida residents and citizens, and their survivors, who have suffered, presently suffer or have died from diseases and medical conditions caused by their addiction to cigarettes that contain nicotine. Phase I of the trial commenced in July 1998 and in July 1999, the jury returned the Phase I verdict. The Phase I verdict concerned certain issues determined by the trial court to be "common" to the causes of action of the plaintiff class. Among other things, the jury found that: smoking cigarettes causes 20 diseases or medical conditions, cigarettes are addictive or dependence producing, defective and unreasonably dangerous, defendants made materially false statements with the intention of misleading smokers, defendants concealed or omitted material information concerning the health effects and/or the addictive nature of smoking cigarettes and agreed to misrepresent and conceal the health effects and/or the addictive nature of smoking cigarettes, and defendants were negligent and engaged in extreme and outrageous conduct or acted with reckless disregard with the intent to inflict emotional distress. The jury also found that defendants' conduct "rose to a level that would permit a potential award or entitlement to punitive damages." The court decided that Phase II of the trial, which commenced November 1999, would be a causation and damages trial for three of the class representatives and a punitive damages trial on a class-wide basis, before the same jury that returned the verdict in Phase I. Phase III of the trial was to be conducted before separate juries to address absent class members' claims, including issues of specific causation and other individual issues regarding entitlement to compensatory damages. In April 2000, the jury awarded compensatory damages of \$12,704 to the three plaintiffs, to be reduced in proportion to the respective plaintiff's fault. The jury also decided that the claim of one of the plaintiffs, who was awarded compensatory damages of \$5,831, was not timely filed. In July 2000, the jury awarded approximately \$145,000,000 in the punitive damages portion of Phase II against all defendants including \$790,000 against Liggett. The court entered a final order of judgment against the defendants in November 2000. The court's final judgment, which provided for interest at the rate of 10% per year on the jury's awards, also denied various post-trial motions, including a motion for new trial and a motion seeking reduction of the punitive damages award. Liggett appealed the court's order.

In May 2003, Florida's Third District Court of Appeals decertified the *Engle* class and set aside the jury's decision in the case against Liggett and the other cigarette makers, including the \$145,000,000 punitive damages award. The intermediate appellate court ruled that there were multiple legal bases why the class action trial, including the punitive damages award, could not be sustained. The court found that the class failed to meet the legal requirements for class certification and that class members needed to pursue their claims on an individualized basis. The court also ruled that the trial plan violated Florida law and the appellate court's 1996 certification decision, and was unconstitutional. The court further found that the proceedings were irretrievably tainted by class counsel's misconduct and that the punitive damages award was bankrupting under Florida law.

In October 2003, the Third District Court of Appeals denied class counsel's motions seeking, among other things, a rehearing by the court. Class counsel filed a motion with the Florida Supreme Court to invoke discretionary review on the basis that the Third District Court of

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Appeals decision construes the due process provisions of the state and federal constitutions and conflicts with other appellate and supreme court decisions. In May 2004, the Florida Supreme Court agreed to review the case. Oral argument was held in November 2004. If the Third District Court of Appeal's ruling is not upheld on further appeal, it will have a material adverse effect on the Company.

In May 2000, legislation was enacted in Florida that limits the size of any bond required, pending appeal, to stay execution of a punitive damages verdict to the lesser of the punitive award plus twice the statutory rate of interest, \$100,000 or 10% of the net worth of the defendant, but the limitation on the bond does not affect the amount of the underlying verdict. In November 2000, Liggett filed the \$3,450 bond required by the Florida law in order to stay execution of the *Engle* judgment, pending appeal. Legislation limiting the amount of the bond required to file an appeal of an adverse judgment has been enacted in more than 30 states.

In May 2001, Liggett, Philip Morris and Lorillard Tobacco Company reached an agreement with the class in the *Engle* case, which provided assurance of Liggett's ability to appeal the jury's July 2000 verdict. As required by the agreement, Liggett paid \$6,273 into an escrow account to be held for the benefit of the *Engle* class, and released, along with Liggett's existing \$3,450 statutory bond, to the court for the benefit of the class upon completion of the appeals process, regardless of the outcome of the appeal. As a result, the Company recorded a \$9,723 pre-tax charge to the consolidated statement of operations for the first quarter of 2001. The agreement, which was approved by the court, assured that the stay of execution, in effect pursuant to the Florida bonding statute, would not be lifted or limited at any point until completion of all appeals, including an appeal to the United States Supreme Court. If Liggett's balance sheet net worth fell below \$33,781 (as determined in accordance with generally accepted accounting principles in effect as of July 14, 2000), the agreement provided that the stay granted in favor of Liggett in the agreement would terminate and the *Engle* class would be free to challenge the Florida bonding statute.

In June 2002, the jury in a Florida state court action entitled *Lukacs v. Philip Morris, et al.* awarded \$37,500 in compensatory damages in a case involving Liggett and two other tobacco manufacturers. In March 2003, the court reduced the amount of the compensatory damages to \$25,100. The jury found Liggett 50% responsible for the damages incurred by the plaintiff. The *Lukacs* case was the first individual case to be tried as part of Phase III of the *Engle* case; the claims of all other individuals who are members of the class were stayed pending resolution of the appeal of the *Engle* verdict. The *Lukacs* verdict, which was subject to the outcome of the *Engle* appeal, has been overturned as a result of the appellate court's ruling. As discussed above, class counsel in *Engle* is pursuing various appellate remedies seeking reversal of the appellate court's decision.

Class certification motions are pending in a number of putative class actions. Classes remain certified against Liggett in West Virginia (*Blankenship*), New York (*Simon*), Kansas (*Smith*) and New Mexico (*Romero*). A number of class certification denials are on appeal.

In August 2000, in *Blankenship v. Philip Morris*, a West Virginia state court conditionally certified (only to the extent of medical monitoring) a class of present or former West Virginia smokers who desire to participate in a medical monitoring plan. In January 2001, the judge declared a mistrial. In July 2001, the court issued an order severing Liggett from the retrial of



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the case which began in September 2001. In November 2001, the jury returned a verdict in favor of the other defendants. In May 2004, the West Virginia Supreme Court affirmed the defense jury verdict, and it denied plaintiffs' petition for rehearing during July of 2004. Plaintiffs did not seek further appellate review of this matter and the case has been concluded in favor of the other defendants.

In April 2001, the California state court in *Brown, et al., v. The American Tobacco Co., Inc. et al.* granted in part plaintiff's motion for class certification and certified a class comprised of adult residents of California who smoked at least one of defendants' cigarettes "during the applicable time period" and who were exposed to defendants' marketing and advertising activities in California. Certification was granted as to plaintiff's claims that defendants violated California's unfair business practices statute. The court subsequently defined "the applicable class period" for plaintiff's claims, pursuant to a stipulation submitted by the parties, as June 10, 1993 through April 23, 2001. In March 2005, the court issued a ruling granting defendants' motion to decertify the class based on a recent change in California law. In April 2005, the court issued a tentative ruling that denied the plaintiff's motion for reconsideration of the order which decertified the case. Liggett is a defendant in the case.

In September 2002, in *In Re Simon II Litigation*, the federal district court for the Eastern District of New York granted plaintiffs' motion for certification of a nationwide non-opt-out punitive damages class action against the major tobacco companies, including Liggett. The class is not seeking compensatory damages, but was created to determine whether smokers across the country may be entitled to punitive damages. In May 2005, the United States Court of Appeals for the Second Circuit vacated the trial court's class certification order and remanded the case to the trial court for further proceedings.

Class action suits have been filed in a number of states against individual cigarette manufacturers, alleging that the use of the terms "lights" and "ultralights" constitutes unfair and deceptive trade practices. One such suit (*Schwab v. Philip Morris, et al.*), pending in federal court in New York against the cigarette manufacturers, seeks to create a nationwide class of "light" cigarette smokers and includes Liggett as a defendant. Trial in *Schwab* is scheduled for January 2006.

In March 2003, in a class action brought against Philip Morris on behalf of smokers of light cigarettes, a state court judge in Illinois in the *Price, et al., v. Philip Morris* case awarded \$7,100,500 in actual damages to the class members, \$3,000,000 in punitive damages to the State of Illinois (which was not a plaintiff in this matter), and approximately \$1,800,000 in attorney's fees and costs. Entry of judgment has been stayed. Philip Morris has appealed the verdict.

Approximately 38 purported state and federal class action complaints were filed against the cigarette manufacturers, including Liggett, for alleged antitrust violations. The actions allege that the cigarette manufacturers have engaged in a nationwide and international conspiracy to fix the price of cigarettes in violation of state and federal antitrust laws. Plaintiffs allege that defendants' price-fixing conspiracy raised the price of cigarettes above a competitive level. Plaintiffs in the 31 state actions purport to represent classes of indirect purchasers of cigarettes in 16 states; plaintiffs in the seven federal actions purport to represent a nationwide class of wholesalers who purchased cigarettes directly from the defendants. The federal class actions were consolidated and, in July 2000, plaintiffs filed a single consolidated complaint that

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did not name Liggett as a defendant, although Liggett complied with discovery requests. In July 2002, the court granted defendants' motion for summary judgment in the consolidated federal cases, which decision was affirmed on appeal by the United States Court of Appeals for the Eleventh Circuit. All state court cases on behalf of indirect purchasers have been dismissed, except for two cases pending in Kansas and New Mexico. A Kansas state court, in the case of *Smith v. Philip Morris, et al.*, granted class certification in November 2001. In April 2003, plaintiffs' motion for class certification was granted in *Romero v. Philip Morris*, a case pending in New Mexico state court. In February 2005, the New Mexico Supreme Court affirmed the trial court's certification order. Liggett is one of the defendants in both the Kansas and New Mexico cases.

*Governmental Actions.* As of March 31, 2005, there were approximately 11 Governmental Actions pending against Liggett. In these proceedings, both foreign and domestic governmental entities seek reimbursement for Medicaid and other health care expenditures. The claims asserted in these health care cost recovery actions vary. In most of these cases, plaintiffs assert the equitable claim that the tobacco industry was "unjustly enriched" by plaintiffs' payment of health care costs allegedly attributable to smoking and seek reimbursement of those costs. Other claims made by some but not all plaintiffs include the equitable claim of indemnity, common law claims of negligence, strict liability, breach of express and implied warranty, breach of special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under state and federal statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under RICO. Trial in the health care recovery case brought by the City of St. Louis, Missouri, and area hospitals against the major cigarette manufacturers is scheduled for January 2006.

*Third-Party Payor Actions.* As of March 31, 2005, there were approximately five Third-Party Payor Actions pending against Liggett. The claims in these cases are similar to those in the Governmental Actions but have been commenced by insurance companies, union health and welfare trust funds, asbestos manufacturers and others. Nine United States Circuit Courts of Appeal have ruled that Third-Party Payors did not have standing to bring lawsuits against cigarette manufacturers. The United States Supreme Court has denied petitions for certiorari in the cases decided by five of the courts of appeal. However, a number of Third-Party Payor Actions, including an action brought by 24 Blue Cross/Blue Shield Plans, remain pending.

In June 2001, a jury in a third party payor action brought by Empire Blue Cross and Blue Shield in the Eastern District of New York rendered a verdict awarding the plaintiff \$17,800 in damages against the major cigarette manufacturers. As against Liggett, the jury awarded the plaintiff damages of \$89. In February 2002, the court awarded plaintiff's counsel \$37,800 in attorneys' fees, without allocating the fee award among the several defendants. Liggett has appealed both the jury verdict and the attorneys' fee award. In September 2003, the United States Court of Appeals for the Second Circuit reversed the portion of the judgment relating to subrogation, certified questions relating to plaintiff's direct claims of deceptive business practices to the New York Court of Appeals and deferred its ruling on the appeal of the attorneys' fees award pending the ruling on the certified questions. In October 2004, the New York Court of Appeals ruled in defendants' favor on the certified questions and found that plaintiff's direct claims are barred on grounds of remoteness. In December 2004, the Second

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Circuit issued a revised decision, vacating the award of compensatory damages and attorneys' fees, and reversing the judgment. In February 2005, the parties stipulated to a dismissal with prejudice.

In other Third-Party Payor Actions claimants have set forth several additional theories of relief sought: funding of corrective public education campaigns relating to issues of smoking and health; funding for clinical smoking cessation programs; disgorgement of profits from sales of cigarettes; restitution; treble damages; and attorneys' fees. Nevertheless, no specific amounts are provided. It is understood that requested damages against the tobacco company defendants in these cases might be in the billions of dollars.

*Federal Government Action.* In September 1999, the United States government commenced litigation against Liggett and the other major tobacco companies in the United States District Court for the District of Columbia. The action seeks to recover an unspecified amount of health care costs paid for and furnished, and to be paid for and furnished, by the Federal Government for lung cancer, heart disease, emphysema and other smoking-related illnesses allegedly caused by the fraudulent and tortious conduct of defendants, to restrain defendants and co-conspirators from engaging in fraud and other unlawful conduct in the future, and to compel defendants to disgorge the proceeds of their unlawful conduct. The complaint alleges that such costs total more than \$20,000,000 annually. The action asserted claims under three federal statutes, the Medical Care Recovery Act ("MCRA"), the Medicare Secondary Payer provisions of the Social Security Act ("MSP") and RICO. In September 2000, the court dismissed the government's claims based on MCRA and MSP, reaffirming its decision in July 2001. In the September 2000 decision, the court also determined not to dismiss the government's RICO claims, under which the government continues to seek court relief to restrain the defendant tobacco companies from allegedly engaging in fraud and other unlawful conduct and to compel disgorgement. In a January 2003 filing with the court, the government alleged that disgorgement by defendants of approximately \$289,000,000 is an appropriate remedy in the case. In April 2004, the court denied Liggett's motion to be dismissed from the case. Trial of the case began in September 2004 and is proceeding. In February 2005, the United States Court of Appeals for the District of Columbia upheld the defendants' motion for summary judgment to dismiss the government's disgorgement claim, ruling that disgorgement is not an available remedy in a civil RICO action. In April 2005, the appellate court denied the government's request that the disgorgement ruling be reconsidered by the full court. The government may appeal to the United States Supreme Court.

*Settlements.* In March 1996, Brooke Group Holding and Liggett entered into an agreement, subject to court approval, to settle the *Castano* class action tobacco litigation. The *Castano* class was subsequently decertified by the court.

In March 1996, March 1997 and March 1998, Brooke Group Holding and Liggett entered into settlements of smoking-related litigation with the Attorneys General of 45 states and territories.

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The settlements released both Brooke Group Holding and Liggett from all smoking-related claims, including claims for health care cost reimbursement and claims concerning sales of cigarettes to minors.

In November 1998, Philip Morris, Brown & Williamson, R.J. Reynolds and Lorillard (collectively, the “Original Participating Manufacturers” or “OPMs”) and Liggett (together with the OPMs and any other tobacco product manufacturer that becomes a signatory, the “Participating Manufacturers”) entered into the Master Settlement Agreement (the “MSA”) with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Mariana Islands (collectively, the “Settling States”) to settle the asserted and unasserted health care cost recovery and certain other claims of those Settling States. The MSA received final judicial approval in each settling jurisdiction.

The MSA restricts tobacco product advertising and marketing within the Settling States and otherwise restricts the activities of Participating Manufacturers. Among other things, the MSA prohibits the targeting of youth in the advertising, promotion or marketing of tobacco products; bans the use of cartoon characters in all tobacco advertising and promotion; limits each Participating Manufacturer to one tobacco brand name sponsorship during any 12-month period; bans all outdoor advertising, with the exception of signs, 14 square feet or less, at retail establishments that sell tobacco products; prohibits payments for tobacco product placement in various media; bans gift offers based on the purchase of tobacco products without sufficient proof that the intended recipient is an adult; prohibits Participating Manufacturers from licensing third parties to advertise tobacco brand names in any manner prohibited under the MSA; prohibits Participating Manufacturers from using as a tobacco product brand name any nationally recognized non-tobacco brand or trade name or the names of sports teams, entertainment groups or individual celebrities; and prohibits Participating Manufacturers from selling packs containing fewer than 20 cigarettes.

The MSA also requires Participating Manufacturers to affirm corporate principles to comply with the MSA and to reduce underage usage of tobacco products and imposes requirements applicable to lobbying activities conducted on behalf of Participating Manufacturers.

Liggett has no payment obligations under the MSA except to the extent its market share exceeds a base share of 125% of its 1997 market share, or approximately 1.65% of total cigarettes sold in the United States. As a result of the Medallion acquisition in April 2002, Vector Tobacco has no payment obligations under the MSA, except to the extent its market share exceeds a base amount of approximately 0.28% of total cigarettes sold in the United States. During 1999 and 2000, Liggett’s market share did not exceed the base amount. According to data from Management Science Associates, Inc., domestic shipments by Liggett and Vector Tobacco accounted for approximately 2.2% of the total cigarettes shipped in the United States during 2001, 2.4% during 2002, 2.5% during 2003 and 2.3% during 2004. On April 15 of any year following a year in which Liggett’s and/or Vector Tobacco’s market shares exceed their base shares, Liggett and/or Vector Tobacco will pay on each excess unit an amount equal (on a per-unit basis) to that due during the same following year by the OPMs under the annual and strategic contribution payment provisions of the MSA, subject to applicable adjustments, offsets and reductions. In March and April 2002, Liggett and Vector Tobacco paid a total of \$31,130 for their 2001 MSA obligations. In March and April 2003, Liggett and Vector Tobacco paid a total of \$37,541 for their 2002 MSA obligations. At that

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time, funds were held back based on Liggett's and Vector Tobacco's belief that their MSA payments for 2002 should be reduced as a result of market share loss to non-participating manufacturers. In June 2003, Liggett and Vector Tobacco entered into a settlement agreement with the Settling States whereby Liggett and Vector Tobacco agreed to pay \$2,478 in April 2004 to resolve these claims. In April 2004, Liggett and Vector Tobacco paid a total of \$50,322 for their 2003 MSA obligations. Liggett and Vector Tobacco have expensed \$23,315 for their estimated MSA obligations for 2004 and \$1,447 for the first three months of 2005 as part of cost of goods sold. Under the annual and strategic contribution payment provisions of the MSA, the OPMs (and Liggett and Vector Tobacco to the extent their market shares exceed their base shares) are required to pay the following annual amounts (subject to certain adjustments):

<u>Year</u>	<u>Amount</u>
2005 - 2007	\$8,000,000
2008 - 2017	\$8,139,000
2018 and each year thereafter	\$9,000,000

These annual payments will be allocated based on relative unit volume of domestic cigarette shipments. The payment obligations under the MSA are the several, and not joint, obligations of each Participating Manufacturer and are not the responsibility of any parent or affiliate of a Participating Manufacturer.

On March 30, 2005, the Independent Auditor under the MSA calculated \$28,668 in MSA payments for Liggett's 2004 sales. On April 15, 2005, Liggett paid \$11,678 of this amount and, in accordance with its rights under the MSA, disputed the balance of \$16,990. Of the disputed amount, Liggett paid \$9,304 into the disputed payments account under the MSA and withheld from payment \$7,686.

By letter dated April 28, 2005, the Settling States provided Liggett with a 30-day notice under the MSA which stated, among other things, that one or more of the Settling States may initiate proceedings against Liggett under Sections IX (i) and XI (d) of the MSA and the June 2003 settlement agreement between Liggett and the Settling States. The Settling States contend that Liggett had no right under the MSA or the June 2003 settlement agreement to pay into the disputed payments account any amount claimed as an adjustment for market share loss for non-participating manufacturers for 2003, although they acknowledge that Liggett has the right to dispute such amounts. The Settling States sent similar letters to several other Subsequent Participating Manufacturers that paid into the disputed payments account.

Liggett has recently been notified that all Participating Manufacturers' payment obligations under the MSA, dating from the agreement's execution in late 1998, have been recalculated utilizing net unit amounts, rather than gross unit amounts (which have been utilized since 1999). The change in the method of calculation could, among other things, require additional payments by Liggett under the MSA of approximately \$2,000 per year for the period 2001 through 2004, or a total of approximately \$8,000, and require Liggett to pay an additional amount of approximately \$2,000 per year in 2005 and in future periods by lowering Liggett's market share exemption under the MSA.

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Liggett has objected to this retroactive change, and intends to challenge it by way of arbitration or court proceeding if it is ultimately implemented. Liggett contends that the retroactive change from utilizing gross unit amounts to net unit amounts is impermissible for several reasons, including:

- utilization of net unit amounts is not required by the MSA (as reflected by, among other things, the utilization of gross unit amounts for the past six years),
- such a change is not authorized without the consent of affected parties to the MSA,
- the MSA provides for four-year time limitation periods for revisiting calculations and determinations, which precludes recalculating Liggett's 1997 Market Share (and thus, Liggett's market share exemption), and
- Liggett and others have relied upon the calculations based on gross unit amounts for the past six years.

The MSA replaces Liggett's prior settlements with all states and territories except for Florida, Mississippi, Texas and Minnesota. Each of these four states, prior to the effective date of the MSA, negotiated and executed settlement agreements with each of the other major tobacco companies, separate from those settlements reached previously with Liggett. Liggett's agreements with these states remain in force and effect, and Liggett made various payments to these states during 1996, 1997 and 1998 under the agreements. These states' settlement agreements with Liggett contained "most-favored nations" provisions, which could reduce Liggett's and Brooke Group Holding's payment obligations based on subsequent settlements or resolutions by those states with certain other tobacco companies. Beginning in 1999, Liggett determined that, based on each of these four states' settlements or resolutions with United States Tobacco Company, Liggett's payment obligations to those states have been eliminated, except for a \$100 a year payment to Minnesota negotiated in 2003, to be paid any year cigarettes manufactured by Liggett are sold in that state. With respect to all non-economic obligations under the previous settlements, both Brooke Group Holding and Liggett are entitled to the most favorable provisions as between the MSA and each state's respective settlement with the other major tobacco companies. Therefore, Liggett's non-economic obligations to all states and territories are now defined by the MSA.

In 2004, the Attorneys General for each of Florida, Mississippi and Texas advised Liggett that they believed that Liggett has failed to make all required payments under the settlement agreements with these three states for the period 1998 through 2003 and that additional payments may be due for 2004 and subsequent years. Liggett believes these allegations are without merit, based, among other things, on the language of the most-favored nations provisions of the settlement agreements. In December 2004, the State of Florida offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of \$13,500. In November 2004, the State of Mississippi offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of \$6,500. In March 2005, the State of Florida reaffirmed its December 2004 offer to settle and provided Liggett with a 60 day notice

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to cure the alleged defaults. In April 2005, the State of Mississippi reaffirmed its November 2004 offer to settle and provided Liggett with a 60 day notice to cure the alleged defaults.

No amounts have been accrued in the accompanying financial statements for any additional amounts that may be payable by Liggett under the MSA due to the recalculation of the Participating Manufacturers' payment obligations or under the settlement agreements with these three states. There can be no assurance that Liggett will prevail and that Liggett will not be required to make additional material payments under the MSA and the settlement agreements with these three states, which payments could adversely affect the Company's consolidated financial position, results of operations or cash flows.

In August 2004, the Company announced that Liggett and Vector Tobacco had notified the Attorneys General of 46 states that they intend to initiate proceedings against the Attorneys General for violating the terms of the MSA. The Company's subsidiaries allege that the Attorneys General violated their rights and the MSA by extending unauthorized favorable financial terms to Miami-based Vibo Corporation d/b/a/ General Tobacco when, on August 19, 2004, the Attorneys General entered into an agreement with General Tobacco allowing it to become a Subsequent Participating Manufacturer under the MSA. General Tobacco imports discount cigarettes manufactured in Colombia, South America.

In the notice sent to the Attorneys General, the Company's subsidiaries indicated that they will seek to enforce the terms of the MSA, void the General Tobacco agreement and enjoin the Settling States and National Association of Attorneys General from listing General Tobacco as a Participating Manufacturer on their websites.

Copies of the various settlement agreements are filed as exhibits to the Company's Annual Report on Form 10-K and the discussion herein is qualified in its entirety by reference thereto.

*Trials.* Trial in the United States government action began on September 21, 2004 in federal court in the District of Columbia. Cases currently scheduled for trial during the next six months include two individual actions, with trial in one of these cases in Florida state court scheduled for May 2005 and trial in another case in Missouri state court scheduled for October 2005. Liggett is the sole defendant in both of these cases. Trial dates, however, are subject to change.

Management is not able to predict the outcome of the litigation pending against Brooke Group Holding or Liggett. Litigation is subject to many uncertainties. In May 2003, a Florida intermediate appellate court overturned a \$790,000 punitive damages award against Liggett and decertified the *Engle* smoking and health class action. In May 2004, the Florida Supreme Court agreed to review the case. Oral argument was held in November 2004. If the intermediate appellate court's ruling is not upheld on further appeal, it will have a material adverse effect on the Company. In November 2000, Liggett filed the \$3,450 bond required under the bonding statute enacted in 2000 by the Florida legislature which limits the size of any bond required, pending appeal, to stay execution of a punitive damages verdict. In May 2001, Liggett reached an agreement with the class in the *Engle* case, which provided assurance to Liggett that the stay of execution, in effect pursuant to the Florida bonding statute, would not be lifted or limited at any point until completion of all appeals, including to the United States Supreme Court. As required by the agreement, Liggett paid \$6,273 into an escrow account to be held for the benefit of the *Engle* class, and released, along with Liggett's existing \$3,450

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statutory bond, to the court for the benefit of the class upon completion of the appeals process, regardless of the outcome of the appeal. As a result, the Company recorded a \$9,723 pre-tax charge to the consolidated statement of operations for the first quarter of 2001. In June 2002, the jury in an individual case brought under the third phase of the *Engle* case awarded \$37,500 (subsequently reduced by the court to \$25,100) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. The verdict, which was subject to the outcome of the *Engle* appeal, has been overturned as a result of the appellate court's ruling. In April 2004, a jury in a Florida state court action awarded compensatory damages of approximately \$540 against Liggett in an individual action. In addition, plaintiff's counsel was awarded legal fees of \$752. Liggett intends to appeal the verdict. It is possible that additional cases could be decided unfavorably and that there could be further adverse developments in the *Engle* case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. Management cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. Management is unable to make a meaningful estimate with respect to the amount or range of loss that could result from an unfavorable outcome of the cases pending against Brooke Group Holding or Liggett or the costs of defending such cases. The complaints filed in these cases rarely detail alleged damages. Typically, the claims set forth in an individual's complaint against the tobacco industry pray for money damages in an amount to be determined by a jury, plus punitive damages and costs. These damage claims are typically stated as being for the minimum necessary to invoke the jurisdiction of the court.

It is possible that the Company's consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such smoking-related litigation.

Liggett's and Vector Tobacco's management are unaware of any material environmental conditions affecting their existing facilities. Liggett's and Vector Tobacco's management believe that current operations are conducted in material compliance with all environmental laws and regulations and other laws and regulations governing cigarette manufacturers. Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has not had a material effect on the capital expenditures, results of operations or competitive position of Liggett or Vector Tobacco.

Liggett has been served in three reparations actions brought by descendants of slaves. Plaintiffs in these actions claim that defendants, including Liggett, profited from the use of slave labor. Seven additional cases have been filed in California, Illinois and New York. Liggett is a named defendant in only one of these additional cases, but has not been served.

There are several other proceedings, lawsuits and claims pending against the Company and certain of its consolidated subsidiaries unrelated to smoking or tobacco product liability. Management is of the opinion that the liabilities, if any, ultimately resulting from such other proceedings, lawsuits and claims should not materially affect the Company's financial position, results of operations or cash flows.



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**Legislation and Regulation:**

Many cities and states have recently enacted legislation banning smoking in public places including offices, restaurants, public buildings and bars. Efforts to limit smoking in public places could have a material adverse effect on the Company.

In January 1993, the Environmental Protection Agency (“EPA”) released a report on the respiratory effect of secondary smoke which concludes that secondary smoke is a known human lung carcinogen in adults and in children, causes increased respiratory tract disease and middle ear disorders and increases the severity and frequency of asthma. In June 1993, the two largest of the major domestic cigarette manufacturers, together with other segments of the tobacco and distribution industries, commenced a lawsuit against the EPA seeking a determination that the EPA did not have the statutory authority to regulate secondary smoke, and that given the scientific evidence and the EPA’s failure to follow its own guidelines in making the determination, the EPA’s classification of secondary smoke was arbitrary and capricious. In July 1998, a federal district court vacated those sections of the report relating to lung cancer, finding that the EPA may have reached different conclusions had it complied with relevant statutory requirements. The federal government appealed the court’s ruling. In December 2002, the United States Court of Appeals for the Fourth Circuit rejected the industry challenge to the EPA report ruling that it was not subject to court review. Issuance of the report may encourage efforts to limit smoking in public areas.

In February 1996, the United States trade representative issued an “advance notice of proposed rule making” concerning how tobacco is imported under a previously established tobacco tariff rate quota (“TRQ”). Currently, tobacco imported under the TRQ is allocated on a “first-come, first-served” basis, meaning that entry is allowed on an open basis to those first requesting entry in the quota year. Others in the cigarette industry have suggested an “end-user licensing” system under which the right to import tobacco under the quota would be initially assigned based on domestic market share. Such an approach, if adopted, could have a material adverse effect on the Company.

In August 1996, the Food and Drug Administration (the “FDA”) filed in the Federal Register a Final Rule classifying tobacco as a “drug” or “medical device”, asserting jurisdiction over the manufacture and marketing of tobacco products and imposing restrictions on the sale, advertising and promotion of tobacco products. Litigation was commenced challenging the legal authority of the FDA to assert such jurisdiction, as well as challenging the constitutionality of the rules. In March 2000, the United States Supreme Court ruled that the FDA does not have the power to regulate tobacco. Liggett supported the FDA Rule and began to phase in compliance with certain of the proposed FDA regulations. Since the Supreme Court decision, various proposals and recommendations have been made for additional federal and state legislation to regulate cigarette manufacturers. Congressional advocates of FDA regulations have introduced legislation that would give the FDA authority to regulate the manufacture, sale, distribution and labeling of tobacco products to protect public health, thereby allowing the FDA to reinstate its prior regulations or adopt new or additional regulations. In October 2004, the Senate passed a bill, which did not become law, providing for FDA regulation of tobacco

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products. A substantially similar bill was reintroduced in Congress in March 2005. The ultimate outcome of these proposals cannot be predicted, but FDA regulation of tobacco products could have a material adverse effect on the Company.

In October 2004, federal legislation was enacted which will eliminate the federal tobacco quota and price support program. Pursuant to the legislation, manufacturers of tobacco products will be assessed \$10,140,000 over a ten year period to compensate tobacco growers and quota holders for the elimination of their quota rights. Cigarette manufacturers will initially be responsible for 96.3% of the assessment (subject to adjustment in the future), which will be allocated based on relative unit volume of domestic cigarette shipments. Management currently estimates that Liggett's assessment will be approximately \$23,000 for the first year of the program which began January 1, 2005. The cost of the legislation to the three largest cigarette manufacturers will likely be less than the cost to smaller manufacturers, including Liggett and Vector Tobacco, because one effect of the legislation is that the three largest manufacturers will no longer be obligated to make certain contractual payments, commonly known as Phase II payments, they agreed in 1999 to make to tobacco-producing states. The ultimate impact of this legislation cannot be determined, but there is a risk that smaller manufacturers, such as Liggett and Vector Tobacco, will be disproportionately affected by the legislation, which could have a material adverse effect on the Company.

In August 1996, Massachusetts enacted legislation requiring tobacco companies to publish information regarding the ingredients in cigarettes and other tobacco products sold in that state. In December 2002, the United States Court of Appeals for the First Circuit ruled that the ingredients disclosure provisions violated the constitutional prohibition against unlawful seizure of property by forcing firms to reveal trade secrets. The decision was not appealed by the state. Liggett began voluntarily complying with this legislation in December 1997 by providing ingredient information to the Massachusetts Department of Public Health and, notwithstanding the appellate court's ruling, has continued to provide ingredient disclosure. Liggett also provides ingredient information annually, as required by law, to the states of Texas and Minnesota. Several other states are considering ingredient disclosure legislation and the Senate bill providing for FDA regulation also calls for, among other things, ingredient disclosure.

Cigarettes are subject to substantial and increasing federal, state and local excise taxes. The federal excise tax on cigarettes is currently \$0.39 per pack. State and local sales and excise taxes vary considerably and, when combined with sales taxes, local taxes and the current federal excise tax, may currently exceed \$4.00 per pack. In 2004, 10 states enacted increases in excise taxes, and two states have enacted increases in excise taxes in 2005. Congress has considered significant increases in the federal excise tax or other payments from tobacco manufacturers, and various states and other jurisdictions have currently under consideration or pending legislation proposing further state excise tax increases. Management believes increases in excise and similar taxes have had an adverse impact on sales of cigarettes.

Various state governments have adopted or are considering adopting legislation establishing ignition propensity standards for cigarettes. Compliance with this legislation could be burdensome and costly. In June 2000, the New York State legislature passed legislation charging the state's Office of Fire Prevention and Control, referred to as the "OFPC," with developing standards for "fire-safe" or self-extinguishing cigarettes. All cigarettes manufactured for sale in New York state must be manufactured to certain self-extinguishment

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standards set out in the regulations. Liggett and Vector Tobacco have not historically provided products that would be compliant under these new OFPC regulations, and certain design and manufacturing changes have been necessary for cigarettes manufactured for sale in New York to comply with the standards. Inventories of cigarettes existing in the wholesale and retail trade as of June 28, 2004 that do not comply with the standards, may continue to be sold provided New York tax stamps have been affixed and such inventories have been purchased in comparable quantities to the same period in the previous year. Liggett and Vector Tobacco have complied with these New York regulatory requirements. Similar legislation is being considered by other state governments and at the federal level. Compliance with such legislation could harm the business of Liggett and Vector Tobacco, particularly if there are varying standards from state to state.

Federal or state regulators may object to Vector Tobacco's reduced carcinogen and low nicotine and nicotine-free cigarette products as unlawful or allege they bear deceptive or unsubstantiated product claims, and seek the removal of the products from the marketplace, or significant changes to advertising. Various concerns regarding Vector Tobacco's advertising practices have been expressed to Vector Tobacco by certain state attorneys general. Vector Tobacco has engaged in discussions in an effort to resolve these concerns and Vector Tobacco has recently agreed to suspend all print advertising for its *Quest* brand while discussions are pending. If Vector Tobacco is unable to advertise its *Quest* brand, it could have a material adverse effect on sales of *Quest*. Allegations by federal or state regulators, public health organizations and other tobacco manufacturers that Vector Tobacco's products are unlawful, or that its public statements or advertising contain misleading or unsubstantiated health claims or product comparisons, may result in litigation or governmental proceedings. Vector Tobacco's business may become subject to extensive domestic and international governmental regulation. Various proposals have been made for federal, state and international legislation to regulate cigarette manufacturers generally, and reduced constituent cigarettes specifically. It is possible that laws and regulations may be adopted covering issues like the manufacture, sale, distribution, advertising and labeling of tobacco products as well as any express or implied health claims associated with reduced carcinogen and low nicotine and nicotine-free cigarette products and the use of genetically modified tobacco. A system of regulation by agencies like the FDA, the Federal Trade Commission or the United States Department of Agriculture may be established. In addition, a group of public health organizations submitted a petition to the FDA, alleging that the marketing of the OMNI product is subject to regulation by the FDA under existing law. Vector Tobacco has filed a response in opposition to the petition. The FTC has also expressed interest in the regulation of tobacco products made by tobacco manufacturers, including Vector Tobacco, which bear reduced carcinogen claims. The ultimate outcome of any of the foregoing cannot be predicted, but any of the foregoing could have a material adverse impact on the Company.

In addition to the foregoing, there have been a number of other restrictive regulatory actions, adverse legislative and political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry. These developments may negatively affect the perception of potential triers of fact with respect to the tobacco industry, possibly to the detriment of certain pending litigation, and may prompt the commencement of additional similar litigation or legislation.

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**Other Matters:**

In March 1997, a stockholder derivative suit was filed in Delaware Chancery Court against New Valley, as a nominal defendant, its directors and Brooke Group Holding by a stockholder of New Valley. The suit alleges that New Valley's purchase of the BrookeMil Ltd. shares from Brooke (Overseas) Ltd., which was then an indirect subsidiary of Brooke Group Holding, in January 1997 constituted a self-dealing transaction which involved the payment of excessive consideration by New Valley. The plaintiff seeks a declaration that New Valley's directors breached their fiduciary duties and Brooke Group Holding aided and abetted such breaches and that damages be awarded to New Valley. In December 1999, another stockholder of New Valley commenced an action in Delaware Chancery Court substantially similar to the March 1997 action. This stockholder alleges, among other things, that the consideration paid by New Valley for the BrookeMil shares was excessive, unfair and wasteful, that the special committee of New Valley's board lacked independence, and that the appraisal and fairness opinion were flawed. By order of the court, both actions were consolidated. In January 2001, the court denied a motion to dismiss the consolidated action. In March 2005, New Valley, its directors and Brooke Group Holding settled the consolidated action. The defendants did not admit any wrongdoing as part of the settlement, which is subject to court approval. Under the agreement, the Company will pay New Valley \$7,000, and New Valley will pay legal fees and expenses of up to \$2,150. The Company recorded a charge to operating, selling, administrative and general expense in 2004 of \$4,177 (net of minority interests) related to the settlement. A hearing on the proposed settlement is scheduled for June 14, 2005.

In July 1999, a purported class action was commenced on behalf of New Valley's former Class B preferred shareholders against New Valley, Brooke Group Holding and certain directors and officers of New Valley in Delaware Chancery Court. The complaint alleges that the recapitalization, approved by a majority of each class of New Valley's stockholders in May 1999, was fundamentally unfair to the Class B preferred shareholders, the proxy statement relating to the recapitalization was materially deficient and the defendants breached their fiduciary duties to the Class B preferred shareholders in approving the transaction. The plaintiffs seek class certification of the action and an award of compensatory damages as well as all costs and fees. The Court dismissed six of plaintiff's nine claims alleging inadequate disclosure in the proxy statement. Brooke Group Holding and New Valley believe that the remaining allegations are without merit and filed a motion for summary judgment on the remaining three claims. Oral argument on the summary judgment motion was held in February 2005.

Although there can be no assurances, Brooke Group Holding and New Valley believe, after consultation with counsel, that the ultimate resolution of these matters will not have a material adverse effect on the Company's or New Valley's consolidated financial position, results of operations or cash flows.

In May 1999, in connection with the Philip Morris brand transaction, Eve Holdings Inc., a subsidiary of Liggett, guaranteed a \$134,900 bank loan to Trademarks LLC. The loan is secured by Trademarks' three premium cigarette brands and Trademarks' interest in the exclusive license of the three brands by Philip Morris. The license provides for a minimum annual royalty payment equal to the annual debt service on the loan plus \$1,000. The Company believes that the fair value of Eve's guarantee was negligible at March 31, 2005.

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In February 2004, Liggett Vector Brands and another cigarette manufacturer entered into a five year agreement with a subsidiary of the American Wholesale Marketers Association to support a program to permit tobacco distributors to secure, on reasonable terms, tax stamp bonds required by state and local governments for the distribution of cigarettes. Under the agreement, Liggett Vector Brands has agreed to pay a portion of losses, if any, incurred by the surety under the bond program, with a maximum loss exposure of \$500 for Liggett Vector Brands. To secure its potential obligations under the agreement, Liggett Vector Brands has delivered to the subsidiary of the Association a \$100 letter of credit and a demand note for \$400. Liggett Vector Brands has incurred no losses to date under this agreement, and the Company believes the fair value of Liggett Vector Brands' obligation under the agreement was immaterial at March 31, 2005.

As of March 31, 2005, New Valley had \$300 of remaining prepetition bankruptcy-related claims. The remaining claims may be subject to future adjustments based on potential settlements or decisions of the court.

**8. EQUITY**

The Company accounts for employee stock compensation plans under APB Opinion No. 25, "Accounting for Stock Issued to Employees", with the intrinsic value-based method permitted by SFAS No. 123, "Accounting for Stock-Based Compensation" as amended by SFAS No. 148. Accordingly, no compensation expense is recognized when the exercise price is equal to the market price of the underlying common stock on the date of grant.

Awards under the Company's stock compensation plans generally vest over periods ranging from four to five years from the date of grant. The expense related to stock option compensation included in the determination of net income for the three months ended March 31, 2005 and March 31, 2004 is less than that which would have been recognized if the fair value method had been applied to all awards since the original effective date of SFAS No. 123. The following table illustrates the effect on net income and income per share if the Company had applied the fair value provisions of SFAS No. 123:

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	Three Months Ended	
	March 31, 2005	March 31, 2004
Net income	\$ 11,310	\$ 4,627
Add: stock option employee compensation expense included in reported net income, net of related tax effects	229	32
Deduct: total stock option employee compensation expense determined under the fair value method for all awards, net of related tax effects	(310)	(548)
Pro forma net income	<u>\$ 11,229</u>	<u>\$ 4,111</u>
Income per share:		
Basic — as reported	<u>\$ 0.27</u>	<u>\$ 0.11</u>
Diluted — as reported	<u>\$ 0.26</u>	<u>\$ 0.11</u>
Basic — pro forma	<u>\$ 0.27</u>	<u>\$ 0.11</u>
Diluted — pro forma	<u>\$ 0.26</u>	<u>\$ 0.09</u>

For purposes of this pro forma presentation, the fair value of each option grant was estimated at the date of the grant using the Black-Scholes option pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including expected stock price characteristics which are significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, the existing models do not necessarily provide a reliable single measure of the fair value of stock-based compensation awards.

**9. INCOME TAXES**

Vector's income tax rate for the three months ended March 31, 2005 does not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes, the receipt of the LTS distribution, the intraperiod allocation at New Valley between income from continuing and discontinued operations and the utilization of deferred tax assets at New Valley. Vector's tax rate for the three months ended March 31, 2004 does not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and the intraperiod allocation at New Valley between income from continuing and discontinued operations. Vector currently anticipates that its income tax rate for the year ended December 31, 2005 will be lower than the rate applicable to the first quarter.

The consolidated balance sheets of the Company include deferred income tax assets and liabilities, which represent temporary differences in the application of accounting rules established by generally accepted accounting principles and income tax laws. As of March 31, 2005, the Company's deferred income tax liabilities exceeded its deferred income tax assets by \$123,867. The largest component of the Company's deferred tax liabilities exists because of differences that resulted from a 1998 and 1999 transaction with Philip Morris Incorporated in which a subsidiary of Liggett contributed three of its premium cigarette brands to Trademarks LLC, a newly-formed limited liability company. In such transaction, Philip Morris acquired an option to purchase the remaining interest in Trademarks for a 90-day period commencing in December 2008, and the Company has an option to require Philip Morris to purchase the

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remaining interest for a 90-day period commencing in March 2010. For additional information concerning the Philip Morris brand transaction, see Note 18 to the consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004.

In connection with the transaction, the Company recognized in 1999 a pre-tax gain of \$294,078 in its consolidated financial statements and established a deferred tax liability of \$103,100 relating to the gain. Upon exercise of the options during the 90-day periods commencing in December 2008 or in March 2010, the Company will be required to pay tax in the amount of the deferred tax liability, which will be offset by the benefit of any deferred tax assets, including any net operating losses, available to the Company at that time. In connection with an examination of the Company's 1998 and 1999 federal income tax returns, the Internal Revenue Service issued to the Company in September 2003 a notice of proposed adjustment. The notice asserts that, for tax reporting purposes, the entire gain should have been recognized in 1998 and in 1999 in the additional amounts of \$150,000 and \$129,900, respectively, rather than upon the exercise of the options during the 90-day periods commencing in December 2008 or in March 2010. If the Internal Revenue Service were to ultimately prevail with the proposed adjustment, it would result in the potential acceleration of tax payments of approximately \$123,000, including interest, net of tax benefits, through March 31, 2005. These amounts have been previously recognized in the Company's consolidated financial statements as tax liabilities. As of March 31, 2005, the Company believes amounts potentially due have been fully provided for in its consolidated statements of operations.

The Company believes the positions reflected on its income tax returns are correct and intends to vigorously oppose any proposed adjustments to its returns. The Company has filed a protest with the Appeals Division of the Internal Revenue Service. No payment is due with respect to these matters during the appeal process. Interest currently is accruing on the disputed amounts at a rate of 8%, with the rate adjusted quarterly based on rates published by the U.S. Treasury Department. If taxing authorities were to ultimately prevail in their assertion that the Company incurred a tax obligation prior to the exercise dates of these options and it was required to make such tax payments prior to 2009 or 2010, and if any necessary financing were not available to the Company, its liquidity could be materially adversely affected.

**10. NEW VALLEY CORPORATION**

*Real Estate Activities.* In December 2002, New Valley purchased two office buildings in Princeton, New Jersey for a total purchase price of \$54,000. New Valley financed a portion of the purchase price through a borrowing of \$40,500 from HSBC Realty Credit Corporation (USA). In February 2005, New Valley completed the sale of the office buildings for \$71,500. The mortgage loan on the properties was retired at closing with the proceeds of the sale. (Refer to Notes 5 and 11.)

New Valley accounts for its 50% interest in Douglas Elliman Realty LLC and in Koa Investors LLC on the equity method. Douglas Elliman Realty operates a residential real estate brokerage

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company in the New York metropolitan area. Koa Investors owns the Sheraton Keauhou Bay Resort & Spa in Kailua-Kona, Hawaii. Following a major renovation, the property reopened in the fourth quarter 2004 as a four star resort with 521 rooms.

New Valley recorded income of \$1,334 and \$709 for the three months ended March 31, 2005 and 2004, respectively, associated with Douglas Elliman Realty. Summarized financial information for the three months ended March 31, 2005 and 2004 and as of December 31, 2004 for Douglas Elliman Realty is presented below.

	<u>March 31, 2005</u>	<u>December 31, 2004</u>
Cash	\$ 20,446	\$ 21,375
Other current assets	4,828	4,726
Property, plant and equipment, net	15,694	15,520
Trademarks	21,663	21,663
Goodwill	36,687	36,676
Other intangible assets, net	2,578	2,748
Other noncurrent assets	1,029	1,112
Notes payable — current	4,820	4,998
Other current liabilities	18,274	18,264
Notes payable — long term	64,138	66,710
Other long-term liabilities	3,083	3,125
Members' equity	12,610	10,723
	<u>Three Months Ended March 31,</u>	<u>Three Months Ended March 31,</u>
	<u>2005</u>	<u>2004</u>
Revenues	\$ 71,402	\$ 53,520
Costs and expenses	66,325	49,772
Depreciation expense	1,126	1,096
Amortization expense	184	299
Interest expense, net	1,548	1,443
Income tax expense	181	—
Net income	<u>\$ 2,038</u>	<u>\$ 910</u>

New Valley recorded a loss of \$1,640 and \$63 for the three months ended March 31, 2005 and 2004, respectively, associated with Koa Investors. Summarized financial information for the three months ended March 31, 2005 and 2004 and as of December 31, 2004 for Koa Investors is presented below.

	<u>March 31, 2005</u>	<u>December 31, 2004</u>
Cash	\$ 381	\$ 2,062
Restricted assets	3,254	5,538
Other current assets	2,555	988
Property, plant and equipment, net	74,742	77,339
Deferred financing costs, net	1,531	1,724
Accounts payable and other current liabilities	9,146	11,064
Notes payable	60,366	60,356
Members' equity	12,951	16,231



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**(Dollars in Thousands, Except Per Share Amounts) — (Continued)**  
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	Three Months Ended March 31,	
	2005	2004
Revenues	\$ 5,530	\$ —
Costs and operating expenses	5,754	—
Management fees	30	125
Depreciation expense	1,319	—
Amortization expense	208	—
Interest expense, net	1,499	—
Net loss	\$ (3,280)	\$ (125)

Koa Investors capitalized all costs related to the acquisition and development of the property during the construction phase, which ceased in connection with the opening of the hotel in the fourth quarter of 2004. Koa Investors anticipates that the hotel will experience operating losses during its opening phase.

*LTS.* In November 2004, New Valley and the other holder of the convertible notes of Ladenburg Thalmann Financial Services Inc. (“LTS”) entered into a debt conversion agreement with LTS. New Valley and the other holder agreed to convert their notes, with an aggregate principal amount of \$18,010, together with the accrued interest, into common stock of LTS. Pursuant to the debt conversion agreement, the conversion price of the note held by New Valley was reduced from the previous conversion price of approximately \$2.08 to \$0.50 per share and New Valley and the other holder each agreed to purchase \$5,000 of LTS common stock at \$0.45 per share.

The note conversion transaction was approved by the LTS shareholders in January 2005 and closed in March 2005. At the closing, New Valley’s note, representing approximately \$9,938 of principal and accrued interest, was converted into 19,876,358 shares of LTS common stock and New Valley purchased 11,111,111 LTS shares.

LTS borrowed \$1,750 from New Valley in 2004 and an additional \$1,750 in the first quarter 2005. At the closing of the debt conversion agreement, New Valley delivered these notes for cancellation as partial payment for its purchase of LTS common stock.

On March 30, 2005, New Valley distributed the 19,876,358 shares of LTS common stock it acquired from the conversion of the note to holders of New Valley common shares through a special distribution. On the same date, the Company distributed the 10,947,448 shares of LTS common stock that it received from New Valley to the holders of its common stock as a special distribution. New Valley stockholders of record on March 18, 2005 received 0.852 of a LTS share for each share of New Valley, and the Company’s stockholders of record on that date received 0.24 of a LTS share for each share of the Company.

Following the distribution, New Valley continues to hold the 11,111,111 shares of LTS common stock (approximately 9% of the outstanding shares), the \$5,000 of LTS’s notes due December 31, 2006 and a warrant to purchase 100,000 shares of its common stock at \$1.00 per share.

*Share Repurchase.* In October 1999, New Valley’s Board of Directors authorized the repurchase of up to 2,000,000 common shares from time to time on the open market or in privately negotiated transactions depending on market conditions. As of March 31, 2005, New Valley had repurchased 1,229,515 shares for approximately \$4,895.

*Restricted Share Award.* On January 10, 2005, New Valley’s President and Chief Operating Officer, who also serves in the same positions with the Company, was awarded a restricted stock grant of 1,250,000 Common Shares pursuant to New Valley’s 2000 Long-Term Incentive Plan.

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Under the terms of the award, one-seventh of the shares vest on July 15, 2005, with an additional one-seventh vesting on each of the five succeeding one-year anniversaries of the first vesting date through July 15, 2010 and an additional one-seventh vesting on January 15, 2011. In the event the President and Chief Operating Officer's employment with New Valley is terminated for any reason other than his death, his disability or a change of control of New Valley or Vector, any remaining balance of the shares not previously vested will be forfeited by him. Vector recorded deferred compensation of \$8,875 (\$3,152 net of income taxes and minority interests), representing the fair market value of the restricted shares on the date of the grant. The deferred compensation will be amortized over the vesting period as a charge to compensation expense. Vector recorded an expense of \$545 (\$194 net of income taxes and minority interests) associated with the grant in the first quarter of 2005. In addition, Vector recorded a decrease to its stockholders' equity of \$2,569, net of income taxes, associated with its decrease in ownership percentage of New Valley.

**11. DISCONTINUED OPERATIONS**

As discussed in Note 10, in February 2005, New Valley completed the sale for \$71,500 of its two office buildings in Princeton, N.J. As a result of the sale, the consolidated financial statements of the Company reflect New Valley's real estate leasing operations as discontinued operations for the three months ended March 31, 2005 and 2004. Accordingly, revenues, costs and expenses, and cash flows of the discontinued operations have been excluded from the respective captions in the consolidated statements of operations and consolidated statements of cash flows. The net operating results of the discontinued operations have been reported, net of applicable income taxes and minority interests, as "Income from discontinued operations", and the net cash flows of these entities have been reported as "Net cash provided by discontinued operations." The assets of the discontinued operations were recorded as "Assets held for sale" in the consolidated balance sheet at December 31, 2004.

Summarized operating results of the discontinued real estate leasing operations for the three months ended March 31, 2005 and 2004 are as follows:

	Three Months Ended March 31,	
	2005	2004
Revenues	\$ 924	\$ 1,781
Expenses	515	1,179
Income from discontinued operations before income taxes and minority interests	409	602
Income tax expense from discontinued operations	223	318
Minority interests	104	150
Income from discontinued operations	<u>\$ 82</u>	<u>\$ 134</u>

The Company recorded a gain in connection with the sale of the office buildings of \$2,952, net of minority interests and income taxes.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
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**(Unaudited)**

**12. SEGMENT INFORMATION**

The Company's significant business segments for each of the three months ended March 31, 2005 and 2004 were Liggett and Vector Tobacco. The Liggett segment consists of the manufacture and sale of conventional cigarettes and, for segment reporting purposes, includes the operations of Medallion acquired on April 1, 2002 (which operations are held for legal purposes as part of Vector Tobacco). The Vector Tobacco segment includes the development and marketing of the low nicotine and nicotine-free cigarette products as well as the development of reduced risk cigarette products and, for segment reporting purposes, excludes the operations of Medallion. The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

Financial information for the Company's continuing operations before taxes and minority interests for the three months ended March 31, 2005 and 2004 follows:

	<u>Liggett</u>	<u>Vector Tobacco</u>	<u>Real Estate</u>	<u>Corporate and Other</u>	<u>Total</u>
<b>Three months ended March 31, 2005</b>					
Revenues	\$ 101,635	\$ 2,538	\$ —	\$ —	\$ 104,173
Operating income (loss)	31,870	(4,432)	—	(8,790)	18,648
Identifiable assets	260,762	7,972	—	236,164	504,898
Depreciation and amortization	1,817	228	—	621	2,666
Capital expenditures	698	12	—	258	968
<b>Three months ended March 31, 2004</b>					
Revenues	\$ 122,221	\$ 4,352	\$ —	\$ —	\$ 126,573
Operating income (loss)	27,783 <sup>(1)</sup>	(8,706) <sup>(1)</sup>	—	(6,236)	12,841 <sup>(1)</sup>
Identifiable assets	310,471	64,821	76,382	155,035	606,709
Depreciation and amortization	1,997	592	—	615	3,204
Capital expenditures	495	35	—	51	581

(1) Includes restructuring and impairment charges in 2004 of \$389 at Liggett and \$264 at Vector Tobacco.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(Dollars in Thousands, Except Per Share Amounts)

### Overview

We are a holding company for a number of businesses. We are engaged principally in:

- the manufacture and sale of cigarettes in the United States through our subsidiary Liggett Group Inc., and
- the development and marketing of the low nicotine and nicotine-free QUEST cigarette products and the development of reduced risk cigarette products through our subsidiary Vector Tobacco Inc.

In recent years, we have undertaken a number of initiatives to streamline the cost structure of our tobacco business and improve operating efficiency and long-term earnings. During 2002, the sales and marketing functions, along with certain support functions, of our Liggett and Vector Tobacco subsidiaries were combined into a new entity, Liggett Vector Brands Inc. This company coordinates and executes the sales and marketing efforts for our tobacco operations.

Effective year-end 2003, we closed Vector Tobacco's Timberlake, North Carolina cigarette manufacturing facility in order to reduce excess cigarette production capacity and improve operating efficiencies company-wide. Production of QUEST and Vector Tobacco's other cigarette brands was transferred to Liggett's state-of-the-art manufacturing facility in Mebane, North Carolina. In July 2004, we completed the sale of the Timberlake facility and equipment.

In April 2004, we eliminated a number of positions in our tobacco operations and subleased excess office space. In October 2004, we announced a plan to restructure the operations of Liggett Vector Brands. Liggett Vector Brands has realigned its sales force and adjusted its business model to more efficiently serve its chain and independent accounts nationwide. In connection with the restructuring, we eliminated approximately 330 full-time positions and 135 part-time positions as of December 15, 2004.

We may consider various additional opportunities to further improve efficiencies and reduce costs. These prior and current initiatives have involved material restructuring and impairment charges, and any further actions taken are likely to involve material charges as well. Although management may estimate that substantial cost savings will be associated with these restructuring actions, there is a risk that these actions could have a serious negative impact on our tobacco operations and that any estimated increases in profitability cannot be achieved.

Our majority-owned subsidiary, New Valley Corporation, is currently engaged in the real estate business and is seeking to acquire additional operating companies and real estate properties. In December 2002, New Valley increased its ownership to 50% in Douglas Elliman Realty, LLC, which operates the largest residential brokerage company in the New York metropolitan area. In February 2005, New Valley completed the sale for \$71,500 of its two office buildings in Princeton, New Jersey.

All of Liggett's unit volume in 2004 and the first quarter of 2005 was in the discount segment, which Liggett's management believes has been the primary growth segment in the industry for over a decade. The significant discounting of premium cigarettes in recent years has led to brands, such as EVE, that were traditionally considered premium brands to become more appropriately categorized as discount, following list price reductions. Effective February 1, 2004, Liggett reduced the list prices for EVE and JADE from the premium price level to the deep discount level for JADE and the branded discount level for EVE.

Liggett's cigarettes are produced in approximately 220 combinations of length, style and packaging. Liggett's current brand portfolio includes:

- LIGGETT SELECT – the second largest brand in the deep discount category,
- EVE – a leading brand of 120 millimeter cigarettes in the branded discount category,
- JADE – a free-standing deep discount menthol brand,
- PYRAMID – the industry's first deep discount product with a brand identity, and
- USA and various control and private label brands.

In 1999, Liggett introduced LIGGETT SELECT, one of the fastest growing brands in the deep discount category. LIGGETT SELECT is now the largest seller in Liggett's family of brands, comprising 46.6% of Liggett's unit volume in the first three months of 2005 and 55.8% of Liggett's unit volume in 2004.

We believe that Liggett has gained a sustainable cost advantage over its competitors through its various settlement agreements. Under the Master Settlement Agreement reached in November 1998 with 46 state attorneys general and various territories, the three largest cigarette manufacturers must make settlement payments to the states and territories based on how many cigarettes they sell annually. Liggett, however, is not required to make any payments unless its market share exceeds approximately 1.65% of the U.S. cigarette market. Additionally, as a result of the Medallion acquisition, Vector Tobacco likewise has no payment obligation unless its market share exceeds approximately 0.28% of the U.S. market.

In recent years, the domestic tobacco business has experienced the following trends:

- Declining unit volumes due to health considerations, diminishing social acceptance of smoking, legislative limitations on smoking in public places, federal and state excise tax increases and settlement-related expenses which have augmented cigarette prices,
- Narrower price spreads between the premium and all discount segments resulting from aggressive premium price promotions by larger competitors including Philip Morris and Reynolds American, while price spreads between the traditional discount and the deep discount markets have been maintained due to the continued influx of smaller companies producing or importing low quality, deep discount cigarettes, and
- Loss of market share for discount cigarettes such as those sold by Liggett due to a continued increase in market share by the smaller cigarette companies producing low quality, deep discount cigarettes.

In January 2003, Vector Tobacco introduced QUEST, its brand of low nicotine and nicotine-free cigarette products. QUEST is designed for adult smokers who are interested in reducing their levels of nicotine intake and is available in both menthol and non-menthol styles. Each QUEST style (regular and menthol) offers three different packagings, with decreasing amounts of nicotine - QUEST 1, 2 and 3. QUEST 1, the low nicotine variety, contains 0.6 milligrams of nicotine. QUEST 2, the extra-low nicotine variety, contains 0.3 milligrams of nicotine. QUEST 3, the nicotine-free variety, contains only trace levels of nicotine — no more than 0.05 milligrams of nicotine per cigarette. QUEST cigarettes utilize a proprietary process that enables the production of nicotine-free tobacco that tastes and smokes like tobacco in conventional cigarettes. All six QUEST varieties are being sold in box style packs and are priced comparably to other premium brands.

QUEST was initially available in New York, New Jersey, Pennsylvania, Ohio, Indiana, Illinois and Michigan. These seven states account for approximately 30% of all cigarette sales in the United States. A multi-million dollar advertising and marketing campaign, with advertisements running in magazines and regional newspapers, supported the product launch. The brand continues to be supported by point-of-purchase awareness campaigns and other store-related promotions.

The premium segment of the industry is currently experiencing intense competitive activity, with increased discounting of premium brands at all levels of retail. Given these marketplace conditions, and the results that we have seen to date with QUEST, we have taken a measured approach to expanding the market presence of the brand. In November 2003, Vector Tobacco introduced three menthol varieties of QUEST in the seven state market. In January 2004, QUEST and QUEST Menthol were introduced into an expansion market in Arizona, which accounts for approximately 2% of the industry volume nationwide.

During the second quarter 2004, based on an analysis of the market data obtained since the introduction of the QUEST product, we determined to postpone indefinitely the national launch of QUEST. Vector Tobacco continues to explore potential opportunities to expand the market for the brand on a more limited basis. Any determination as to future expansion of the market presence of QUEST will be based on the ongoing and projected demand for the product, market conditions in the premium segment and the prevailing regulatory environment, including any restrictions on the advertising of the product.

During the second quarter 2004, we recognized a non-cash charge of \$37,000 to adjust the carrying value of excess leaf tobacco inventory for the QUEST product, based on estimates of future demand and market conditions. If actual demand for the product or market conditions are less favorable than those estimated, additional inventory write-downs may be required.

QUEST brand cigarettes are currently marketed solely to permit adult smokers, who wish to continue smoking, to gradually reduce their intake of nicotine. The products are not labeled or advertised for smoking cessation or as a safer form of smoking.

In October 2003, we announced that Jed E. Rose, Ph.D., Director of Duke University Medical Center's Nicotine Research Program and co-inventor of the nicotine patch, had conducted a study at Duke University Medical Center to provide preliminary evaluation of the use of the QUEST technology as a smoking cessation aid. In the preliminary study on QUEST, 33% of QUEST 3 smokers were able to achieve four-week continuous abstinence, a standard threshold for smoking cessation. Management believes these results show real promise for the QUEST technology as a smoking cessation aid. We have received guidance from the Food and Drug Administration as to the additional clinical research and regulatory filings necessary to market QUEST as a smoking cessation product. Management believes that obtaining the Food and Drug Administration's approval to market QUEST as a smoking cessation product will be an important factor in the long-term commercial success of the QUEST brand. No assurance can be given that such approval can be obtained or as to the timing of any such approval if received.

#### **Recent Developments**

*Lawsuit Settlement.* In March 2005, we, along with New Valley and its directors, settled a stockholder derivative suit that alleges, among other things, that New Valley paid excessive consideration to purchase our BrookeMil Ltd. subsidiary in 1997. For additional information concerning the suit, see Note 7 to our consolidated financial statements. The defendants did not admit any wrongdoing as part of the settlement, which is subject to court approval. Under the agreement, we will pay New Valley \$7,000, and New Valley will pay legal fees and expenses of

up to \$2,150. We recorded a charge to operating, selling, administrative and general expense in 2004 of \$4,177 (net of minority interests) related to the settlement. A hearing on the settlement is scheduled for June 14, 2005.

*Issuance of Convertible Notes.* In November 2004, we sold \$65,500 of our 5% variable interest senior convertible notes due November 15, 2011 in a private offering to qualified institutional investors in accordance with Rule 144A under the Securities Act of 1933. The buyers of the notes had the right, for a 120-day period ending March 18, 2005, to purchase an additional \$16,375 of the notes. At December 31, 2004, buyers had exercised their rights to purchase an additional \$1,405 of the notes, and the remaining \$14,959 principal amount of notes were purchased during the first quarter of 2005. In April 2005, we issued an additional \$30,000 principal amount of 5% variable interest senior convertible notes due November 15, 2011 in a separate private offering to qualified institutional investors in accordance with Rule 144A. These notes, which were issued under a new indenture at a price of 103.5%, were on the same terms as the \$81,864 principal amount of notes previously issued in connection with the November 2004 placement.

*Ladenburg Distribution.* In March 2005, New Valley converted a convertible note of Ladenburg Thalmann Financial Services Inc. into 19,876,358 shares of Ladenburg common stock and purchased 11,111,111 Ladenburg shares for \$5,000. On March 30, 2005, New Valley distributed the 19,876,358 shares of Ladenburg common stock it acquired from the conversion of the note to holders of New Valley common shares through a special distribution. On the same date, we distributed the 10,947,448 shares of Ladenburg common stock that we received from New Valley to the holders of our common stock as a special distribution. New Valley stockholders of record on March 18, 2005 received 0.852 of a Ladenburg share for each share of New Valley, and our stockholders of record on that date received 0.24 of a Ladenburg share for each share of ours.

*Tobacco Quota Elimination.* In October 2004, federal legislation was enacted which will eliminate the federal tobacco quota and price support program. Pursuant to the legislation, manufacturers of tobacco products will be assessed \$10,140,000 over a ten year period to compensate tobacco growers and quota holders for the elimination of their quota rights. Cigarette manufacturers will initially be responsible for 96.3% of the assessment (subject to adjustment in the future), which will be allocated based on relative unit volume of domestic cigarette shipments. Management currently estimates that Liggett's assessment will be approximately \$23,000 for the first year of the program which began January 1, 2005. The cost of the legislation to the three largest cigarette manufacturers will likely be less than the cost to smaller manufacturers, including Liggett and Vector Tobacco, because one effect of the legislation is that the three largest manufacturers will no longer be obligated to make certain contractual payments, commonly known as Phase II payments, they agreed in 1999 to make to tobacco-producing states. The ultimate impact of this legislation cannot be determined, but there is a risk that smaller manufacturers, such as Liggett and Vector Tobacco, will be disproportionately affected by the legislation, which could have a material adverse effect on us.

Effective October 22, 2004, Liggett increased the list price of all its brands by \$.65 per carton. The increase was taken due to the recently passed federal tobacco buyout legislation.

*Liggett Vector Brands Restructurings.* Liggett Vector Brands, as part of the continuing effort to adjust the cost structure of our tobacco business and improve operating efficiency, eliminated 83 positions during April 2004, sublet its New York office space and relocated several employees. As a result of these actions, we recognized pre-tax restructuring charges of \$2,735 in 2004, including \$798 relating to employee severance and benefit costs and \$1,937 for contract termination and other associated costs. Approximately \$503 of these charges represent non-cash items.

On October 6, 2004, we announced an additional plan to restructure the operations of Liggett Vector Brands, our sales, marketing and distribution agent for our Liggett and Vector Tobacco subsidiaries. Liggett Vector Brands has realigned its sales force and adjusted its business model to more efficiently serve its chain and independent accounts nationwide. In connection with the restructuring, we eliminated approximately 330 full-time positions and 135 part-time positions as of December 15, 2004.

As a result of the actions announced in October 2004, we currently expect to realize annual cost savings of approximately \$30,000 beginning in 2005. We recognized pre-tax restructuring charges of \$10,583 in 2004, with \$5,659 of the charges related to employee severance and benefit costs and \$4,924 to contract termination and other associated costs. Approximately \$2,503 of these charges represented non-cash items. Additionally, we incurred other charges in 2004 for various compensation and related payments to employees which were related to the restructuring. These charges of \$1,670 were included in operating, selling, administrative and general expenses.

*Timberlake Restructuring.* In October 2003, we announced that we would close Vector Tobacco's Timberlake, North Carolina cigarette manufacturing facility in order to reduce excess cigarette production capacity and improve operating efficiencies company-wide. Production of the QUEST line of low nicotine and nicotine-free cigarettes, as well as production of Vector Tobacco's other cigarette brands, was moved to Liggett's state-of-the-art manufacturing facility in Mebane, North Carolina.

Annual cost savings related to the Timberlake restructuring and impairment charges and the actions taken at Liggett Vector Brands in the first half of 2004 were estimated to be at least \$23,000 beginning in 2004. Management believes the anticipated annual cost savings have been achieved beginning in 2004. Management will continue to review opportunities for additional cost savings in our tobacco business.

*Tax Matters.* In connection with the 1998 and 1999 transaction with Philip Morris Incorporated in which a subsidiary of Liggett contributed three of its premium cigarette brands to Trademarks LLC, a newly-formed limited liability company, we recognized in 1999 a pre-tax gain of \$294,078 in our consolidated financial statements and established a deferred tax liability of \$103,100 relating to the gain. In such transaction, Philip Morris acquired an option to purchase the remaining interest in Trademarks for a 90-day period commencing in December 2008, and we have an option to require Philip Morris to purchase the remaining interest for a 90-day period commencing in March 2010. Upon exercise of the options during the 90-day periods commencing in December 2008 or in March 2010, we will be required to pay tax in the amount of the deferred tax liability, which will be offset by the benefit of any deferred tax assets, including any net operating losses, available to us at that time. In connection with an examination of our 1998 and 1999 federal income tax returns, the Internal Revenue Service issued to us in September 2003 a notice of proposed adjustment. The notice asserts that, for tax reporting purposes, the entire gain should have been recognized in 1998 and in 1999 in the additional amounts of \$150,000 and \$129,900, respectively, rather than upon the exercise of the options during the 90-day periods commencing in December 2008 or in March 2010. If the Internal Revenue Service were to ultimately prevail with the proposed adjustment, it would result in the potential acceleration of tax payments of approximately \$123,000, including interest, net of tax benefits, through March 31, 2005. These amounts have been previously recognized in our consolidated financial statements as tax liabilities. As of March 31, 2005, we believe amounts potentially due have been fully provided for in our consolidated statements of operations.

We believe the positions reflected on our income tax returns are correct and intend to vigorously oppose any proposed adjustments to our returns. We have filed a protest with the Appeals Division of the Internal Revenue Service. No payment is due with respect to these matters during the appeals process. Interest currently is accruing on the disputed amounts at a rate of 8%, with the rate adjusted quarterly based on rates published by the U.S. Treasury



Department. If taxing authorities were to ultimately prevail in their assertion that we incurred a tax obligation prior to the exercise dates of these options and we were required to make such tax payments prior to 2009 or 2010, and if any necessary financing were not available to us, our liquidity could be materially adversely affected.

*Tobacco Settlement Agreements.* Liggett has recently been notified that all Participating Manufacturers' payment obligations under the Master Settlement Agreement, dating from the agreement's execution in late 1998, have been recalculated utilizing net unit amounts, rather than gross unit amounts (which have been utilized since 1999). The change in the method of calculation could, among other things, require additional payments by Liggett under the Master Settlement Agreement of approximately \$2,000 per year for the period 2001 through 2004, or a total of approximately \$8,000, and require Liggett to pay an additional amount of approximately \$2,000 per year in 2005 and in future periods by lowering Liggett's market share exemption under the Master Settlement Agreement. Liggett contends that the retroactive change from utilizing gross unit amounts to net unit amounts is impermissible and has objected to the change. Liggett intends to challenge it by way of arbitration or court proceeding if it is ultimately implemented.

On March 30, 2005, the Independent Auditor under the Master Settlement Agreement calculated \$28,668 in Master Settlement Agreement payments for Liggett's 2004 sales. On April 15, 2005, Liggett paid \$11,678 of this amount and, in accordance with its rights under the Master Settlement Agreement, disputed the balance of \$16,990. Of the disputed amount, Liggett paid \$9,304 into the disputed payments account under the Master Settlement Agreement and withheld from payment \$7,686.

By letter dated April 28, 2005, the settling states under the Master Settlement Agreement provided Liggett with a 30-day notice under the Master Settlement Agreement which stated, among other things, that one or more of the settling states may initiate proceedings against Liggett under Sections IX (i) and XI (d) of the Master Settlement Agreement and the June 2003 settlement agreement between Liggett and the settling states. The settling states contend that Liggett had no right under the Master Settlement Agreement or the June 2003 settlement agreement to pay into the disputed payments account any amount claimed as an adjustment for market share loss for non-participating manufacturers for 2003, although they acknowledge that Liggett has the right to dispute such amounts. The settling states sent similar letters to several other Subsequent Participating Manufacturers that paid into the disputed payments account.

In 2004, the Attorneys General for each of Florida, Mississippi and Texas advised Liggett that they believed that Liggett has failed to make all required payments under the settlement agreements with these three states for the period 1998 through 2003 and that additional payments may be due for 2004 and subsequent years. Liggett believes these allegations are without merit, based, among other things, on the language of the most-favored nations provisions of the settlement agreements. In December 2004, the State of Florida offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of \$13,500. In November 2004, the State of Mississippi offered to settle all amounts allegedly owed by Liggett for the period through 2003 for the sum of \$6,500. In March 2005, the State of Florida reaffirmed its December 2004 offer to settle and provided Liggett with a 60 day notice to cure the alleged defaults. In April 2005, the State of Mississippi reaffirmed its November 2004 offer to settle and provided Liggett with a 60 day notice to cure the alleged defaults.

No amounts have been accrued in the accompanying financial statements for any additional amounts that may be payable by Liggett under the Master Settlement Agreement, due to the recalculation of the Participating Manufacturers' payment obligations, or under the settlement agreements with these three states. There can be no assurance that Liggett will prevail and that Liggett will not be required to make additional material payments under the Master Settlement

Agreement and the settlement agreements with these three states, which payments could adversely affect our consolidated financial position, results of operations or cash flows.

*Real Estate Activities.* In December 2002, New Valley purchased two office buildings in Princeton, New Jersey for a total purchase price of \$54,000. New Valley financed a portion of the purchase price through a borrowing of \$40,500 from HSBC Realty Credit Corporation (USA). In February 2005, New Valley completed the sale of the office buildings for \$71,500. The mortgage loan on the properties was retired at closing with the proceeds of the sale.

New Valley accounts for its 50% interests in Douglas Elliman Realty LLC and Koa Investors LLC on the equity method. Douglas Elliman Realty operates the largest residential brokerage company in the New York metropolitan area. Koa Investors LLC owns the Sheraton Keauhou Bay Resort & Spa in Kailua-Kona, Hawaii. Following a major renovation, the property reopened in the fourth quarter 2004 as a four star resort with 521 rooms.

#### **Recent Developments in Legislation, Regulation and Litigation**

The cigarette industry continues to be challenged on numerous fronts. New cases continue to be commenced against Liggett and other cigarette manufacturers. As of March 31, 2005, there were approximately 340 individual suits, 16 purported class actions and 16 governmental and other third-party payor health care reimbursement actions pending in the United States in which Liggett was a named defendant. A civil lawsuit has been filed by the United States federal government seeking disgorgement of approximately \$289,000,000 from various cigarette manufacturers, including Liggett. A federal appellate court ruled in February 2005 that disgorgement is not an available remedy in the case. In April 2005, the appellate court denied the government's request that the disgorgement ruling be reconsidered by the full court. The government may appeal to the United States Supreme Court. Trial of the case began on September 21, 2004 and is proceeding. In one of these cases, in 2000, an action against cigarette manufacturers involving approximately 1,000 named individual plaintiffs was consolidated before a single West Virginia state court. Liggett is a defendant in most of the cases pending in West Virginia. In January 2002, the court severed Liggett from the trial of the consolidated action. Two purported class actions have been certified in state court in Kansas and New Mexico against the cigarette manufacturers for alleged antitrust violations. As new cases are commenced, the costs associated with defending these cases and the risks relating to the inherent unpredictability of litigation continue to increase.

There are six individual smoking-related actions where Liggett is the only defendant, with trial in one of these cases currently scheduled for May 2005 and trial in another scheduled for October 2005. In April 2004, in one of these cases, a Florida state court jury awarded compensatory damages of \$540 against Liggett. In addition, plaintiff's counsel was awarded legal fees of \$752. Liggett has appealed the verdict. In February 2005, in another of these cases, a Florida state court jury returned a verdict in favor of Liggett. The plaintiff's post-trial motion seeking a new trial is pending. In March 2005, in another case in Florida state court where Liggett is the only defendant, the court granted Liggett's motion for summary judgment disposing of the case in its entirety. The plaintiff has appealed.

In May 2003, a Florida intermediate appellate court overturned a \$790,000 punitive damages award against Liggett and decertified the *Engle* smoking and health class action. In May 2004, the Florida Supreme Court agreed to review the case. Oral argument was held in November 2004. If the intermediate appellate court's ruling is not upheld on further appeal, it will have a material adverse effect on us. In November 2000, Liggett filed the \$3,450 bond required under the bonding statute enacted in 2000 by the Florida legislature which limits the size of any bond required, pending appeal, to stay execution of a punitive damages verdict. In May 2001, Liggett reached an agreement with the class in the *Engle* case, which provided assurance to Liggett that

the stay of execution, in effect under the Florida bonding statute, would not be lifted or limited at any point until completion of all appeals, including to the United States Supreme Court. As required by the agreement, Liggett paid \$6,273 into an escrow account to be held for the benefit of the *Engle* class, and released, along with Liggett's existing \$3,450 statutory bond, to the court for the benefit of the class upon completion of the appeals process, regardless of the outcome of the appeal. In June 2002, the jury in an individual case brought under the third phase of the *Engle* case awarded \$37,500 (subsequently reduced by the court to \$25,100) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. The verdict, which is subject to the outcome of the *Engle* appeal, has been overturned as a result of the appellate court's ruling discussed above. It is possible that additional cases could be decided unfavorably and that there could be further adverse developments in the *Engle* case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. Management cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met.

Federal or state regulators may object to Vector Tobacco's low nicotine and nicotine-free cigarette products and reduced risk cigarette products it may develop as unlawful or allege they bear deceptive or unsubstantiated product claims, and seek the removal of the products from the marketplace, or significant changes to advertising. Various concerns regarding Vector Tobacco's advertising practices have been expressed to Vector Tobacco by certain state attorneys general. Vector Tobacco has engaged in discussions in an effort to resolve these concerns and Vector Tobacco has recently agreed to suspend all print advertising for its QUEST brand while discussions are pending. If Vector Tobacco is unable to advertise its QUEST brand, it could have a material adverse effect on sales of QUEST. Allegations by federal or state regulators, public health organizations and other tobacco manufacturers that Vector Tobacco's products are unlawful, or that its public statements or advertising contain misleading or unsubstantiated health claims or product comparisons, may result in litigation or governmental proceedings.

In recent years, there have been a number of restrictive regulatory actions from various Federal administrative bodies, including the United States Environmental Protection Agency and the Food and Drug Administration. There have also been adverse political decisions and other unfavorable developments concerning cigarette smoking and the tobacco industry, including the commencement and certification of class actions and the commencement of third-party payor actions. These developments generally receive widespread media attention. We are not able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation, but our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any smoking-related litigation. See Note 7 to our consolidated financial statements for a description of legislation, regulation and litigation.

### **Critical Accounting Policies**

*General.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities and the reported amounts of revenues and expenses. Significant estimates subject to material changes in the near term include restructuring and impairment charges, inventory valuation, deferred tax assets, allowance for doubtful accounts, promotional accruals, sales returns and allowances, actuarial assumptions of pension plans, embedded derivative liability, the tobacco quota buyout, settlement accruals and litigation and defense costs. Actual results could differ from those estimates.

*Revenue Recognition.* Revenues from sales of cigarettes are recognized upon the shipment of finished goods to the customer, there is persuasive evidence of an arrangement, the sale price

is determinable and collectibility is reasonably assured. We provide an allowance for expected sales returns, net of related inventory cost recoveries. Since our primary line of business is tobacco, our financial position and our results of operations and cash flows have been and could continue to be materially adversely effected by significant unit sales volume declines, litigation and defense costs, increased tobacco costs or reductions in the selling price of cigarettes in the near term.

*Marketing Costs.* We record marketing costs as an expense in the period to which such costs relate. We do not defer the recognition of any amounts on our consolidated balance sheets with respect to marketing costs. We expense advertising costs as incurred, which is the period in which the related advertisement initially appears. We record consumer incentive and trade promotion costs as a reduction in revenue in the period in which these programs are offered, based on estimates of utilization and redemption rates that are developed from historical information.

*Restructuring and Asset Impairment Charges.* We have recorded charges related to employee severance and benefits, asset impairments, contract termination and other associated exit costs during 2002, 2003 and 2004. The calculation of severance pay requires management to identify employees to be terminated and the timing of their severance from employment. The calculation of benefits charges requires actuarial assumptions including determination of discount rates. As discussed further below, the asset impairments were recorded in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which requires management to estimate the fair value of assets to be disposed of. On January 1, 2003, we adopted SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." Charges related to restructuring activities initiated after this date were recorded when incurred. Prior to this date, charges were recorded at the date of an entity's commitment to an exit plan in accordance with EITF 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." These restructuring charges are based on management's best estimate at the time of restructuring. The status of the restructuring activities is reviewed on a quarterly basis and any adjustments to the reserve, which could differ materially from previous estimates, are recorded as an adjustment to operating income.

*Impairment of Long-Lived Assets.* We evaluate our long-lived assets for possible impairment whenever events or changes in circumstances indicate that the carrying value of the asset, or related group of assets, may not be fully recoverable. Examples of such events or changes in circumstances include a significant adverse charge in the manner in which a long-lived asset, or group of assets, is being used or a current expectation that, more likely than not, a long-lived asset, or group of assets, will be disposed of before the end of its estimated useful life. The estimate of fair value of our long-lived assets is based on the best information available, including prices for similar assets and the results of using other valuation techniques. Since judgment is involved in determining the fair value of long-lived assets, there is a risk that the carrying value of our long-lived assets may be overstated or understated.

In October 2003, we announced that we would close Vector Tobacco's Timberlake, North Carolina cigarette manufacturing facility and produce its cigarette products at Liggett's Mebane, North Carolina facility. We evaluated the net realizable value of the long-lived assets located at the Timberlake facility which is no longer used in operations. Based on management's estimates of the values, we initially recognized non-cash asset impairment charges of \$18,752 in the third quarter of 2003 on machinery and equipment. As of June 30, 2004, we decreased the asset impairment accrual to reflect the actual amounts to be realized from the Timberlake sale and to reduce values of other excess machinery and equipment in accordance with SFAS No. 144.

*Contingencies.* We record Liggett's product liability legal expenses and other litigation costs as operating, selling, general and administrative expenses as those costs are incurred. As discussed in Note 7 of our consolidated financial statements and above under the heading

“Recent Developments in Legislation, Regulation and Litigation”, legal proceedings covering a wide range of matters are pending or threatened in various jurisdictions against Liggett. Management is unable to make a meaningful estimate with respect to the amount or range of loss that could result from an unfavorable outcome of pending smoking-related litigation or the costs of defending such cases, and we have not provided any amounts in our consolidated financial statements for unfavorable outcomes, if any. Litigation is subject to many uncertainties, and it is possible that our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such smoking-related litigation.

*Settlement Agreements.* As discussed in Note 7 to our consolidated financial statements, Liggett and Vector Tobacco are participants in the Master Settlement Agreement, the 1998 agreement to settle governmental healthcare cost recovery actions brought by various states. Liggett and Vector Tobacco have no payment obligations under the Master Settlement Agreement except to the extent their market shares exceed approximately 1.65% and 0.28%, respectively, of total cigarettes sold in the United States. Their obligations, and the related expense charges under the Master Settlement Agreement, are subject to adjustments based upon, among other things, the volume of cigarettes sold by Liggett and Vector Tobacco, their relative market shares and inflation. Since relative market shares are based on cigarette shipments, the best estimate of the allocation of charges under the Master Settlement Agreement is recorded in cost of goods sold as the products are shipped. Settlement expenses under the Master Settlement Agreement recorded in the accompanying consolidated statements of operations were \$1,447 for the three months ended March 31, 2005 and \$4,728 for the three months ended March 31, 2004. Adjustments to these estimates are recorded in the period that the change becomes probable and the amount can be reasonably estimated.

*Derivatives; Beneficial Conversion Feature.* We measure all derivatives, including certain derivatives embedded in other contracts, at fair value and recognize them in the consolidated balance sheet as an asset or a liability, depending on our rights and obligations under the applicable derivative contract. In November 2004, we issued in a private placement 5% variable interest senior convertible notes due 2011 where a portion of the total interest payable on the notes is computed by reference to the cash dividends paid on our common stock. This portion of the interest payment is considered an embedded derivative. Pursuant to SFAS No. 133, “Accounting for Derivative Instruments and Hedging Activities”, as amended by SFAS No. 138, “Accounting for Certain Derivative Instruments and Certain Hedging Activities”, we have bifurcated this dividend portion of the interest on the notes and, based on a valuation by an independent third party, estimated the fair value of the embedded derivative liability. At issuance of the notes, the estimated initial fair value of the embedded derivative liability was \$24,738, which was recorded as a discount to the notes and is classified as a derivative liability on the consolidated balance sheet. At March 31, 2005, with the issuance of \$16,364 of additional notes, the derivative liability was estimated at \$30,379. Changes to the fair value of this embedded derivative are reflected quarterly as an adjustment to interest expense.

After giving effect to the recording of the embedded derivative liability as a discount to the notes, the Company’s common stock had a fair value at the issuance date of the notes in excess of the conversion price resulting in a beneficial conversion feature. Emerging Issues Task Force (EITF) No. 98-5, “Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Convertible Ratios”, requires that the intrinsic value of the beneficial conversion feature (\$17,031 at March 31, 2005) be recorded to additional paid-in capital and as a discount on the notes. The discount is then amortized to interest expense over the term of the notes using the effective interest rate method.

*Inventories.* Tobacco inventories are stated at lower of cost or market and are determined primarily by the last-in, first-out (LIFO) method at Liggett and the first-in, first-out (FIFO) method at Vector Tobacco. Although portions of leaf tobacco inventories may not be used or sold within one year because of time required for aging, they are included in current assets, which is common practice in the industry. We estimate an inventory reserve for excess quantities and

obsolete items based on specific identification and historical write-offs, taking into account future demand and market conditions. At March 31, 2005, approximately \$1,488 of our leaf inventory was associated with Vector Tobacco's QUEST product. During the second quarter of 2004, we recognized a non-cash charge of \$37,000 to adjust the carrying value of excess leaf tobacco inventory for the QUEST product, based on estimates of future demand and market conditions. If actual demand for the product or market conditions are less favorable than those estimated, additional inventory write-downs may be required.

*Employee Benefit Plans.* The determination of our net pension and other postretirement benefit income or expense is dependent on our selection of certain assumptions used by actuaries in calculating such amounts. Those assumptions include, among others, the discount rate, expected long-term rate of return on plan assets and rates of increase in compensation and healthcare costs. In accordance with accounting principles generally accepted in the United States of America, actual results that differ from our assumptions are accumulated and amortized over future periods and therefore, generally affect our recognized income or expense in such future periods. While we believe that our assumptions are appropriate, significant differences in our actual experience or significant changes in our assumptions may materially affect our future net pension and other postretirement benefit income or expense.

Net pension expense for defined benefit pension plans and other postretirement benefit expense aggregated approximately \$4,500 for 2004, and we currently anticipate such expense will be approximately \$4,250 for 2005. In contrast, our funding obligations under the pension plans are governed by ERISA. To comply with ERISA's minimum funding requirements, we do not currently anticipate that we will be required to make any funding to the pension plans for the pension plan year beginning on January 1, 2005 and ending on December 31, 2005. Any additional funding obligation that we may have for subsequent years is contingent on several factors and is not reasonably estimable at this time.

## **Results of Operations**

The following discussion provides an assessment of our results of operations, capital resources and liquidity and should be read in conjunction with our consolidated financial statements and related notes included elsewhere in this report. The consolidated financial statements include the accounts of VGR Holding, Liggett, Vector Tobacco, Liggett Vector Brands, New Valley and other less significant subsidiaries. Our interest in New Valley's common shares was 55.1% at March 31, 2005.

For purposes of this discussion and other consolidated financial reporting, our significant business segments for the three months ended March 31, 2005 and 2004 were Liggett and Vector Tobacco. The Liggett segment consists of the manufacture and sale of conventional cigarettes and, for segment reporting purposes, includes the operations of Medallion acquired on April 1, 2002 (which operations are held for legal purposes as part of Vector Tobacco). The Vector Tobacco segment includes the development and marketing of the low nicotine and nicotine-free cigarette products as well as the development of reduced risk cigarette products and, for segment reporting purposes, excludes the operations of Medallion.

	Three Months Ended	
	March 31,	
	2005	2004
<b>Revenues:</b>		
Liggett	\$101,635	\$122,221
Vector Tobacco	2,538	4,352
Total tobacco revenues	<u>\$104,173</u>	<u>\$126,573</u>
<b>Operating income:</b>		
Liggett	\$ 31,870	\$ 27,783 <sup>(1)</sup>
Vector Tobacco	(4,432)	(8,706) <sup>(1)</sup>
Total tobacco	27,438	19,077
Corporate and other	(8,790)	(6,236)
Total operating income	<u>\$ 18,648</u>	<u>\$ 12,841<sup>(1)</sup></u>

(1) Includes restructuring and impairment charges in 2004 of \$389 at Liggett and \$264 at Vector Tobacco.

Three Months Ended March 31, 2005 Compared to Three Months Ended March 31, 2004

**Revenues.** Total revenues were \$104,173 for the three months ended March 31, 2005 compared to \$126,573 for the three months ended March 31, 2004. This 17.7% (\$22,400) decrease in revenues was due to an \$20,586 or 16.8% decrease in revenues at Liggett and a \$1,814 or 41.7% decrease in revenues at Vector Tobacco.

**Tobacco Revenues.** In August 2004, Liggett increased its net sales price of LIGGETT SELECT by \$1.00 per carton. In October 2004, Liggett increased the list price of all its brands by \$.65 per carton.

Effective February 1, 2004, Liggett reduced the list prices for EVE and JADE from the premium price level to the branded discount level, in the case of EVE, and the deep discount level, in the case of JADE. During 2003, the net list price for JADE had been at the deep discount level after giving effect to off-invoice promotional spending. In August 2004, the list price for JADE was increased by \$1.35 per carton.

All of Liggett's sales in 2004 and the first quarter of 2005 were in the discount category. For the three months ended March 31, 2005, net sales at Liggett totaled \$101,635, compared to \$122,221 for the three months ended March 31, 2004. Revenues decreased by 16.8% (\$20,586) due to an 28.0% decrease in unit sales volume (approximately 650 million units) accounting for \$34,204 in unfavorable volume variance and \$117 in unfavorable sales mix partially offset by a combination of list price increases and reduced promotional spending of \$13,735. Net revenues of the LIGGETT SELECT brand decreased \$13,271 for the first quarter of 2005 compared to the first quarter of 2004, and its unit volume decreased 33.8% in the 2005 period compared to 2004. Unit sales volume was adversely affected by delays in implementing the strategic changes in distribution associated with the restructuring at Liggett Vector Brands in the fourth quarter of 2004, and the affect of large industry-wide wholesale purchases at year end 2004 in response to, and in anticipation of, competitors' pricing actions associated with the tobacco quota buyout.

Revenues at Vector Tobacco for the three months ended March 31, 2005 were \$2,538 compared to revenues of \$4,352 in 2004 period, a 41.7% decline, due to decreased sales volume.

Vector Tobacco's revenues in both three month periods related primarily to sales of QUEST. Given market place conditions, and the results we have seen to date with QUEST, we have taken a measured approach to expanding the market presence of the brand.

*Tobacco Gross Profit.* Tobacco gross profit was \$45,175 for the three months ended March 31, 2005 compared to \$52,473 for the three months ended March 31, 2004, a decrease of \$7,298 or 13.9% when compared to the prior year period, due to the reduced sales volume. Liggett's brands contributed 98.2% to our tobacco gross profit and Vector Tobacco contributed 1.8% for the three months ended March 31, 2005. Over the same period in 2004, Liggett brands contributed 96.2% to our gross profit and Vector Tobacco's brands contributed 3.8%.

Liggett's gross profit of \$44,359 for the three months ended March 31, 2005 decreased \$6,100 from gross profit of \$50,459 for the three months ended March 31, 2004. As a percent of revenues (excluding federal excise taxes), gross profit at Liggett decreased to 64.5% for the three months ended March 31, 2005 compared to 65.9% for the same period in 2004. This decrease in Liggett's gross profit in 2005 was attributable to the items discussed above.

Vector Tobacco's gross profit was \$816 for the three months ended March 31, 2005 compared to a gross profit of \$2,014 for the three months ended March 31, 2004. The decrease was due primarily to reduced sales volume.

*Expenses.* Operating, selling, general and administrative expenses were \$26,527 for the three months ended March 31, 2005 compared to \$38,979, net of restructuring charges, for the same period last year, a decrease of \$12,452 or 31.9%. In the 2004 period, these expenses are net of restructuring charges of \$389 at Liggett and \$264 at Vector Tobacco. Expenses at Liggett were \$12,489 for the three months ended March 31, 2005 compared to \$22,287 for the same period in the prior year, a decrease of \$9,798. The decrease in expense for the three months ended March 31, 2005 was due primarily to the reduced sales force resulting from the 2004 restructuring. Liggett's product liability legal expenses and other litigation costs were \$1,229 for the three months ended March 31, 2005 compared to \$1,738 for the same period in the prior year. Expenses at Vector Tobacco for the three months ended March 31, 2005 were \$5,248 compared to expenses of \$10,720 for the three months ended March 31, 2004, a decrease of \$5,208, due to the sale of the Timberlake facility in 2004 and the reduction in headcount in the fourth quarter of 2004.

For the three months ended March 31, 2005, Liggett's operating income increased to \$31,870 compared to \$27,783 for the same period in 2004 due primarily to the reduced operating, selling, general and administrative expenses offset by the impact of the lower sales volume. Vector Tobacco's operating loss was \$4,432 for the three months ended March 31, 2005 compared to a loss of \$8,706 for the same period in 2004.

*Other Income (Expenses).* For the three months ended March 31, 2005, other income (expenses) was \$4,348 compared to a loss of \$4,514 for the three months ended March 31, 2004. For the three months ended March 31, 2005, a gain on the LTS conversion of \$9,461, a gain on investments of \$1,430, and interest and dividend income of \$710 were offset by interest expense of \$6,647, equity loss from non-consolidated New Valley real estate businesses of \$306 and an equity loss in LTS of \$299. The equity loss resulted from losses at New Valley of \$1,640 related to its investment in Koa Investors, LLC, which owns the Sheraton Keauhou Bay Resort and Spa in Kailua-Kona, Hawaii, offset by income of \$1,334 related to New Valley's investment in Douglas Elliman Realty, LLC. For the three months ended March 31, 2004, interest expense of \$6,101 was offset by interest and dividend income of \$695, a gain on investments of \$251 and equity income from non-consolidated New Valley real estate businesses of \$646.



*Income from Continuing Operations.* The income from continuing operations before income taxes and minority interests for the three months ended March 31, 2005 was \$22,996 compared to income of \$8,327 for the three months ended March 31, 2004. The income tax provision was \$12,704 and minority interests in income of subsidiaries was \$2,016 for the three months ended March 31, 2005. This compared to a tax provision of \$4,370 and minority interests in losses of subsidiaries of \$536 for the three months ended March 31, 2004. Our income tax rate for the three months ended March 31, 2005 does not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes, the receipt of the LTS distribution, the intraperiod allocation at New Valley between income from continuing and discontinued operations and the utilization of deferred tax assets as New Valley. Our tax rate for the three months ended March 31, 2004 does not bear a customary relationship to statutory income tax rates as a result of the impact of nondeductible expenses, state income taxes and the intraperiod allocation at New Valley between income from continuing and discontinued operations. We currently anticipate that our income tax rate for the year ended December 31, 2005 will be lower than the rate applicable to the first quarter.

## Discontinued Operations

In February 2005, New Valley completed the sale for \$71,500 of its two office buildings in Princeton, N.J. As a result of the sale, the consolidated financial statements of the Company reflect New Valley's real estate leasing operations as discontinued operations for the three months ended March 31, 2005 and 2004. Accordingly, revenues, costs and expenses, and cash flows of the discontinued operations have been excluded from the respective captions in the consolidated statements of operations and consolidated statements of cash flows. The net operating results of the discontinued operations have been reported, net of applicable income taxes and minority interests, as "Income from discontinued operations", and the net cash flows of these entities have been reported as "Net cash provided by discontinued operations." The assets of the discontinued operations were recorded as "Assets held for sale" in the consolidated balance sheet at December 31, 2004.

Summarized operating results of the discontinued real estate leasing operations for the three months ended March 31, 2005 and March 31, 2004 are as follows:

	Three Months Ended March 31,	
	2005	2004
Revenues	\$ 924	\$1,781
Expenses	515	1,179
Income from discontinued operations before income taxes and minority interests	409	602
Income tax expense from discontinued operations	223	318
Minority interests	104	150
Income from discontinued operations	<u>\$ 82</u>	<u>\$ 134</u>

The Company recorded a gain in connection with the sale of the office buildings of \$2,952, net of minority interest and income taxes.

## Liquidity and Capital Resources

Net cash and cash equivalents increased \$30,505 for the three months ended March 31, 2005 and decreased \$485 for the three months ended March 31, 2004.

Net cash provided by operations for the three months ended March 31, 2005 was \$6,390 compared to net cash provided for the three months ended March 31, 2004 of \$1,343. Cash provided by operations in the 2005 period resulted primarily from reduced operating losses at Vector Tobacco, increased operating income at Liggett and adjustments to income for deferred income taxes and non-cash depreciation and amortization expense offset principally by non-cash gain on the conversion of LTS debt into common stock of LTS. Net cash provided in 2004 resulted primarily from operating income of \$12,841, a decrease in inventory and the non-cash impact of depreciation and amortization offset by a decrease in current liabilities and an increase in accounts receivable.

Cash used in investing activities was \$1,568 in the first quarter of 2005 compared to cash provided of \$17,471 in the 2004 period. In the first quarter of 2005, cash was used for the purchase of investment securities for \$2,724, capital expenditures of \$968, the issuance by New Valley of notes receivable from LTS for \$1,750 and the purchase by New Valley of LTS common stock for \$1,500. This was offset primarily through the sale or maturity of investment securities for \$5,420. In the first quarter of 2004, cash was provided principally through the sale or maturity of investment securities for \$29,950 offset primarily by the purchase of investment securities of \$10,317, the investment in non-consolidated real estate businesses by New Valley of \$1,500 and capital expenditures of \$581.

Cash used in financing activities was \$2,751 for the three months ended March 31, 2005 compared to cash used of \$19,905 in the comparable period in 2004. In the first quarter of 2005, cash was used for dividends of \$16,735, repayments on debt of \$1,434 and deferred financing charges of \$678. These were offset by the proceeds from the sale of convertible notes of \$14,959 and proceeds from the exercise of options of \$779. In the first quarter of 2004, cash was used principally for distributions on common stock of \$15,635 and repayments of debt of \$4,949, partially offset by proceeds of \$667 from exercise of options.

Cash flows provided from discontinued operations were \$28,434 for the three months ended March 31, 2005, which consisted of \$30,023 provided from the sale and operations of the New Valley office buildings in Princeton, N.J. reduced by \$1,589 in connection with the payment of a state income tax assessment by New Valley.

*Liggett.* Liggett has a \$50,000 credit facility with Wachovia Bank, N.A. A total of \$364 was outstanding under the facility at March 31, 2005. Availability as determined under the facility was approximately \$29,793 based on eligible collateral at March 31, 2005. The facility is collateralized by all inventories and receivables of Liggett and a mortgage on its manufacturing facility. Borrowings under the facility bear interest at a rate equal to 1.0% above the prime rate of Wachovia. The facility requires Liggett's compliance with certain financial and other covenants including a restriction on Liggett's ability to pay cash dividends unless Liggett's borrowing availability under the facility for the 30-day period prior to the payment of the dividend, and after giving effect to the dividend, is at least \$5,000 and no event of default has occurred under the agreement, including Liggett's compliance with the covenants in the credit facility, including an adjusted net worth and working capital requirement. In addition, the facility imposes requirements with respect to Liggett's adjusted net worth (not to fall below \$8,000 as computed in accordance with the agreement) and working capital (not to fall below a deficit of \$17,000 as computed in accordance with the agreement). At March 31, 2005, Liggett was in compliance with all covenants under the credit facility; Liggett's adjusted net worth was \$49,290 and net working capital was \$23,223, as computed in accordance with the agreement.

100 Maple LLC, a company formed by Liggett in 1999 to purchase its Mebane, North Carolina manufacturing plant, has a term loan of \$4,179 outstanding as of March 31, 2005 under Liggett's credit facility. The remaining balance of the term loan is payable in 14 monthly installments of \$77 with a final payment on June 1, 2006 of \$3,095. Interest is charged at the same rate as applicable to Liggett's credit facility, and the outstanding balance of the term loan reduces the maximum availability under the credit facility. Liggett has guaranteed the term loan, and a first mortgage on the Mebane property and manufacturing equipment collateralizes the term loan and Liggett's credit facility.

In March 2000, Liggett purchased equipment for \$1,000 through the issuance of a note, payable in 60 monthly installments of \$21 with an effective annual interest rate of 10.14%. This note was paid in full during the first quarter of 2005. In April 2000, Liggett purchased equipment for \$1,071 through the issuance of notes, payable in 60 monthly installments through April 2005 of \$22 with an effective interest rate of 10.20%.

Beginning in October 2001, Liggett upgraded the efficiency of its manufacturing operation at Mebane with the addition of four new state-of-the-art cigarette makers and packers, as well as related equipment. The total cost of these upgrades was approximately \$20,000. Liggett took delivery of the first two of the new lines in the fourth quarter of 2001 and financed the purchase price of \$6,404 through the issuance of notes, guaranteed by us and payable in 60 monthly installments of \$106 with interest calculated at the prime rate. In March 2002, the third line was delivered, and the purchase price of \$3,023 was financed through the issuance of a note, payable in 30 monthly installments of \$62 and then 30 monthly installments of \$51 with an interest rate of LIBOR plus 2.8%. In May 2002, the fourth line was delivered, and Liggett financed the purchase price of \$2,871 through the issuance of a note, payable in 30 monthly installments of \$59 and then 30 monthly installments of \$48 with an interest rate of LIBOR plus 2.8%. In September 2002, Liggett purchased additional equipment for \$1,573 through the issuance of a note guaranteed by us, payable in 60 monthly installments of \$26 plus interest rate calculated at LIBOR plus 4.31%. Each of these equipment loans are secured by the purchased equipment.

During 2003, Liggett leased two 100 millimeter box packers, which will allow Liggett to meet the growing demand for this cigarette style, and a new filter maker to improve product quality and capacity. These operating lease agreements provide for payments totaling approximately \$4,500.

In July 2003, Liggett granted an unaffiliated third party an option to purchase Liggett's former manufacturing facility and other excess real estate in Durham, North Carolina with a net book value at March 31, 2005 of approximately \$2,213. The option agreement permits the purchaser to acquire the property during a two-year period expiring July 15, 2005, at a purchase price of \$15,250. At March 31, 2005, Liggett has received nonrefundable option fees of \$1,250, creditable against the purchase price. The purchaser is currently seeking financing for the transaction, and there can be no assurance the sale of the property will occur.

Liggett (and, in certain cases, Brooke Group Holding, our predecessor and a wholly-owned subsidiary of VGR Holding) and other United States cigarette manufacturers have been named as defendants in a number of direct and third-party actions (and purported class actions) predicated on the theory that they should be liable for damages from cancer and other adverse health effects alleged to have been caused by cigarette smoking or by exposure to so-called secondary smoke from cigarettes. We believe, and have been so advised by counsel handling the respective cases, that Brooke Group Holding and Liggett have a number of valid defenses to claims asserted against them. Litigation is subject to many uncertainties. In May 2003, a Florida intermediate appellate court overturned a \$790,000 punitive damages award against Liggett and decertified the *Engle* smoking and health class action. In May 2004, the Florida Supreme Court agreed to review the case. Oral argument was held in November 2004. If the intermediate appellate court's ruling is not upheld on further appeal, it will have a material adverse effect on us. In November 2000, Liggett filed the \$3,450 bond required under the bonding statute enacted in 2000 by the Florida legislature which limits the size of any bond required, pending appeal, to stay execution of a punitive damages verdict. In May 2001, Liggett reached an agreement with the class in the *Engle* case, which provided assurance to Liggett that the stay of execution, in effect pursuant to the Florida bonding statute, would not be lifted or limited at any point until completion of all appeals, including to the United States Supreme Court. As required by the agreement, Liggett paid \$6,273 into an escrow account to be held for the benefit of the *Engle* class, and released, along with Liggett's existing \$3,450 statutory bond, to the court for the benefit of the class upon completion of the appeals process, regardless of the outcome of the appeal. In June 2002, the jury in an individual case brought under the third phase of the *Engle* case awarded \$37,500 (subsequently

reduced by the court to \$25,100) of compensatory damages against Liggett and two other defendants and found Liggett 50% responsible for the damages. The verdict, which was subject to the outcome of the *Engle* appeal, has been overturned as a result of the appellate court's ruling discussed above. In April 2004, a Florida state court jury awarded compensatory damages of \$540 against Liggett in an individual action. In addition, plaintiff's counsel was awarded legal fees of \$752. Liggett has appealed the verdict. It is possible that additional cases could be decided unfavorably and that there could be further adverse developments in the *Engle* case. Liggett may enter into discussions in an attempt to settle particular cases if it believes it is appropriate to do so. Management cannot predict the cash requirements related to any future settlements and judgments, including cash required to bond any appeals, and there is a risk that those requirements will not be able to be met. An unfavorable outcome of a pending smoking and health case could encourage the commencement of additional similar litigation. In recent years, there have been a number of adverse regulatory, political and other developments concerning cigarette smoking and the tobacco industry. These developments generally receive widespread media attention. Neither we nor Liggett are able to evaluate the effect of these developing matters on pending litigation or the possible commencement of additional litigation or regulation. See Note 7 to our consolidated financial statements.

Management is unable to make a meaningful estimate of the amount or range of loss that could result from an unfavorable outcome of the cases pending against Brooke Group Holding or Liggett or the costs of defending such cases. It is possible that our consolidated financial position, results of operations or cash flows could be materially adversely affected by an unfavorable outcome in any such tobacco-related litigation.

*V.T. Aviation.* In February 2001, V.T. Aviation LLC, a subsidiary of Vector Research Ltd., purchased an airplane for \$15,500 and borrowed \$13,175 to fund the purchase. The loan, which is collateralized by the airplane and a letter of credit from us for \$775, is guaranteed by Vector Research, VGR Holding and us. The loan is payable in 119 monthly installments of \$125 including annual interest of 2.31% above the 30-day commercial paper rate, with a final payment of \$1,927, based on current interest rates.

*VGR Aviation.* In February 2002, V.T. Aviation purchased an airplane for \$6,575 and borrowed \$5,800 to fund the purchase. The loan is guaranteed by us. The loan is payable in 119 monthly installments of \$40, including annual interest at 2.75% above the 30-day commercial paper rate, with a final payment of \$3,233 based on current interest rates. During the fourth quarter of 2003, this airplane was transferred to our direct subsidiary, VGR Aviation LLC, which has assumed the debt.

*Vector Tobacco.* On April 1, 2002, a subsidiary of ours acquired the stock of The Medallion Company, Inc., a discount cigarette manufacturer, and related assets from Medallion's principal stockholder. Following the purchase of the Medallion stock, Vector Tobacco merged into Medallion and Medallion changed its name to Vector Tobacco Inc. The total purchase price for the Medallion shares and the related assets consisted of \$50,000 in cash and \$60,000 in notes, with the notes guaranteed by us and by Liggett. Of the notes, \$25,000 have been repaid with the final quarterly principal payment of \$3,125 made on March 31, 2004. The remaining \$35,000 of notes bear interest at 6.5% per year, payable semiannually, and mature on April 1, 2007.

*New Valley.* In December 2002, New Valley financed a portion of its purchase of two office buildings in Princeton, New Jersey with a \$40,500 mortgage loan from HSBC Realty Credit Corporation (USA). The loan had a term of four years, bore interest at a floating rate of 2% above LIBOR, and was collateralized by a first mortgage on the office buildings, as well as by an assignment of leases and rents. Principal was amortized to the extent of \$54 per month during the term of the loan. The loan was prepayable without penalty and was non-recourse against

New Valley, except for various specified environmental and related matters, misapplication of tenant security deposits and insurance and condemnation proceeds, and fraud or misrepresentation by New Valley in connection with the indebtedness.

In February 2005, New Valley completed the sale of the office buildings. The mortgage loan on the properties was retired at closing with the proceeds of the sale.

*Vector.* We believe that we will continue to meet our liquidity requirements through 2005. Corporate expenditures (exclusive of Liggett, Vector Research, Vector Tobacco and New Valley) over the next twelve months for current operations include cash interest expense of approximately \$23,200, dividends on our outstanding shares (currently at an annual rate of approximately \$67,800) and corporate expenses. We anticipate funding our expenditures for current operations with available cash resources, proceeds from public and/or private debt and equity financing, management fees from subsidiaries and tax sharing and other payments from Liggett or New Valley. New Valley may acquire or seek to acquire additional operating businesses through merger, purchase of assets, stock acquisition or other means, or to make other investments, which may limit its ability to make such distributions.

In November 2004, we sold \$65,500 of our 5% variable interest senior convertible notes due November 15, 2011 in a private offering to qualified institutional investors in accordance with Rule 144A under the Securities Act of 1933. The buyers of the notes had the right, for a 120-day period ending March 18, 2005, to purchase an additional \$16,375 of the notes. At December 31, 2004, buyers had exercised their rights to purchase an additional \$1,405 of the notes, and the remaining \$14,959 principal amount of notes were purchased during the first quarter of 2005. In April 2005, we issued an additional \$30,000 principal amount of 5% variable interest senior convertible notes due November 15, 2011 in a separate private offering to qualified institutional investors in accordance with Rule 144A. These notes, which were issued under a new indenture at a price of 103.5%, were on the same terms as the \$81,864 principal amount of notes previously issued in connection with the November 2004 placement.

The notes pay interest on a quarterly basis at a rate of 5% per year with an additional amount of interest payable on the notes on each interest payment date. This additional amount is based on the amount of cash dividends actually paid by us per share on our common stock during the prior three-month period ending on the record date for such interest payment multiplied by the number of shares of our common stock into which the notes are convertible on such record date (together, the "Total Interest"). Notwithstanding the foregoing, however, during the period prior to November 15, 2006, the interest payable on each interest payment date will be the higher of (i) the Total Interest and (ii) 6 3/4% per year. The notes are convertible into our common stock, at the holder's option. The conversion price of \$19.40 per share is subject to adjustment for various events, including the issuance of stock dividends.

The notes will mature on November 15, 2011. We must redeem 12.5% of the total aggregate principal amount of the notes outstanding on November 15, 2009. In addition to such redemption amount, we will also redeem on November 15, 2009 and on each interest accrual period thereafter an additional amount, if any, of the notes necessary to prevent the notes from being treated as an "Applicable High Yield Discount Obligation" under the Internal Revenue Code. The holders of the notes will have the option on November 15, 2009 to require us to repurchase some or all of their remaining notes. The redemption price for such redemptions will equal 100% of the principal amount of the notes plus accrued interest. If a fundamental change occurs, we will be required to offer to repurchase the notes at 100% of their principal amount, plus accrued interest and, under certain circumstances, a "make-whole premium" payable in cash and/or common stock.

In July 2001, we completed the sale of \$172,500 (net proceeds of approximately \$166,400) of our 6.25% convertible subordinated notes due July 15, 2008 through a private offering to qualified institutional investors in accordance with Rule 144A under the Securities Act of 1933. The notes

pay interest at 6.25% per annum and are convertible into our common stock, at the option of the holder. The conversion price, which was \$24.03 at March 31, 2005, is subject to adjustment for various events, and any cash distribution on our common stock results in a corresponding decrease in the conversion price. In December 2001, \$40,000 of the notes were converted into our common stock, and in October 2004, \$8 of the notes were converted. A total of \$132,492 principal amount of the notes were outstanding at March 31, 2005.

Our consolidated balance sheets include deferred income tax assets and liabilities, which represent temporary differences in the application of accounting rules established by generally accepted accounting principles and income tax laws. As of March 31, 2005, our deferred income tax liabilities exceeded our deferred income tax assets by \$123,867. The largest component of our deferred tax liabilities exists because of differences that resulted from a 1998 and 1999 transaction with Philip Morris Incorporated in which a subsidiary of Liggett contributed three of its premium brands to Trademarks LLC, a newly-formed limited liability company. In such transaction, Philip Morris acquired an option to purchase the remaining interest in Trademarks for a 90-day period commencing in December 2008, and we have an option to require Philip Morris to purchase the remaining interest commencing in March 2010. For additional information concerning the Philip Morris brand transaction, see Note 18 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2004.

In connection with the transaction, we recognized in 1999 a pre-tax gain of \$294,078 in our consolidated financial statements and established a deferred tax liability of \$103,100 relating to the gain. Upon exercise of the options during the 90-day periods commencing in December 2008 or in March 2010, we will be required to pay tax in the amount of the deferred tax liability, which will be offset by the benefit of any deferred tax assets, including any net operating losses, available to us at that time. In connection with an examination of our 1998 and 1999 federal income tax returns, the Internal Revenue Service issued to us in September 2003 a notice of proposed adjustment. The notice asserts that, for tax reporting purposes, the entire gain should have been recognized in 1998 and in 1999 in the additional amounts of \$150,000 and \$129,900, respectively, rather than upon the exercise of the options during the 90-day periods commencing in December 2008 or in March 2010. If the Internal Revenue Service were to ultimately prevail with the proposed adjustment, it would result in the potential acceleration of tax payments of approximately \$123,000, including interest, net of tax benefits, through March 31, 2005. These amounts have been previously recognized in our consolidated financial statements as tax liabilities. As of March 31, 2005, we believe amounts potentially due have been fully provided for in our consolidated statements of operations.

We believe the positions reflected on our income tax returns are correct and intend to vigorously oppose any proposed adjustments to our returns. We have filed a protest with the Appeals Division of the Internal Revenue Service. No payment is due with respect to these matters during the appeal process. Interest currently is accruing on the disputed amounts at a rate of 8%, with the rate adjust quarterly based on rates published by the U.S. Treasury Department. If taxing authorities were to ultimately prevail in their assertion that we incurred a tax obligation prior to the exercise dates of these options and we were required to make such tax payments prior to 2009 or 2010, and if any necessary financing were not available to us, our liquidity could be materially adversely affected.

#### **Off-Balance Sheet Arrangements**

We have various agreements in which we may be obligated to indemnify the other party with respect to certain matters. Generally, these indemnification clauses are included in contracts arising in the normal course of business under which we customarily agree to hold the other party harmless against losses arising from a breach of representations related to such matters as title to assets sold and licensed or certain intellectual property rights. Payment by us under such indemnification clauses is generally conditioned on the other party making a claim that is subject

to challenge by us and dispute resolution procedures specified in the particular contract. Further, our obligations under these arrangements may be limited in terms of time and/or amount, and in some instances, we may have recourse against third parties for certain payments made by us. It is not possible to predict the maximum potential amount of future payments under these indemnification agreements due to the conditional nature of our obligations and the unique facts of each particular agreement. Historically, payments made by us under these agreements have not been material. As of March 31, 2005, we were not aware of any indemnification agreements that would or are reasonably expected to have a current or future material adverse impact on our financial position, results of operations or cash flows.

In May 1999, in connection with the Philip Morris brand transaction, Eve Holdings Inc., a subsidiary of Liggett, guaranteed a \$134,900 bank loan to Trademarks LLC. The loan is secured by Trademarks' three premium cigarette brands and Trademarks' interest in the exclusive license of the three brands by Philip Morris. The license provides for a minimum annual royalty payment equal to the annual debt service on the loan plus \$1,000. We believe that the fair value of Eve's guarantee was negligible at March 31, 2005.

In February 2004, Liggett Vector Brands and another cigarette manufacturer entered into a five year agreement with a subsidiary of the American Wholesale Marketers Association to support a program to permit tobacco distributors to secure, on reasonable terms, tax stamp bonds required by state and local governments for the distribution of cigarettes. Under the agreement, Liggett Vector Brands has agreed to pay a portion of losses, if any, incurred by the surety under the bond program, with a maximum loss exposure of \$500 for Liggett Vector Brands. To secure its potential obligations under the agreement, Liggett Vector Brands has delivered to the subsidiary of the Association a \$100 letter of credit and a demand note for \$400. Liggett Vector Brands has incurred no losses to date under this agreement, and we believe the fair value of Liggett Vector Brands' obligation under the agreement was immaterial at March 31, 2005.

At March 31, 2005, we had outstanding approximately \$3,624 of letters of credit, collateralized by certificates of deposit. The letters of credit have been issued as security deposits for leases of office space, to secure the performance of our subsidiaries under various insurance programs and to provide collateral for various subsidiary borrowing and capital lease arrangements.

### **Market Risk**

We are exposed to market risks principally from fluctuations in interest rates, foreign currency exchange rates and equity prices. We seek to minimize these risks through our regular operating and financing activities and our long-term investment strategy. The market risk management procedures of us and New Valley cover all market risk sensitive financial instruments.

As of March 31, 2005, approximately \$24,242 of our outstanding debt had variable interest rates, which increases the risk of fluctuating interest rates. Our exposure to market risk includes interest rate fluctuations in connection with our variable rate borrowings, which could adversely affect our cash flows. As of March 31, 2005, we had no interest rate caps or swaps. Based on a hypothetical 100 basis point increase or decrease in interest rates (1%), our annual interest expense could increase or decrease by approximately \$262.

We held investment securities available for sale totaling \$20,446 at March 31, 2005. Adverse market conditions could have a significant effect on the value of these investments.

New Valley also holds long-term investments in limited partnerships and limited liability companies. These investments are illiquid, and their ultimate realization is subject to the performance of the investee entities.

## **New Accounting Pronouncements**

In 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123R). SFAS No. 123R requires companies to measure compensation cost for share-based payments at fair value. We will adopt this new standard prospectively, on January 1, 2006, and have not yet determined whether the adoption of SFAS No. 123R will have a material impact on our consolidated financial position, results of operations or cash flows.

In 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 requires that abnormal idle facility expense and spoilage, freight and handling costs be recognized as current-period charges. In addition, SFAS No. 151 requires that allocation of fixed production overhead costs to inventories be based on the normal capacity of the production facility. We are required to adopt the provisions of SFAS No. 151 prospectively after January 1, 2006, but the effect of adoption is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

## **SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

We and our representatives may from time to time make oral or written "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995, including any statements that may be contained in the foregoing discussion in "Management's Discussion and Analysis of Financial Condition and Results of Operations", in this report and in other filings with the Securities and Exchange Commission and in our reports to stockholders, which reflect our expectations or beliefs with respect to future events and financial performance. These forward-looking statements are subject to certain risks and uncertainties and, in connection with the "safe-harbor" provisions of the Private Securities Litigation Reform Act, we have identified under "Risk Factors" in Item 1 of our Annual Report on Form 10-K, as amended, for the year ended December 31, 2004 filed with the Securities and Exchange Commission above important factors that could cause actual results to differ materially from those contained in any forward-looking statement made by or on behalf of us.

Results actually achieved may differ materially from expected results included in these forward-looking statements as a result of these or other factors. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date on which such statements are made. We do not undertake to update any forward-looking statement that may be made from time to time by or on behalf of us.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations – Market Risk" is incorporated herein by reference.



#### **ITEM 4. CONTROLS AND PROCEDURES**

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, and, based on their evaluation, our principal executive officer and principal financial officer have concluded that these controls and procedures are effective.

There were no significant changes in our internal control over financial reporting during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## PART II

### OTHER INFORMATION

#### Item 1. Legal Proceedings

Reference is made to Note 7, incorporated herein by reference, to our consolidated financial statements included elsewhere in this report which contains a general description of certain legal proceedings to which Brooke Group Holding, VGR Holding, New Valley or their subsidiaries are a party and certain related matters. Reference is also made to Exhibit 99.1 for additional information regarding the pending smoking-related material legal proceedings to which Brooke Group Holding and/or Liggett are party. A copy of Exhibit 99 will be furnished without charge upon written request to us at our principal executive offices, 100 S.E. Second St., Miami, Florida 33131, Attn. Investor Relations.

#### Item 6. Exhibits

- \* 4.1 Indenture, dated as of April 13, 2005, by and between Vector and Wells Fargo Bank, N.A., relating to the 5% Variable Interest Senior Convertible Notes due 2011 (the "Notes"), including the form of Note (incorporated by reference to Exhibit 4.1 in Vector's Form 8-K dated April 14, 2005).
- \* 4.2 Registration Rights Agreement, dated as of April 13, 2005, by and between Vector and Jefferies & Company, Inc. ("Jefferies") (incorporated by reference to Exhibit 4.2 in Vector's Form 8-K dated April 14, 2005).
- 10.1 Stipulation and Agreement of Settlement, dated March 11, 2005, entered into on behalf of Vector and New Valley, relating to Goodwin v. New Valley Corporation.
- \* 10.2 Purchase Agreement, dated as of March 30, 2005, among Vector and Jefferies (incorporated by reference to Exhibit 1.1 in Vector's Form 8-K dated March 30, 2005).
- \* 10.3 Letter Agreement, dated April 13, 2005, between Vector and Howard M. Lorber (incorporated by reference to Exhibit 10.3 in Vector's Form 8-K dated April 14, 2005).
- 31.1 Certification of Chief Executive Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer, Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification of Chief Executive Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer, Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 99.1 Material Legal Proceedings.

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\*Incorporated by reference

**SIGNATURE**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

**VECTOR GROUP LTD.**  
**(Registrant)**

By: /s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen  
Vice President and Chief  
Financial Officer

Date: May 10, 2005

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

IN RE NEW VALLEY CORPORATION	)	Consolidated
DERIVATIVE LITIGATION	)	Civil Action No. 17649-NC
	)	

STIPULATION AND AGREEMENT OF SETTLEMENT

The parties to the above-captioned action, by and through their respective attorneys, hereby enter into the following Stipulation and Agreement of Settlement (the "Stipulation" or "Settlement," as appropriate), subject to the approval of the Court of Chancery of the State of Delaware (the "Court"):

WHEREAS,

A. Two actions were commenced in the Court, styled Fuss v. New Valley Corporation, C.A. No. 15613-NC and Goodwin v. New Valley Corporation, C.A. No. 16840-NC (the "Actions").

B. The Actions were filed as derivative actions on behalf of the nominal defendant, New Valley Corporation ("New Valley" and/or the "Company"). Also named as individual defendants in the Actions were various New Valley directors, namely, Arnold I. Burns ("Burns"), Henry C. Beinstein ("Beinstein"), Ronald J. Kramer, Richard J. Lampen, Bennett S. LeBow, Howard M. Lorber, Richard S. Ressler, Barry W. Ridings ("Ridings"), and Victor M. Rivas (collectively, the "Individual Defendants"), and Brooke Group Ltd. ("Brooke" and, together with the Individual Defendants and New Valley, the "Defendants").

C. Brooke, now known as Brooke Group Holding Inc., an indirect, wholly owned subsidiary of Vector Group Ltd. ("Vector"), was New Valley's controlling

stockholder at the time of the Transaction (defined in recital "D" below) and was the beneficial owner of approximately 40% of New Valley's common stock, approximately 60% of New Valley's Class A Preferred shares, and approximately 10% of New Valley's Class B Preferred shares. BrookeMil Ltd. ("BML") was a subsidiary of Brooke and a Russian real estate development company at the time of the Transaction.

D. In each of the initial operative complaints in the Actions, plaintiffs claimed that the Individual Defendants knowingly breached their fiduciary duty of loyalty to New Valley and its shareholders by (1) acquiescing in the acquisition by New Valley of BML from Brooke (the "Transaction"), (2) accepting terms in the Transaction that were unfair to New Valley, (3) overpaying Brooke for the purchase of BML at a price exceeding BML's fair market value and book value, and (4) engaging in self-dealing and interested transactions, which were not recommended by a properly functioning or independent Special Committee of the New Valley Board of Directors and which were not at arms length. The complaints also asserted that the Transaction constituted corporate "waste."

E. On February 13, 1997, plaintiff Richard Fuss ("Fuss") filed a derivative complaint on behalf of nominal defendant New Valley against the directors of New Valley and Brooke alleging breach of fiduciary duty.

F. On November 17, 1998, in accordance with 8 Del. C. ss. 220, Richard C. Goodwin ("Goodwin"), formerly a plaintiff herein and at that time a beneficial owner of New Valley shares, and Cede & Co. ("Cede"), as nominee for Goodwin, served a demand letter on New Valley, seeking to inspect New Valley's books and records relating to the disputed Transaction.

G. On December 11, 1998, Goodwin filed a verified complaint against New Valley, seeking to enforce his inspection rights under 8 Del. C. ss. 220 to determine whether to pursue a derivative action against New Valley's officers and/or directors for waste and/or self-dealing with respect to the Transaction. On January 4, 1999, defendant moved to dismiss the Goodwin verified complaint for failure to comply with the requirements of 8 Del. C. ss. 220, including, but not limited to, failure to state a proper purpose and a claim upon which relief can be granted. Shortly before trial on the demand for inspection, the parties settled the dispute over the inspection rights and New Valley gave certain of the requested documents to Goodwin.

H. On December 9, 1999, Goodwin filed a derivative complaint with allegations similar to those contained in plaintiff Fuss' February 13, 1997 derivative complaint. The Goodwin complaint contained additional factual allegations based, in part, on the documents New Valley produced pursuant to Goodwin's action under 8 Del. C. ss. 220.

I. By order dated February 7, 2000, the Court consolidated the Fuss and Goodwin actions and directed that Goodwin's complaint serve as the operative complaint in the consolidated action. The Court appointed the law firms of Grant & Eisenhofer and Abbey Gardy as plaintiffs' committee of the whole.

J. On February 28, 2000, plaintiffs filed an amended derivative complaint ("Amended Complaint"), which corrected certain factual errors regarding the composition of New Valley's board of directors at the time plaintiff Goodwin filed his original complaint. In the Amended Complaint, plaintiffs again claimed, INTER ALIA, that

the Individual Directors violated their fiduciary duty of loyalty by approving the Transaction and asserted that the Transaction constituted corporate "waste."

K. On March 13, 2000, Defendants filed a motion to dismiss the plaintiffs' Amended Complaint, which the Court denied by memorandum opinion and order dated January 11, 2001.

L. Thereafter, plaintiffs conducted extensive document discovery from Defendants and third parties and deposed Individual Defendants Burns, Beinstein and Ridings.

M. On October 3, 2003, Defendants moved for summary judgment against plaintiff Goodwin. On June 28, 2004, the Court granted Defendants' motion for summary judgment against plaintiff Goodwin on the grounds that Goodwin lacked standing, inter alia, because he failed to satisfy the contemporaneous ownership requirement for derivative actions by virtue of a lapse of ownership of New Valley stock during the months of October 2000 through March 2001.

N. Counsel for plaintiff have examined the relevant facts and law relating to the matters set forth in the Amended Complaint and have conferred with experts regarding damages caused by the Defendants' alleged breaches of fiduciary duty and plaintiff and his counsel have concluded that the terms and conditions of the Settlement (as defined below) are fair, reasonable, adequate, and in the best interests of the Company and its stockholders. Plaintiff has entered into this Stipulation after taking into account, among other things, (1) the value of the Settlement to the Company and its public shareholders, (2) the risks of continued litigation, and (3) the conclusion of plaintiff's

counsel that the terms and conditions of the Settlement are fair, reasonable, adequate, and in the best interests of the Company and its stockholders.

NOW, THEREFORE, IT IS STIPULATED AND AGREED, in consideration of the benefits afforded as described herein, subject to the approval of the Court and pursuant to Court of Chancery Rule 23.1, as follows:

1. All claims, rights, demands, causes of action, suits, matters and issues known or unknown by plaintiff, any other past or present stockholder of the Company, or the Company, or by their or its predecessors, successors or assigns (or any person claiming by, through, in the right of, or on behalf of them or the Company by subrogation, assignment or otherwise), whether asserted directly, derivatively or otherwise, against Defendants (including the Company, as nominal defendant) or any of their families, parent entities, affiliates, subsidiaries, predecessors, successors or assigns, and each and all of their respective past, present or future officers, directors, associates, stockholders, controlling persons, representatives, employees, attorneys, financial or investment advisors, consultants, accountants, investment bankers, commercial bankers, engineers, advisors or agents, heirs, executors, trustees, general or limited partners or partnerships, personal representatives, estates or administrators (collectively, the "Released Persons"), whether under state, federal, common or administrative law, which have been, or could have been, asserted relating to the Transaction, the related disclosure materials, disclosures, facts and allegations that are or could (insofar as such transactions, disclosures, facts and allegations relate to, result from, or occurred in connection with, the subject matter of the Actions) be the subject of the Actions (collectively, the "Settled Claims"), shall be compromised, settled, released and dismissed with prejudice, upon and



subject to the following terms and conditions; provided, however, that the Settled Claims shall not include the right to enforce the terms of this Stipulation.

2. In full and final settlement of the Actions, the parties agree that:

(a) Vector will pay seven million dollars (\$7,000,000) in cash to New Valley (i) if no appeal is taken from the entry of the Final Order (defined in paragraph 4, below), within five (5) business days following the last date on which such an appeal could have been timely filed; and (ii) if an appeal is taken from the entry of the Final Order, within five (5) business days of the first to occur of (x) affirmance of the Final Order on appeal following the exhaustion of all possible appeals and (y) the expiration of the time to file a further appeal from an affirmance on appeal of the Final Order with no such further appeal having been filed.

(b) As soon as practicable after the execution of this Stipulation, the parties jointly shall apply to the Court for an Order in the form attached hereto as Exhibit A (the "Scheduling Order"), which shall provide, inter alia: (a) that a notice substantially in the form attached hereto as Exhibit B (the "Notice") is approved, and that distribution of the Notice in the manner and the form set forth in the Scheduling Order is the best notice practicable under the circumstances and meets the requirements of due process and applicable law and shall constitute due and sufficient notice of the proposed Settlement to all persons entitled to receive notice; and (b) that a hearing (the "Settlement Hearing") shall be held at a date set by the Court to determine whether the Settlement is fair, reasonable and adequate and should be approved by the Court.

3. The Company shall be responsible for the reproduction and distribution of the Notice in accordance with the Scheduling Order and all costs related to such Notice

shall be paid by the Company whether or not the Settlement is approved. Prior to or at the Settlement Hearing, counsel for the Company shall file with the Court an appropriate affidavit with respect to preparation and distribution of the Notice.

4. If the Settlement is approved by the Court, the parties promptly shall request that the Court enter a final order and judgment dismissing the Actions with prejudice (the "Final Order"), substantially in the form attached hereto as Exhibit C.

5. At or before the Settlement Hearing, plaintiff's counsel may apply for an award of fees not to exceed two million one hundred thousand dollars (\$2,100,000) and documented expenses not exceeding fifty thousand dollars (\$50,000), to be paid by New Valley as plaintiff's counsel shall direct. Defendants agree not to oppose an application up to those amounts. The fairness, reasonableness and adequacy of the Settlement may be considered and ruled upon by the Court independently of any award of attorneys' fees and expenses. Defendants retain the rights to oppose any other application for fees or disbursements by plaintiff, plaintiff's counsel or any other person. Subject to the terms and conditions of this Stipulation, such fees and expenses shall become payable within two (2) business days from the later of the date on which (i) the order approving the Settlement is entered or (ii) any separate Order of the Court awarding plaintiff's counsel fees and expenses is entered. As a condition precedent to receiving payment of attorneys fees and expenses in conformity with this paragraph, plaintiff's counsel agree, jointly and severally, to repay to New Valley the fees and expenses so received, or the appropriate portion thereof, within 60 days in the event that either the Settlement is overturned on appeal or the amount of plaintiff's counsel's approved fees and expenses is lowered on appeal.

6. Each of the parties shall have the option to withdraw from and terminate the Settlement in the event that (a) either the Scheduling Order or the Final Order are not entered substantially in the forms specified herein, including such modifications thereto as may be ordered by the Court with the consent of the parties; or (b) the Settlement is not approved by the Court or is disapproved or substantially modified upon appeal. For purposes of this section, a disallowance or modification by the Court or on appeal of the fees and expenses provided for in paragraph 5 hereof shall not be deemed a modification or disapproval of the Settlement or the Final Order. In the event that a party withdraws from and terminates this Settlement, that party must provide, within five (5) business days of the event giving rise to such action, written notice of such withdrawal or termination and the grounds therefore to all signatories to this Stipulation.

7. In the event the Settlement proposed herein is not approved by the Court, or the Court approves the Settlement but such approval is reversed or vacated on appeal, reconsideration or otherwise and such order reversing or vacating the Settlement becomes final by lapse of time or otherwise, or if any of the conditions to such Settlement are not fulfilled, then the Settlement proposed herein shall be of no further force and effect, and this Stipulation and all negotiations, proceedings and statements relating thereto and any amendment thereof shall be null and void and without prejudice to any party hereto, and each party shall be restored to his, her or its respective position as it existed prior to the execution of this Stipulation, including the repayment of attorneys' fees and expenses as set forth above.

8. If the Settlement is terminated for any reason whatsoever, all negotiations, proceedings, agreements, documents, and statements made in connection herewith shall

not be deemed or construed to be evidence or an admission by any party of any act, matter or proposition and shall not be used in any manner or for any purpose in any subsequent proceeding in the Actions, or in any other action or proceeding.

9. The provisions contained in this Stipulation are not and shall not be argued by any person to be or to be deemed to be a presumption, concession or admission by any defendant of any fault, liability or wrongdoing as to any facts or claims alleged or asserted in this or any other action or proceeding, or to be or to be deemed to be a presumption, concession or admission by plaintiff of any lack of merit in the claims alleged or asserted, and shall not be interpreted, construed, deemed, invoked, offered or received in evidence or otherwise used by any person in this or any other action or proceeding, civil, criminal or administrative, except in a proceeding to enforce the terms or conditions of the Stipulation.

10. Defendants have denied and continue to deny that they have engaged in any misconduct or breaches of duty alleged in the Actions, and they have denied and continue to deny the material allegations of the Amended Complaint and all prior complaints in the Actions, and assert that the claims alleged are without merit, and that their conduct at all times has been lawful and proper. Nevertheless, Vector believes that the continued litigation of the Actions could have a substantial adverse effect upon its reputation, and it has agreed to fund the settlement payment set forth in paragraph 2 hereof to ensure that it does not suffer such reputational injury.

11. If any claims which are or would be subject to the release and dismissal contemplated by the Settlement are asserted against any Released Person in any court

prior to the Settlement becoming Final, plaintiff shall join in any motion to dismiss or stay such proceedings.

12. Each of the attorneys executing this Stipulation on behalf of one or more parties hereto warrants and represents that he or she duly has been authorized and empowered to execute the Stipulation on behalf of his or her respective clients.

13. This Stipulation constitutes the entire agreement among the parties, and supersedes any prior agreements among the parties (including, without limitation, the proposed settlement in principle) with respect to the subject matter hereof. This Stipulation may not be amended nor may any of its provisions be waived except by a writing executed by all of the parties hereto.

14. This Stipulation, upon becoming operative, shall be binding upon and inure to the benefit of the parties hereto (and in the case of the benefits, all Released Persons) and their respective executors, administrators, legal representatives, heirs, transferees, successors in interest and assigns and upon any corporation, partnership or other entity into or with which any party may merge or consolidate.

15. All of the exhibits hereto are incorporated herein by reference as if set forth herein verbatim, and the terms of all exhibits are expressly made part of this Stipulation.

16. This Stipulation shall be governed by and interpreted according to Delaware law, without reference to rules of conflicts of laws.

17. The waiver by any party of any breach of this Stipulation shall not be deemed or construed as a waiver of any other breach, whether prior, subsequent, or contemporaneous, of this Stipulation.

18. This Stipulation may be executed in any number of actual or telecopied counterparts and by each of the different parties thereto on several counterparts, each of which when so executed and delivered shall be an original. The executed signature page(s) from each actual or telecopied counterpart may be joined together and attached to one such original and shall constitute one and the same instrument.

19. The parties hereto and their attorneys agree to cooperate fully with one another and to use their best efforts in seeking and securing Court approval of this Stipulation and the Settlement.

Dated: March 11, 2005

/s/ Jay W. Eisenhofer

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Jay W. Eisenhofer  
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/s/ Norman M. Monhait

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/s/ Michael L. Hirschfeld

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Attorneys for Defendants

**RULE 13a-14(a) CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Bennett S. LeBow, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vector Group Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2005

/s/ Bennett S. LeBow

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Bennett S. LeBow

Chairman and Chief Executive Officer



**RULE 13a-14(a) CERTIFICATION OF CHIEF FINANCIAL OFFICER**

I, Joselynn D. Van Siclen, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Vector Group Ltd.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 10, 2005

/s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen

Vice President and Chief Financial Officer

**SECTION 1350 CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

In connection with the Quarterly Report of Vector Group Ltd. (the "Company") on Form 10-Q for the quarter ended March 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Bennett S. LeBow, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

May 10, 2005

/s/ Bennett S. LeBow

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Bennett S. LeBow

Chairman and Chief Executive Officer

**SECTION 1350 CERTIFICATION OF CHIEF FINANCIAL OFFICER**

In connection with the Quarterly Report of Vector Group Ltd. (the "Company") on Form 10-Q for the quarter ended March 31, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joselynn D. Van Siclen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to my knowledge:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

May 10, 2005

/s/ Joselynn D. Van Siclen

Joselynn D. Van Siclen

Vice President and Chief Financial Officer

## I. GOVERNMENTAL HEALTH CARE RECOVERY ACTIONS

UNITED STATES OF AMERICA V. PHILIP MORRIS, INC., ET AL., Case No. 1:99CV02496, USDC, District of Columbia (case filed 9/22/99). The United States of America seeks to recover the proceeds received, and to be received, by tobacco company defendants and certain affiliates for wrongful sales of tobacco products. In October 2000, the District Court dismissed the government's claims pursuant to the Medicare Secondary Payor Act and the Medical Cost Recovery Act, but denied motions to dismiss RICO claims. In February 2005, the United States Court of Appeals for the District of Columbia ruled that disgorgement is not an available remedy. In April 2005, the appellate court denied the government's request that the disgorgement ruling be reconsidered. The government may appeal to the United States Supreme Court. This action is currently at trial. See Note 7, Contingencies, for a more detailed discussion of the case.

COUNTY OF COOK V. PHILIP MORRIS, ET AL., Case No. 97L04550, Circuit Court, State of Illinois, Cook County (case filed 7/21/97). County of Cook seeks to obtain declaratory and equitable relief and restitution as well as to recover money damages resulting from payment by the County for tobacco-related medical treatment for its citizens and health insurance for its employees. Appellate Court affirmed dismissal on September 28, 2004; Petition to appeal with Illinois Supreme Court.

GENERAL SICK FUND (KUPAT HOLIM CLALIT) V. PHILIP MORRIS, INC., ET AL., Case No. 1571/98, District Court, Israel, Jerusalem (case filed 9/28/98). General Sick Fund seeks monetary damages and declaratory and injunctive relief on behalf of itself and all of its members.

REPUBLIC OF PANAMA V. THE AMERICAN TOBACCO COMPANY, INC., ET AL., Case No. 98-17752, Civil District Court, State of Louisiana, Orleans Parish (case filed 10/20/98). The Republic of Panama seeks compensatory and injunctive relief for damages incurred by the Republic in paying for the Medicaid expenses of indigent smokers. Transferred to the Judicial Panel on Multidistrict Litigation in the United States District Court of the District of Columbia on 11/6/00.

THE STATE OF SAO PAULO V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 20 00-02058, Civil District Court, Louisiana, Parish of Orleans (case filed 2/9/00). The State of Sao Paulo seeks reimbursement of the funds expended on behalf of those injured by and addicted to defendants' tobacco products.

COUNTY OF WAYNE V. PHILIP MORRIS INCORPORATED, ET AL., USDC, Eastern District, Michigan. County of Wayne seeks to obtain damages, remediation through tobacco education and anti-addiction programs, injunctive relief, attorneys' fees and costs.

CITY OF ST. LOUIS, ET AL. V. AMERICAN TOBACCO COMPANY, INC., ET AL., Case No. CV-982-09652, Circuit Court, State of Missouri, City of St. Louis (case filed 12/4/98). City of St. Louis and area hospitals seek to recover past and future costs expended to provide healthcare to

Medicaid, medically indigent, and non-paying patients suffering from tobacco-related illnesses. Trial is slated to commence in January 2006.

COUNTY OF ST. LOUIS, MISSOURI V. AMERICAN TOBACCO COMPANY, INC., ET AL., Case No. 982-09705, Circuit Court, State of Missouri, City of St. Louis (case filed 12/10/98). County seeks to recover costs from providing healthcare services to Medicaid and indigent patients, as part of the State of Missouri terms as a party to the Master Settlement Agreement.

THE CROW CREEK SIOUX TRIBE V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. CV 97-09-082, Tribal Court of The Crow Creek Sioux Tribe, State of South Dakota (case filed 9/26/97). Indian tribe seeks equitable and injunctive relief for damages incurred by the tribe in paying for the expenses of indigent smokers.

REPUBLIC OF BOLIVIA V. PHILIP MORRIS COMPANIES, INC., ET AL., Case No. 6949\*JG99, District Court, State of Texas, Brazoria County, State of Texas (case filed 1/20/99). The Republic of Bolivia seeks compensatory and injunctive relief for damages incurred by the Republic in paying for the Medicaid expenses of indigent smokers.

THE STATE OF RIO DE JANEIRO OF THE FEDERATED REPUBLIC OF BRAZIL V. PHILIP MORRIS COMPANIES, INC., ET AL., Case No. CV-32198, District of Angelina County, State of Texas (case filed 7/12/99). The State of Rio de Janeiro of The Federated Republic of Brazil seeks compensatory and injunctive relief for damages incurred by the Republic in paying for the Medicaid expenses of indigent smokers.

## II. THIRD-PARTY PAYOR ACTIONS

FIBREBOARD CORPORATION, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 791919-8, Superior Court of California, County of Alameda (case filed 11/10/97). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

GLOVER, ET AL. V. PHILIP MORRIS USA, ET AL., Case No. 3:04-CV-403-J-16 MMH,, USDC, Middle District of Florida (case filed 5/26/04). Plaintiffs are seeking to recover for the Medicare program all the expenditures it made from May, 26, 1998 to the present for the healthcare services received by Medicare beneficiaries for the treatment of certain tobacco related diseases.

CENTRAL ILLINOIS LABORERS HEALTH & WELFARE TRUST FUND, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-L516, USDC, Southern District of Illinois (case filed 5/22/97). Health and Welfare Trust Fund seeks injunctive relief and economic reimbursement to recover moneys expended by Fund to provide medical treatment to its participants and beneficiaries suffering from smoking-related illnesses.

KAISER ALUMINUM & CHEMICAL CORPORATION, ET AL V. RJR NABISCO, ET AL., Case No. 2000-615, Circuit Court of Mississippi, Jefferson County (case filed 12/15/00). Asbestos company seeks reimbursement for damages paid to asbestos victims for medical and other relief, which damages allegedly are attributable to the tobacco companies.

BLUE CROSS AND BLUE SHIELD OF NEW JERSEY, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 98-3287, New York, Eastern District. Action brought on behalf of twenty-four Blue Cross/Blue Shield insurers seeking to recover health care costs attributable to smoking. Judgment has been entered on a jury verdict and award of attorneys fees in favor of one plan, Empire Blue Cross and Blue Shield. The case has been appealed to the United States Court of Appeals for the Second Circuit. In September 2003, the Second Circuit rendered a decision which, among other things, certified certain legal questions concerning that appeal to the Court of Appeals of the State of New York, which agreed to review the certified questions. The Court of Appeals of the State of New York rendered a decision in October 2004. In December 2004, the Second Circuit vacated the award of compensatory damages and attorney's fees. In February 2005, the parties stipulated to a dismissal with prejudice. See Note 7, Contingencies, for a more detailed discussion of the case.

### III. SLAVERY REPARATIONS

JOHNSON, ET AL. V. AETNA , INC., ET AL., Case No. 02-2712, USDC, Louisiana, Eastern District. This class action is brought on behalf of all African American slave descendants for slavery reparations.

BANKHEAD, ET AL. V. LLOYD'S OF LONDON, ET AL., Case No. 05 CV 6966, USDC, Southern District of New York (case filed 9/3/02). This class action is brought on behalf of all African American slave descendants for slavery reparations.

TIMOTHY HURDLE V. FLEET BOSTON FINANCIAL, ET AL., Case No. 02-02653, USD, Northern District of California (case filed 09/10/02). This class action is brought on behalf of all African American slave descendants for slavery reparations.

### IV. CLASS ACTION CASES

JEFFERSON COUNTY, ET AL. V. PHILIP MORRIS, INC., ET AL., Case No. CV 02-6170, Circuit Court, Jefferson County, Alabama (case filed 10/10/02). This action is for injunctive relief and damages. Plaintiffs allege a class action against the tobacco defendants for their smoking related medical expenses unpaid by Medicaid.

BROWN, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 711400, Superior Court of California, County of San Diego (case filed 10/1/97). This personal injury class action is brought on behalf of plaintiff and all similarly situated allegedly injured smokers resident in California. In April 2001, the court granted in part plaintiff's motion

for class certification. In March 2005, the court granted defendant's motion to decertify the case based on a recent change in California law. In April 2005, the court issued a tentative ruling that denied plaintiff's motion for reconsideration of the order that decertified the case. See Note 7, Contingencies, for a more detailed discussion of this case.

ENGLE, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 94-08273 CA 20, Circuit Court, Florida, Dade County (case filed 5/5/94). This personal injury class action is brought on behalf of plaintiff and all similarly situated allegedly injured smokers resident in Florida. The case was certified as a class action in October 1994. Trial commenced in July 1998. A judgment for compensatory and punitive damages was entered in November 2000. The judgment was reversed by the intermediate appellate court in May 2003. The Florida Supreme Court accepted the case for appeal and oral argument was held in November 2004. See Note 7, Contingencies, for a more detailed discussion of this case.

CLEARY, ET AL. V. PHILIP MORRIS, INC., ET AL., Case No. 98 L06427, Circuit Court of the State of Illinois, Cook County (case filed 6/11/98). This personal injury class action is brought on behalf of plaintiff and all similarly situated smokers resident in Illinois.

YOUNG, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 2:97-CV-03851, Civil District Court, State of Louisiana, Orleans Parish (case filed 11/12/97). This personal injury class action is brought on behalf of plaintiff and all similarly situated allegedly injured smokers resident in Louisiana.

RICHARDSON, ET AL. V. PHILIP MORRIS, ET AL., Case No. 96145050/CL212596, Circuit Court, Baltimore City, Maryland (case filed on 5/29/96). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated allegedly addicted smokers resident in Maryland.

OWENS ILLINOIS, INC. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2000-0077, Circuit Court, Mississippi, Sharkey County (case filed 4/9/01). There are no individual plaintiffs in this case, and while it may be dismissed, it is currently active.

SCHWAB, ET AL. V. PHILIP MORRIS USA, INC., ET AL., Case No. CV-04 1945, USDC, Eastern District of New York (case filed 5/11/04). This class action seeks economic damages on behalf of plaintiffs and all others similarly situated under the RICO act challenging the practices of defendants in connection with the marketing, advertising, promotion, distribution and sale of light cigarettes in comparison to regular cigarettes delivering lower levels of tar and/ or nicotine. Plaintiff seeks certification of a nationwide class. Trial in the case is scheduled for January 2006.

SIMON, ET AL. V. PHILIP MORRIS INC, ET AL., Case No CV 99 1988, USDC, Eastern District of New York (case filed 4/9/99). This personal injury action is brought on behalf of plaintiffs seeking certification of a nationwide class under the applicable provisions of Rule 23 of the Federal Rules of Civil Procedure, on behalf of persons who have smoked defendant's cigarettes and who presently have a claim for personal injuries or damages, or wrongful death, arising from the smoking of defendants' cigarettes.

IN RE SIMON (II) LITIGATION, Case No 00-CV-5332, USDC, Eastern District of New York (case filed 9/6/2000). This action consolidates claims of ten other individual and class action personal injury tobacco cases, and is brought on behalf of plaintiffs seeking certification of a nationwide class under the applicable provisions of Rule 23 of the Federal Rules of Civil Procedure. In September 2002, the court granted plaintiff's motion for certification of a nationwide punitive damages class. In May 2005, the United States Court of Appeals for the Second Circuit vacated the trial court's certification order and remanded the case to the trial court for further proceedings. See Note 7, Contingencies, for a more detailed discussion of this case. (Consolidated Cases: 99-CV-1988, 00-CV-2340, 00-CV-4632, 00-CV-4442, 98-CV-1492, 99-CV-6142, 98-CV-3287, 98-CV-7658, 98-CV-0675, 99-CV-7392).

CREEKMORE, ET AL. V. BROWN & WILLIAMSON TOBACCO CORPORATION, ET AL., Case No. 98 CV 03403, Superior Court of North Carolina, Buncombe County (case filed 11/19/98). This personal injury class action is brought on behalf of plaintiffs and all similarly situated allegedly injured smokers resident in North Carolina.

MARTINEZ, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 030900239, 3rd Judicial Court of Utah, Salt Lake County (case filed 01/07/03). This "addiction-as-injury" class action is brought on behalf of plaintiff and all similarly situated allegedly injured smokers resident in Utah.

INGLE, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-C-21-S, Circuit Court, State of West Virginia, McDowell County (case filed 2/4/97). This personal injury putative class action is brought on behalf of plaintiff and all similarly situated allegedly injured smokers resident in West Virginia.

IN RE TOBACCO MM (6000) (BLANKENSHIP), Case No. 00-C-6000, Circuit Court, West Virginia, Ohio County. Class action seeking payments for costs of medical monitoring for current and former smokers. Liggett was severed from trial of other tobacco company defendants. Judgment upon jury verdict in favor of other tobacco company defendants was affirmed by the West Virginia Supreme Court in May 2004, which denied plaintiff's petition for rehearing during July of 2004. Plaintiffs did not seek further appellate review of this matter and the case has been concluded in favor of the other defendants.

MCCUNE V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 97-C-204, Circuit Court, State of West Virginia, Kanawha County (case filed 1/31/97). This "addiction-as-injury" putative class action is brought on behalf of plaintiff and all similarly situated allegedly addicted smokers resident in West Virginia.

PARSONS, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 98-C-388, Circuit Court, State of West Virginia, Kanawha County (case filed 4/9/98). This personal injury class action is brought on behalf of plaintiff's decedent and all West Virginia residents having claims for personal injury arising from exposure to both cigarette smoke and asbestos fibers.



V. INDIVIDUAL SMOKER CASES

CAMPBELL, WILLIE ET AL. V. BROWN & WILLIAMSON TOBACCO CORPORATION ET AL., Case No. CV-02-184-MJ-C, USDC, Southern District, Alabama. Three individuals suing.

ADAMS, DIXIE, ET AL . V. AMERICAN TOBACCO CO, INC., ET AL., Case No. GC 030373, Superior Court, Los Angeles County, California. Three individuals suing.

BROWN V., ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 00AS02085, Superior Court, Sacramento County, California (case filed 4/18/00). Two individuals suing.

DONALDSON, ET AL. V. RAYBESTOS MANHATTAN, INC., ET AL., Case No.998147, Superior Court of California, County of San Francisco (case filed 9/25/98). Two individuals suing.

THOMAS, ALBERT V. THE TOBACCO RESEARCH COMMITTEE, ET AL., Case No. 1:04CV02094, USDC, District Court of Columbia (case filed 12/3/04). One individual suing (Pro Se).

CHRISTENSEN, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 02136, Court of Special Appeals, District of Columbia (case filed 9/03). Two individuals suing.

PLUMMER, BRENDA, ET AL. V. THE AMERICAN TOBACCO., Case No. 6480, Superior Court, District of Columbia. Three individuals suing.

SIMS, ET AL. V. PHILIP MORRIS, INC., ET AL., Case No. 1:01CV01107, USDC, District of Columbia (case filed 5/23/01). Three individuals suing.

ARMAND V. PHILIP MORRIS, ET AL., Case No. 97-31179-CICI, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 7/9/97). Two individuals suing.

ARNOLD, JAMES, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 04 00472, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 01/16/04). One individuals suing. - Abated pending resolution of ENGLE.

ATCHESON V. R. J. REYNOLDS, ET AL., Case No. 97-31148-CICU, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 7/29/97). One individual suing.

AUSTIN, W., V. R. J. REYNOLDS , ET AL., Case No. 05-00680, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

BARTLEY, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-11153, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/21/97). Two individuals suing.

BLAIR V. R. J. REYNOLDS, ET AL., Case No. 97-31177, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 7/29/97). One individual suing.

BLAKE, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 01-13549, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 6/7/01). Two individuals suing.

BLANK V. PHILIP MORRIS, ET AL., Case No. 97-05443, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 4/10/97). Two individuals suing.

BLUM V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 96005881, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County. One individual suing.

BRADLEY, ET AL. V. AMERICAN TOBACCO, ET AL., Case No. 6:02-CV-01385, USDC, Middle District, Florida. Two individuals.

BRITAN, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 01-13451, County Court of the 11th Judicial Circuit, Florida, Miami-Dade County. One individual suing.

BRONSTEIN, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-008769, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). Two individuals suing.

BROWN, JACKIE V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-0790, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

BROWN, S. , ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 03-18552 CA 04, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 08/11/03). Two individuals suing.

BURNS, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-11175-27, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 4/3/98). One individual suing.

CAGLE, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 02 10718, 13th Judicial Circuit, Florida, Hillsborough County (case filed 11/22/02). Two individuals suing. Abated pending resolution of ENGLE.

CALHOUN, C., ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 02-7970, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 8/27/02). Two individuals suing. Abated pending resolution of ENGLE.

CICCONE, ET AL. V. BROWN & WILLIAMSON TOBACCO CORPORATION, ET AL., Case No. 0413258, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 8/19/04). One individual suing.

CLARK, CAROL M. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 02-16981, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County, (case filed 7/3/02). One individual suing.

COFFEY V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 01-09335, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

COTTO, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-748, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 1/22/03). Two individuals suing. Abated pending resolution of ENGLE.

COLIC, ET AL V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-10844, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

COWART V. LIGGETT GROUP INC, ET AL., Case No.98-01483CA, Circuit Court of the 11th Judicial Circuit, Florida, Duval County (case filed 3/16/98). One individual suing.

COX V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-00677, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

DAVIS, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-11145, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). One individual suing.

DAVIS, BEVERLY, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 02-48914, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 10/4/02). Jury decision in April 2004 awarded compensatory damages of \$540, 000 against Liggett. In addition, plaintiff's counsel was awarded legal fees of \$752,000. Liggett has appealed the judgment.

DAVISON, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97008776, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). Two individuals suing.

DE LA TORRE, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-11161, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). One individual suing.

DILL V. PHILIP MORRIS, ET AL., Case No. 97-05446, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 4/10/97). One individual suing.

DITSLEAR V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-0899, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

DOUGHERTY V. PHILIP MORRIS INC., ET AL., Case No. 1999 32074 CICI, Circuit Court, Florida, Volusia County (case filed 11/17/99). One individual suing.

DUECKER V. LIGGETT GROUP INC., Case No. 98-03093 CA, Circuit Court of the 4th Judicial Circuit, Florida, Duval County (case filed 7/5/98). One individual suing. Liggett is the only defendant.

FERLANTI, ET AL. V. LIGGETT GROUP INC., ET AL., Case No.0321697, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 12/11/03). Two individuals suing. Liggett is the only defendant. In March 2005, the court granted Liggett's motion for summary judgment disposing of the case in its entirety. The plaintiff has appealed.

FLAKS, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-008750, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). Two individuals suing.

FUCHS V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-00681, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

GARRETSON, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 97-32441 CICI, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 10/22/96). One individual suing.

GOLDBERG, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-008780, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). Two individuals suing.

GRANT, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-2673-Div. I, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

GRAY, ET AL. V. THE AMERICAN TOBACCO CO., ET AL., Case No. 97-21657 CA 42, Circuit Court of the 11th Judicial Circuit, Florida, Putnam County (case filed 10/15/97). Two individuals suing.

GUARCH, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 02-3308 CA 22, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 2/5/02). Two individuals suing.

HARRIS, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-1151, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). Two individuals suing. Abated pending resolution of ENGLE.

HARRIS, DONALD, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 02-8105, 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

HART, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 9708781, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). One individual suing.

HAYES, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 97-31007, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 6/30/97). Two individuals suing.

HAYHURST, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 03-12302, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/14/03). Two individuals suing.

HECKER V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-9336, 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

HENIN V. PHILIP MORRIS, ET AL., Case No. 97-29320 CA 05, Circuit Court of the 11th Judicial Circuit, Florida, Dade County (case filed 12/26/97). One individual suing.

HENNING. ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-11159, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). Two individuals suing.

HITCHENS, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97008783, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97).

HUTTO, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-02552, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

JONES, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 02-21922 CA 22, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 08/29/02). Two individuals suing.

LAPPIN V. R.J. REYNOLDS, ET AL., Case No. 97-31371 CICI, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 6/2/97). One individual suing.

LASCHKE, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 96-8131-CI-008, Circuit Court of the 6th Judicial Circuit, Florida, Pinellas County (case filed 12/20/96). Two individuals suing. Dismissal reversed on appeal. Remanded to the 6th Judicial Circuit.

LEWIS, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 05-02167, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

LEVINE V. R.J. REYNOLDS, ET AL., Case No. CL 95-98769 (AH), Circuit Court of the 15th Judicial Circuit, Florida, Palm Beach County (case filed 7/24/96). One individual suing.

LOBLEY V. PHILIP MORRIS, ET AL., Case No. 97-1033-CA-10-L, Circuit Court of the 18th Judicial Circuit, Florida, Seminole County (case filed 7/29/97). Two individuals suing.

LUKACS, JOHN V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Circuit Court of the 11th Judicial Circuit Court, Florida, Miami-Dade County. One individual suing. See Note 7, Contingencies, for a more detailed discussion of this case.

LUSTIG, ET AL. V. BROWN & WILLIAMSON TOBACCO CO., ET AL., Case No. 97 11168, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). One individual suing.

MAGALDI, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 02-2120 CA 11, Circuit court of the 11th Judicial Court, Florida, Miami-Dade County (case filed 8/21/02). Two individuals suing.

MAGLIARISI, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97008895, Circuit Court of the 17 Judicial Circuit, Florida, Broward County (case filed 6/11/97). One individual suing.

MANLEY, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-11173-27, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 4/3/98). Two individuals suing.

MARTINEZ, ET AL. V. LIGGETT GROUP INC., Case No. 02-20943-CA15, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 10/14/02). One individual suing. Liggett is the only defendant. The jury returned a defense verdict in February 2005. The plaintiff's post-trial motion seeking a new trial is pending.

MCBRIDE, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 02-0585, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 6/4/02). One individual suing. Abated pending resolution of ENGLE.

MCDONALD, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 03-4767, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 5/19/03). One individual suing. Abated pending resolution of ENGLE.

MCINTEER V. R.J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-00947, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

MECKLER, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-03949-CA, Circuit Court of the 4th Judicial Circuit, Florida, Duval County (case filed 7/10/97). One individual suing.

MULLIN V. PHILIP MORRIS, ET AL., Case No. 95-15287 CA 15, Circuit Court of the 11th Judicial Circuit, Florida, Dade County (case filed 11/7/95). One individual suing.

O'ROURKE V. LIGGETT GROUP INC., ET AL., Case No. 97-31345-CICI, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 6/2/97). One individual suing.

PEREZ, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 96-1721-CIV-T-24B, USDC, Middle District of Florida (case filed 8/20/96). One individual suing.

PHILLIPS V. R.J. REYNOLDS, ET AL., Case No. 97-31278, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 5/27/97). One individual suing.

PIPOLO V. PHILIP MORRIS, ET AL., Case No. 97-05448, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 4/10/97). Two individuals suing.

QUINN, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-4768, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County (case filed 5/19/03). One individual suing. Abated pending resolution of ENGLE.

RAUCH, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-11144, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). Two individuals suing.

RAWLS, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 97-01354 CA, Circuit Court of the 4th Judicial Circuit, Florida, Duval County (case filed 3/6/97). One individual suing.

RODRIGUEZ V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 02-04912-CA-11, Circuit Court, Florida, Miami-Dade County. One individual suing.

SCHULTZ V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 99019898, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 11/24/99). One individual suing.

SCHWARTZ, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. CA 030027078, Circuit Court of the 15th Judicial Circuit, Florida, Palm Beach County (case filed 02/24/03). Two individuals suing. Liggett is the only defendant. The case is scheduled for trial in May 2005.

SHAW, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-008755, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). Two individuals suing.

SHAW, BARBARA, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 05-2863, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

SHEEHAN V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 01-9559, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. One individual suing. Abated pending resolution of ENGLE.

SHIRAH, ET AL. V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-1589-Div. C, Circuit Court of the 13th Judicial Circuit, Florida, Hillsborough County. Two individual suing. Abated pending resolution of ENGLE.

SPOTTS V. R.J. REYNOLDS, ET AL., Case No. 97-31373 CICI, Circuit Court of the 4th Judicial Circuit, Florida, Volusia County (case filed 9/16/97). One individual suing.

STAFFORD V. BROWN & WILLIAMSON, ET AL., Case No. 97-7732-CI-019, Circuit Court of the 6th Judicial Circuit, Florida, Pinellas County (case filed 11/14/97). One individual suing. Abated pending resolution of ENGLE.

STEWART, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 97 2025 CA, Circuit Court of the 5th Judicial Circuit, Florida, Lake County (case filed 9/16/97). Two individuals suing.

STRICKLAND, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 98-00764, Circuit Court of the 11th Judicial Circuit, Florida, Dade County (case filed 1/8/98). Two individuals suing.

STROHMETZ V. PHILIP MORRIS, ET AL., Case No. 98-03787 CA, Circuit Court of the 4th Judicial Circuit, Florida, Duval County (case filed 7/16/98). One individual suing.

SWANK-REICH V. BROWN & WILLIAMSON, ET AL., Case No. 97008782, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). One individual suing.

THOMSON, BARRY, V. R.J. REYNOLDS, ET AL., Case No. 97-400-CA, Circuit Court of the 7th Judicial Circuit, Florida, Flagler County (case filed 9/2/97). One individual suing.

THOMSON, EILEEN, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-11170, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 7/21/97). One individual suing.

VENTURA V. R.J. REYNOLDS TOBACCO CO., ET AL., Case No. 97-27024 CA (09), Circuit Court of the 11th Judicial Circuit, Florida, Dade County (case filed 11/26/97). One individual suing.

WALKER V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-8482, 13th Judicial Circuit, Florida, Hillsborough County. (case filed 09/11/03). One individual suing. Abated pending resolution of ENGLE.

WARD V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 03-8480, 13th Judicial Circuit, Florida, Hillsborough County. (case filed 09/11/03). One individual suing. Abated pending resolution of ENGLE.

WASHINGTON, ET AL. V. PHILIP MORRIS, ET AL., Case No. 97-10575 CIDL, Circuit Court of the 7th Judicial Circuit, Florida, Volusia County (case filed 9/16/97). Two individuals suing.

WELLS V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 02 21340 CA 30, Circuit Court of the 11th Judicial Circuit, Florida, Miami-Dade County (case filed 8/22/02). One individual suing.

WEIFFENBACH, ET UX. V. PHILIP MORRIS, ET AL., Case No. 96-1690-CIV-T-24C, USDC, Middle District of Florida (case filed 8/30/96). Two individuals suing.

WISCH V. LIGGETT GROUP INC., ET AL., Case No. 97-008759, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 6/10/97). One individual suing.



WITT V. BROWN & WILLIAMSON CORPORATION, ET AL., Case No. 04-8530, 13th Judicial Circuit, Florida, Hillsborough County. One individual suing.

ZARRELLA, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 0313947, Circuit Court of the 17th Judicial Circuit, Florida, Broward County (case filed 8/12/03). Two individuals suing.

BROWN-JONES V. THE AMERICAN TOBACCO CO., ET AL., Case No. 98-RCCV-28, Superior Court of Georgia, Richmond County (case filed 1/13/98). Two individuals suing.

BADON, ET UX. V. RJR NABISCO INC., ET AL., Case No. 10-13653, 38th Judicial District, Louisiana, Cameron Parish (case filed 5/24/94). Six individuals suing.

DIMM, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 53919, 18th Judicial District Court, Parish of Iberville, Louisiana. Seven individuals suing.

HUNTER, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002/18748m District Court, Parish of Orleans, Louisiana. (12/4/2002) Two Individuals suing.

NEWSOM, ET AL. V. R.J. REYNOLDS, ET AL., Case No. 105838, 16th Judicial District Court, Parish of St. Mary, Louisiana (case filed 5/17/00). Five individuals suing.

OSER V. THE AMERICAN TOBACCO CO., ET AL., Case No. 97-9293, Civil District of the Judicial District Court, State of Louisiana, Orleans Parish (case filed 5/27/97). One individual suing.

RACCA, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 10-14999, 38th Judicial District Court, State of Louisiana, Cameron Parish (case filed 7/16/98). Eleven individuals suing.

REESE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2003-12761, 22nd Judicial District Court, Louisiana, St. Tammany (case filed 6/10/03). Five individuals suing.

BATEMAN, PERRY V. A C AND S INC., ET AL., Case No. 24-X-02-001595, Circuit Court, Maryland, Baltimore City. One individuals suing.

BARBE, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-001362, Circuit Court, Maryland, Baltimore City (6/7/02). Two individuals suing.

BECKER, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-99-002152, Circuit Court, Maryland, Baltimore City (case filed 10/22/99). Two individuals suing.

BENNETT, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000192, Circuit Court, Maryland, Baltimore City (case filed 1/25/02). Two individuals suing.

BERKEY V. OWENS-ILLINOID GLASS CO., ET AL., Case No. 24-X-03-001009, Circuit Court, Maryland, Baltimore City. One individual suing.

BIEDRZYCKI, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-98-149503, Circuit Court, Maryland, Baltimore City (case filed 5/29/98) . Two individuals suing.

BISIGNANI, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-97-010510, Circuit Court, Maryland, Baltimore City (case filed 1/10/97). Two individuals suing.

BOYD, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-00-000305, Circuit Court, Maryland, Baltimore City (case filed 4/21/00). Two individuals suing.

BRAUN, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000676, Circuit Court, Maryland, Baltimore City (case filed 6/13/03). Two individuals suing.

BUTTA, GLORIA, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002559, Circuit Court, Maryland, Baltimore City (case filed 11/22/02). Four individuals suing.

CARAVELLO, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-95-15350, Circuit Court, Maryland, Baltimore City. Two individuals suing.

CARNES, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-98-028535, Circuit Court, Maryland, Baltimore City. Two individuals suing.

CASPER AL. V. A C AND S ET AL., Case No. 24-X-01-001604, Circuit Court, Maryland, Baltimore City (case filed 10/22/01). Two individuals suing.

CAVEY , ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-98-093530, Circuit Court, Maryland, Baltimore City. Two individuals suing.

CITRANO, ET AL. V. A C AND S INC., ET AL. , Case No.24-X-02-001513, Circuit Court, Maryland, Baltimore City (case filed 6/24/02). One individual suing.

CISSIN V. A C AND S INC., ET AL., Case No.24-X-01-000078, Circuit Court, Maryland, Baltimore City (case filed 01/17/01). One individual suing.

CHATHAM, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-01-000780, Circuit Court, Maryland, Baltimore City. Two individuals suing.

CONN, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000983, Circuit Court, Maryland, Baltimore City. Two individuals suing.

COTY, ET AL. V. QUIGLEY CO., INC., ET AL., Case No. 24-X-04-000212, Circuit Court, Maryland, Baltimore City. Two individuals suing.

COYNE, ET AL. V. A C AND S INC., ET AL, Case No. 24-X-99-001004, Circuit Court, Maryland, Baltimore City (case filed 5/28/99). Four individuals suing.

CULBERTSON, ET AL. V. OWENS ILLINOIS GLASS CO. ET AL., Case No. 24-X-03-0002060, Circuit Court, Maryland, Baltimore City (case filed 2/14/03). One individual suing.

DOHLER, ET UX. V. OWENS -ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000451, Circuit Court, Maryland, Baltimore City (Case filed 4/25/03). Two individuals suing.

DUNAJA, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000189, Circuit Court, Maryland, Baltimore City (case filed 2/10/03). Seven individuals suing.

EICHELBERGER, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000378, Circuit Court, Maryland, Baltimore City (case filed 4/11/03). Six individuals suing.

EIKENBERG, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-99-001782, Circuit Court, Maryland, Baltimore City (case filed 9/8/99). Two individuals suing.

ENGLE, WILLIAM, ET UX V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002162, Circuit Court, Maryland, Baltimore City (case filed 9/27/02). Two individuals suing.

EVERSON, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-219536, Circuit Court, Maryland, Baltimore City (case filed 8/7/98). Two individuals suing.

FAIR, JOYCE, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-219540, Circuit Court, Maryland, Baltimore City (case filed 8/7/98). Six individuals suing.

FAZENBAKER, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000137, Circuit Court, Maryland, Baltimore City (case filed 1/31/03). One individual suing.

FELTON, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000866, Circuit Court, Maryland, Baltimore City (case filed 7/25/03). Two individuals suing.

FIORENZA, ET AL. V. OWENS -ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002448, Circuit Court, Maryland, Baltimore City (case filed 11/6/02). Two individuals suing.

FLEISCHMAN, ET AL. V. OWENS -ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-001120, Circuit Court, Maryland, Baltimore City. One individual suing.

FRITZ, ET UX V. A C AND S INC., ET AL, Case No. 24-X-02-000825, Circuit Court, Maryland, Baltimore City (case filed 4/5/02). Two individuals suing.

FOX, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-96-239541, Circuit Court, Maryland, Baltimore City. Two individuals suing.

GEORGE, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000211, Circuit Court, Maryland, Baltimore City. Five individuals suing.

GERVASI, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-020506, Circuit Court, Maryland, Baltimore City (case filed 1/20/98). Two individuals suing.

GRANT, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-00-001432, Circuit Court, Maryland, Baltimore City ( case filed 12/1/00). Two individuals suing.

GROSE, V. A C AND S INC., ET AL., Case No. 24-X-99-002199, Circuit Court, Maryland, Baltimore City (10/29/99). One individual suing.

HAIRSINE, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-289544, Circuit Court, Maryland, Baltimore City (case filed 10/16/98). Two individuals suing.

HAJINICOLAS, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000829, Circuit Court, Maryland, Baltimore City (case filed 4/5/02). Two individuals suing.

HARPER, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-289543, Circuit Court, Maryland, Baltimore City (case filed 10/16/98). Two individuals suing.

HARRIS, ET AL. V. OWENS ILLINOIS GLASS CO. INC., ET AL., Case No. 24-X-02-002656, Circuit Court, Maryland, Baltimore City (case filed 12/6/02). One individual suing.

HEMPFIELD, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000055, Circuit Court, Maryland, Baltimore City (case filed 1/17/03). Two individuals suing.

HENN, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-00-001374, Circuit Court, Maryland, Baltimore City (case filed 11/22/00). Two individuals suing.

HENNIGER, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000681, Circuit Court, Maryland, Baltimore City. Two individuals suing.

HILL V. A C AND S INC., ET AL., Case No. 24-X-02-000957, Circuit Court, Maryland, Baltimore City (case filed 4/12/02). One individual suing.

HILL, THELMA C., ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000143, Circuit Court, Maryland, Baltimore City. Two individuals suing.

HOLMES, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-90-264509, Circuit Court, Maryland, Baltimore City. One individual suing.

HUFFMAN, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-90-358501, Circuit Court, Maryland, Baltimore City (6/18/90). Two individuals suing.

HUNCHER, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-97-353534, Circuit Court, Maryland, Baltimore City (case filed 12/19/97). Two individuals suing.

INGRAM, ET AL. V. B. F. GOODRICH COMPANY, ET AL., Case No. 24-X-01-002030, Circuit Court, Maryland, Baltimore City (case filed 12/10/01). Two individuals suing.

IRELAND, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-002493, Circuit Court, Maryland, Baltimore City (11/15/02). Five individuals suing.

JACOB, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000931, Circuit Court, Maryland, Baltimore City (case filed 4/12/02). Four individuals suing.

JAGODZINSKI, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-001365, Circuit Court, Maryland, Baltimore City (6/7/02). Three individuals suing.

JAMES, ET AL. V. OWENS CORNING FIBERGLAS CORP., ET AL., Case No. 24-X-98-072526, Circuit Court, Maryland, Baltimore City ( case filed 03/13/98). Two individuals suing.

JENNETTE, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-135533, Circuit Court, Maryland, Baltimore City (case filed 5/15/98). Four individuals suing.

JOHNSON, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-95146511, Circuit Court, Maryland, Baltimore City (case filed 1/6/97). Two individuals suing.

JONES, H, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-00-000061, Circuit Court, Maryland, Baltimore City (case filed 1/27/00). Two individuals suing.

JONES, W, ET UX. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002649, Circuit Court, Maryland, Baltimore City (case filed 12/6/02). One individual suing.

JORDON, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X95-055503, Circuit Court, Maryland, Baltimore City. Three individuals suing.

KAHLER, ET AL. V. A C AND S, INC., ET AL., Case No. 24-X-02-002634, Circuit Court, Maryland, Baltimore City. Two individuals suing.

KENNEDY, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000729, Circuit Court, Maryland, Baltimore City. Two individuals suing.

KRAUS, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002351, Circuit Court, Maryland, Baltimore City (case filed 10/18/02). Two individuals suing.

LANG, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002564, Circuit Court, Maryland, Baltimore City (11/22/02). Three individuals suing.

LEGRAND, ET UX. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000986, Circuit Court, Maryland, Baltimore City. Two individuals suing.

LEWIS, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-01-001906, Circuit Court, Maryland, Baltimore City (11/29/01). Two individuals suing.

MACKENZIE, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-98-341506, Circuit Court, Maryland, Baltimore City (case filed 12/7/98). Two individuals suing.

MARSHALL, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-89-188528, Circuit Court, Maryland, Baltimore City. Two individuals suing.

MASIMORE V. A C AND S INC., ET AL., Case No. 24-X-01-000578, Circuit Court, Maryland, Baltimore City (case filed 04/19/01). One individual suing.

MCCORMACK, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-90-358501, Circuit Court, Maryland, Baltimore City (case filed 8/1/90). Two individuals suing.

MCCORMICK, ROSE, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000260, Circuit Court, Maryland, Baltimore City (case filed 3/7/03). Two individuals suing.

MCCOY, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-001436, Circuit Court, Maryland, Baltimore City (case filed 6/14/02). Five individuals suing.

MCCLUNG, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000743, Circuit Court, Maryland, Baltimore City ( case filed 6/20/03). Two individuals suing.

MCDERMOTT, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-97-045522, Circuit Court, Maryland, Baltimore City (case filed 9/8/00). One individual suing.

NEEDHAM, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-001192, circuit Court, Maryland, Baltimore City. Two individuals suing.

NIELSEN, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-00-000479, Circuit Court, Maryland, Baltimore City (case filed 5/16/00). Two individuals suing.

PARTON, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000063, Circuit Court, Maryland, Baltimore City (case filed 1/17/03). Seven individuals suing.

PIERCE, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-98-219529, Circuit Court, Maryland, Baltimore City. Two individuals suing.

PIERCY, ET AL. V. OWENS- ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002314, Circuit Court, Maryland, Baltimore City (case filed 10/11/02). Two individuals suing.

POMPA, ET AL. V. OWENS CORNING FIBERGLAS, ET AL., Case No. 24-X-98-072505, Circuit Court, Maryland, Baltimore City (case filed 3/13/98). One individual suing.

PRESSLEY V. A C AND S INC., ET AL., Case No. 24-X-02-002682, Circuit Court, Maryland, Baltimore City (case filed 12/13/02). One individual suing.

PRICE, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-001058, Circuit Court, Maryland, Baltimore City. Two individuals suing.

PUSINSKY, ET AL., V. A C AND S INC., ET AL., Case No. 24-X-99-000929, Circuit Court, Maryland, Baltimore City (case filed 5/21/99). Two individuals suing.

RHOADES, ET UX. V. QUIGLEY COMPANY, INC., ET AL., Case No. 24-X-04-000060, Circuit Court, Maryland, Baltimore City. Two individuals suing.

RIDGLEY, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000124, Circuit Court, Maryland, Baltimore City (case filed 1/31/03). Two individuals suing.

ROBERTS V. A C AND S INC., ET AL., Case No. 24-X-02-001161, Circuit Court, Maryland, Baltimore City (case filed 5/10/02). One individual suing.

ROLLINS, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000748, Circuit Court, Maryland, Baltimore City (case filed 3/28/02). Two individuals suing.

RUSSELL, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-98-343501, Circuit Court, Maryland, Baltimore City (case filed 12/9/98). Two individuals suing.

RYAN, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-97-045529, Circuit Court, Maryland, Baltimore City. One individuals suing.

SASSLER, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X96341506, Circuit Court, Maryland, Baltimore City. Three individuals suing.

SAVOIE, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-001666, Circuit Court, Maryland, Baltimore City (7/25/2002). Two individuals suing.

SILBERSACK, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-97083510, Circuit Court, Maryland, Baltimore City (case filed 3/24/96). Three individuals suing.

SMITH, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-01-000771, Circuit Court, Maryland, Baltimore City (case filed 5/25/01). Two individuals suing.

SMITH, K., ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000954, Circuit Court, Maryland, Baltimore City (case filed 4/12/02). Two individuals suing.

SPERANZELLA, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-99-002733, Circuit Court, Maryland, Baltimore City (case filed 12/22/99). One individual suing.

STEFANSKI, ET AL. V. QUIGLEY CO., INC., Case No. 24-X-04-000207, Circuit Court, Maryland, Baltimore City. Five individuals suing.

STUCHINSKI, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-02-000243, Circuit Court, Maryland, Baltimore City (case filed 1/31/02). Two individuals suing.

STRAUSBURG, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-135539, Circuit Court, Maryland, Baltimore City (case filed 5/15/98). Four individuals suing.

STOCKSTILL, ET AL. V. OWENS ILLINOIS GRACE COMPANY, ET AL., Case No. 24-X-03-000272, Circuit Court, Maryland, Baltimore City (case filed 3/7/03). Two individuals suing.

THAMES, ET AL. V. A C AND S INC., ET AL., Case No. 24-X94-325506, Circuit Court, Maryland, Baltimore City (case filed 11/21/94). Two individuals suing.

TULL, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-01-000537, Circuit Court, Maryland, Baltimore City (case filed 4/11/01). Two individuals suing.

TURNER V. A C AND S INC., ET AL., Case No. 24-X-98-301502, Circuit Court, Maryland, Baltimore City. One individual suing.

TWINE V. A C AND S INC., ET AL., Case No. 24-X-02-000582, Circuit Court, Maryland, Baltimore City (3/8/02). One individual suing.

WALKER, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000161, Circuit Court, Maryland, Baltimore City (case filed 1/31/03). Two individuals suing.

WALPOLE, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-02-002177, Circuit Court, Maryland, Baltimore City (case filed 9/27/02). Two individuals suing.

WALTER, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-91-310530, Circuit Court, Maryland, Baltimore City. Two individuals suing.

WAUGH, ET AL. V. QUIGLEY COMPANY, INC., ET AL., Case No. 24-X-04-000209, Circuit Court, Maryland, Baltimore City. Four individuals suing.

WILSON, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-95146533, Circuit Court, Maryland, Baltimore City (case filed 5/26/95). Three individuals suing.



WILLIAMS, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-99-000113, Circuit Court, Maryland, Baltimore City (case filed 1/20/99). Two individuals suing.

WINKLER, ET AL. V. OWENS CORNING FIBERGLAS CORPORATION, ET AL., Case No. 24-X-98-402564, Circuit Court, Maryland, Baltimore City. Two individuals suing.

WITKOWSKI, ET AL. V. A C AND S INC., ET AL., Case No. 24-X-98-020519, Circuit Court, Maryland, Baltimore City (case filed 1/20/98). One individual suing.

WEST, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000970, Circuit Court, Maryland, Baltimore City. Five individuals suing.

WRIGHT, ET AL. V. OWENS ILLINOIS GLASS CO., ET AL., Case No. 24-X-03-000162, Circuit Court, Maryland, Baltimore City (case filed 1/31/03). Two individuals suing.

YOUNG, ET AL. V. OWENS CORNING FIBERGLASS CORPORATION, ET AL., Case No. 24-X-97-139547, Circuit Court, Maryland, Baltimore City (case filed 5/19/97). Two individuals suing.

ZNOVENA, ET AL. V. AC AND S INC., ET AL., Case No. 24-X-97240553CX1848, Circuit Court, Maryland, Baltimore City (case filed 8/24/98). Two individuals suing.

MONTY V. HARVARD PILGRIM HEALTH CARE, ET AL., Demand Letter. Superior Court, Massachusetts. No suit filed.

NYSKO, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Demand letter and draft complaint, Superior Court of Massachusetts, Middlesex County. No suit filed.

PISCIONE V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Demand letter and draft complaint, Superior Court of Massachusetts, Middlesex County. No suit filed.

SATCHELL V. THE TOBACCO INSTITUTE, INC., ET AL., Demand Letter. Superior Court, Massachusetts. No suit filed.

ANGELETHY, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 02-KV-0315-J, Circuit Court, Mississippi, Adams County (case filed 4/21/03). Six individuals suing.

ANDERSON, HARVEY, L., ET AL. V. R. J. REYNOLDS, ET AL., Case No. 2002-309, Chancery Court, Mississippi, Adams County (case filed 4/25/02). Two individuals suing.

BANKS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2000-136, Circuit Court, Mississippi, Jefferson County (case filed 12/22/2000). Six individuals suing.

BARKER, PEARLIE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-64, Circuit Court, Mississippi, Jefferson County (case filed 3/30/01). Three individuals suing.

BELL, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-271, Chancery Court, Mississippi, Jefferson County (case filed 12/18/01). Six individuals suing.

BLYTHE V. RAPID AMERICAN CORPORATION, ET AL., Case No. CI 96-0080-AS, Circuit Court, Mississippi, Jackson County (case filed 9/23/96). One individual suing.

BROWN, GLAYSON, ET AL. V. R.J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-0022(1) Circuit Court, Mississippi, George County (case filed 3/30/01). 224 individuals suing.

BUFORD, ET AL. V R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-268, Chancery Court, Mississippi, Jefferson County (case filed 12/17/01).

CHAMBLISS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-273, Circuit Court, Mississippi, George County (case filed 12/21/01). Four individuals suing.

COCHRAN, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 2002-0366(3), Circuit Court, Mississippi, George County (case filed 12/31/02). One individual suing.

COOK, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 2001-166, Chancery Court, Mississippi, Claiborne County (case filed 10/01/01). Two individuals suing.

COMBUSTION ENGINEERING, ET AL. V. R. J. R. NABISCO, INC., ET AL., Case No. 2001-86, Circuit Court, Mississippi, Claiborne County (case filed 4/18/01). Six individuals are suing.

COMBUSTION ENGINEERING, ET AL. V. R. J. R. NABISCO, ET AL., Case No. 2000-617, Circuit Court, Mississippi, Jefferson County (case filed 4/18/01). Claims of plaintiff Combustion Engineering only were dismissed with prejudice by order dated 8/26/04. The claims of individual plaintiffs are still pending. Five individuals are suing.

FISCHER, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 02-0196, Circuit Court, Mississippi, Wilkinson County (case filed 4/29/03). Five individuals suing.

GLASS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-338, Circuit Court, Mississippi, Jefferson County (case filed 12/20/02). Seven individuals suing.

GOSS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-308, Chancery Court, Mississippi, Adams County (case filed 4/25/02). Three individuals suing.

GRIFFIN, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-274, Chancery Court, Mississippi, Jefferson County (case filed 1/9/02). Four individuals are suing.

HARRIED, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-041, Chancery Court, Mississippi, Jefferson County (case filed 03/01/02). Two individuals suing.

HARRIS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-853, Chancery Court, Mississippi, Adams County (case filed 4/21/03). Six individuals suing.

HILL, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 2001-163, Chancery Court, Mississippi, Claiborne County (case filed 9/27/01). Two individuals suing.

HOLMES, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-424, Chancery Court, Mississippi, Copiah County (case filed 9/11/02). Five individuals suing.

HUMPHREY, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2000-608, Circuit Court, Mississippi, Jefferson County (case filed 12/1/00). Twenty individuals are suing.

JENNINGS, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 2000-238, Circuit Court, Mississippi, Claiborne County (case filed 11/2/00). Fourteen individuals suing.

KAISER ALUMINUM AND CHEMICAL CORPORATION, ET AL. V. R. J. R. NABISCO, INC., ET AL., Case No. 2000-615, Circuit Court, Mississippi, Jefferson County (case filed 12/15/00). Claims of plaintiff Kaiser Aluminum and Chemical Corporation only were dismissed with prejudice by Agreed Final Judgment of Dismissal dated 6/16/04. The claims of individual plaintiffs are still pending.

KELLY, ET AL. V. R. J. REYNOLDS, ET AL., Case No. 2002-404, Circuit Court, Mississippi, Claiborne County. Seven individuals suing.

MCDUGEL, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-040, Chancery Court, Mississippi, Jefferson County (case filed 03/01/02). Three individuals suing.

MCGEE, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 2000-596, Circuit Court, Mississippi, Jefferson County (case filed 11/16/00). Nineteen individuals suing.

MITCHELL, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-392, Chancery Court, Mississippi, Adams County (case filed 05/28/02). Three individuals suing.

MURPHY, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-390, Chancery Court, Mississippi, Adams County (case filed 05/28/02). Three individuals suing.

OLIVER, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-275, Chancery Court, Mississippi, Jefferson County (case filed 12/21/01). Four individuals are suing.

PATTERSON, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 5:04cv174, USDC, Southern District, Mississippi, Western Division (case filed 7/7/04). One individual suing.

PILGRAM, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. G2002-2374W/4, Chancery Court, Mississippi, Hinds County (case filed 12/30/02). Eighteen individuals suing.

SMITH, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-391, Chancery Court, Mississippi, Adams County (case filed 05/28/02). Three individuals suing.

STARKS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-071, Chancery Court, Mississippi, Jefferson County (case filed 04/25/02). Three individuals suing.

STEVENS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 03-KV-0055-J, Circuit Court, Mississippi, Adams County (case filed 4/30/03). One individual suing.

T&N, LTD, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-87, Circuit Court, Mississippi, Claiborne County (case filed 4/18/01). Liggett & Myers and Brooke Group were dismissed 8/16/01; Liggett Group is still a defendant. Claims of plaintiff T&N, Ltd. only were dismissed with prejudice by Agreed Final Judgment of Dismissal dated 6/16/04. The claims of individual plaintiffs are still pending. Three individuals are suing.

T&N, LTD, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2000-618, Circuit Court, Mississippi, Jefferson County (case filed 4/18/01). Liggett & Myers and Brooke Group were dismissed 8/16/01; Liggett Group is still a defendant. Claims of plaintiff T&N, Ltd. only were dismissed with prejudice by Agreed Final Judgment of Dismissal dated 6/16/04. The claims of individual plaintiffs are still pending. Two individuals are suing.

THOMAS, EZELL, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 96-0065, Circuit Court, Mississippi, Jefferson County (case filed 1996).

W. R. GRACE, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2001-58, Circuit Court, Mississippi, Jefferson County (case filed 3/23/01). Liggett & Myers and Brooke Group were dismissed 8/16/01; Liggett Group is still a defendant. This suit was stayed pending resolution of the Owens Corning case before the Mississippi Supreme Court

WALTERS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-845, Chancery Court, Mississippi, Adams County (case filed 12/31/02). Thirteen individuals suing.

WHITE, ET AL. V. PHILIP MORRIS, INC. ET AL., Case No. 97-0053, Chancery Court, Mississippi, Jefferson County (case filed 4/24/97). Three individuals suing.

WILSON, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-208, Chancery Court, Mississippi, Adams County (case filed 03/15/02). Four individuals suing.

WOODS, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 2002-06, Chancery Court, Mississippi, Claiborne County (case filed 1/9/02). Two individuals are suing.

ALEXANDER, ET AL. V. BROWN & WILLIAMSON TOBACCO CORPORATION, ET AL., Case No. 03-CV-202909, Circuit Court, Missouri, Jackson County (case filed 5/21/03). Nineteen individuals suing.

BAYRO, ET AL. V. PHILIP MORRIS, INC., ET AL., Circuit Court, Missouri, Jackson County. Three individuals suing. Liggett has not yet been served with the complaint.

DAVIS, ET AL. V. AMERICAN TOBACCO COMPANY, ET AL., Case No. 2:00-CV-26-CEJ, USDC, Missouri, Eastern District (case filed 9/25/00). Two individuals suing.

MATTERN, ET AL. V. BROWN & WILLIAMSON TOBACCO CORPORATION, ET AL., Case No. 032-09705, Circuit Court, 22nd Judicial Circuit, Missouri, St. Louis City (case filed 9/5/03) Two individuals suing. Plaintiff has dismissed all defendants except Liggett. The case is scheduled for trial in October 2005.

ARMENDARIZ V. PHILIP MORRIS, ET AL., Case No. 999/862, District Court, Nebraska, Douglas County (case filed 11/17/00). One individual suing.

MUMIN V. PHILIP MORRIS, ET AL., Doc. 1000 No. 46, District Court, Nebraska, Douglas County (case filed 11/27/00). One individual suing.

ALVAREZ V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102872/02, Supreme Court of New York, New York County. One individual suing.

ALVARADO V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102874/02, Supreme Court of New York, New York County. One individual suing.

BRANTLEY V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 114317/01, Supreme Court of New York, New York County. Individual suing.

CRESCENZO V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102817/02, Supreme Court of New York, New York County. Individual suing.

DEBOBES V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 29544/92, Supreme Court of New York, Nassau County. One Individual suing.

FABIANO, ET AL. V. PHILIP MORRIS INCORPORATED, ET AL., Case No. 04-102715, Supreme Court of New York, New York County (case filed 2/20/2004). Two individuals suing.

HAUSRATH, ET AL. V. PHILIP MORRIS INC., ET AL, Case No. I2001-09526, Superior Court, New York, Erie County (case filed 01/24/02). Two individuals suing.

HOBART V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102869/02, Supreme Court of New York, New York County. Individual suing.

HOCHMAN V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102860/02, Supreme Court of New York, New York County. Individual suing.

JAMES V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 103034/02, Supreme Court of New York, New York County. Individual suing.

MACH, ET AL. V. PHILIP MORRIS USA, INC., ET AL., Case No. 21401/04, Supreme Court of New York, Kings County. One individual suing

MCCORMACK V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102864/02, Supreme Court of New York, New York County. Individual suing.

OBERST V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 108428/98, Supreme Court of New York, New York County. Individual suing.

SHEA, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 008938/03, Supreme Court of New York, Nassau County. Two individuals suing.

SMITH, ET AL. V. THE AMERICAN TOBACCO CO., ET AL., Case No. 020525/97, Supreme Court of New York, Queens County (case filed 9/19/97). Eight individuals suing.

STANDISH, ET AL. V. THE AMERICAN TOBACCO CO., ET AL., Case No. 18418-97, Supreme Court of New York, Bronx County (case filed 7/28/97). One individual suing.

TORMEY, THOMAS M., ET AL. V. THE AMERICAN TOBACCO, ET AL., Case No. 2005-0506, Supreme Court of New York, Onondaga County (case filed 1/25/05). Two individuals suing.

YEDWABNICK, BERNARD, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 20525/97, Supreme Court of New York, Queens County.

YUEN V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 102861/02, Supreme Court of New York, New York County. One individual suing.

WILSON, ET AL. V. LIGGETT & MYERS, ET AL., USDC, Middle District Court, North Carolina. One individual suing.

CROFT, ET AL. V. AKRON GASKET & PACKING, ET AL., Case No. CV04541681, Court of Common Pleas, Ohio, Cuyahoga County. Two individuals suing.

BUSCEMI V. BROWN & WILLIAMSON, ET AL., Case No. 002007, Court of Common Pleas, Pennsylvania, Philadelphia County (case filed 9/21/99). Two individuals suing.

AYALA , THE ESTATE OF, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2175(VJ/PG), USDC, District of Puerto Rico, Puerto Rico (case filed 8/8/02). Five individuals suing.

CABRERA, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 03-207, USDC, District of Puerto Rico, Puerto Rico (case filed 10/7/03). Three individuals suing.

CRUZ, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2507(RLA), USDC, District of Puerto Rico, Puerto Rico (case filed 10/7/02). Twenty-three individuals suing.

DE JESUS DIAZ, ET AL. V. PHILIP MORRIS INC, ET AL., Case No. 03-1900, USDC, District of Puerto Rico, Puerto Rico (case filed 8/21/03). Two Hundred Sixty-Six individuals suing.

DE JESUS RIVERA, ET AL. V. R. J. REYNOLDS TOBACCO, ET AL., Case No. 03-1099, USDC, District of Puerto Rico, Puerto Rico (case filed 01/03/03). Twelve individuals suing.

LINDER, ET AL. V. LIGGETT MYERS, ET AL., Case No. 02-2435, USDC, District of Puerto Rico, Puerto Rico (case filed 1/3/03). Two individuals suing.

LOPEZ, THE ESTATE OF, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2173(RLA), USDC, District of Puerto Rico, Puerto Rico (case filed 8/8/02). Nine individuals suing.

LOPEZ, ISABEL QUINTANA, ET AL. V. LIGGETT GROUP INC., ET AL., Case No. 03-2048, USDC, District of Puerto Rico, Puerto Rico (case filed 9/26/03). Two individuals suing.

MALDONADO, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No 05-1148 (JP), USDC, District of Puerto Rico, Puerto Rico (case filed 2/4/05). Five individuals suing. Liggett has not yet been served.

MARTINEZ, THE ESTATE OF, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2171 (HL), USDC, District of Puerto Rico, Puerto Rico (case filed 8/8/02). Six individuals suing.

PANDAL, THE ESTATE OF, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 03-1642 (SEC), USDC, District of Puerto Rico, Puerto Rico (case filed 6/9/03). Five individuals suing.

REYES, THE ESTATE OF , ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2174(SEC), USDC, District of Puerto Rico, Puerto Rico (case filed 8/8/02). Ten individuals suing.

RODRIGUEZ-TORRES, ET AL. V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 03-1644 (SEC), USDC, District of Puerto Rico (case filed 6/10/03). Eight individuals suing.

RUIZ DIAZ, ET AL., V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 03-1003 JAG, USDC, District of Puerto Rico (case filed 1/3/03). Eight individuals suing.

VELEZ, THE ESTATE OF, ET AL. V. PHILIP MORRIS INC., ET AL., Case No. 02-2172(JAG), USDC, District of Puerto Rico, Puerto Rico (case filed 8/8/02). Twelve individuals suing.

VELEZ, MARIBEL ARTURET, V. R. J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 03-2049, USDC, District of Puerto Rico, Puerto Rico (case filed 9/28/03). One Individual suing.

BROWN V. BROWN & WILLIAMSON TOBACCO CORP., ET AL., Case No. 98-5447, Superior Court, Rhode Island (case filed 10/30/98). One individual suing.

NICOLO V. PHILIP MORRIS, ET AL., Case No. 96-528 B, USDC, Rhode Island (case filed 9/24/96). One individual suing.

ADAMS V. BROWN & WILLIAMSON, ET AL., Case No. 96-17502, District Court of the 164th Judicial District, Texas, Harris County (case filed 4/30/96). One individual suing.

COLUNGA V. AMERICAN BRANDS, INC., ET AL., Case No. C-97-265, USDC, Texas, Southern District (case filed 4/17/97). One individual suing.

HALE, ET AL. V. AMERICAN BRANDS, INC., ET AL., Case No. C-6568-96B, District Court of the 93rd Judicial District, Texas, Hidalgo County (case filed 1/30/97). One individual suing.

HAMILTON, ET AL. V. BGLS, INC., ET AL., Case No. C 70609 6 D, USDC, Texas, Southern District (case filed 2/26/97). Five individuals suing.

HODGES, ET VIR V. LIGGETT GROUP, INC., ET AL., Case No. 8000\*JG99, District Court of the 239th Judicial District, Texas, Brazoria County (case filed 5/5/99). Two individuals suing.

JACKSON, HAZEL, ET AL. V. PHILIP MORRIS, INC., ET AL., Case No. G-01-071, USDC, Texas, Southern District (case filed 2/7/2001). Five individuals suing.

LUNA V. AMERICAN BRANDS, ET AL., Case No. 96-5654-H, USDC, Texas, Southern District (case filed 2/18/97). One individual suing.

MCLEAN, ET AL. V. PHILIP MORRIS, ET AL., Case No. 2-96-CV-167, USDC, Texas, Eastern District (case filed 8/30/96). Three individuals suing.

MIRELES V. AMERICAN BRANDS, INC., ET AL., Case No. 966143A, District Court of the 28th Judicial District, Texas, Nueces County (case filed 2/14/97). One individual suing.

MISELL, ET AL. V. AMERICAN BRANDS, ET AL., Case No. 96-6287-H, District Court of the 347th Judicial District, Texas, Nueces County (case filed 1/3/97). Four individuals suing.

RAMIREZ V. AMERICAN BRANDS, INC., ET AL., Case No. M-97-050, USDC, Texas, Southern District (case filed 12/23/96). One individual suing.

THOMPSON, ET AL. V. BROWN & WILLIAMSON, ET AL., Case No. 97-2981-D, District Court of the 105th Judicial District, Texas, Nueces County (case filed 12/15/97). Two individuals suing.

BOWDEN, ET AL. V. R.J. REYNOLDS TOBACCO COMPANY, ET AL., Case No. 98-0068-L, USDC, Virginia, Western District (case filed 1/6/99).

VAUGHAN V. MARK L. EARLEY, ET AL., Case No. 760 CH 99 K 00011-00, Circuit Court, Virginia, Richmond (case filed 1/8/99). One individual suing.

BREWER, ET AL. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 01-C-82, Circuit Court, West Virginia, Ohio County. Two individuals suing.



IN RE TOBACCO PI (5000), Case NO. 00-C-5000, Circuit Court, West Virginia, Ohio County. Consolidating approximately 1,000 individual smoker actions which were pending prior to 2001. Liggett has been severed from the trial of the consolidated action.

LITTLE, W. V. THE AMERICAN TOBACCO COMPANY, ET AL., Case No. 01-C-235, Circuit Court, West Virginia, Ohio County (case filed 6/4/01). One individual suing.

FLOYD V. STATE OF WISCONSIN, ET AL., Case No. 99 CV 001125, Circuit Court, Wisconsin, Milwaukee County (case filed 2/10/99). One individual suing.

#### VI. PRICE FIXING CASES

SMITH, ET AL. V. PHILIP MORRIS COMPANIES, INC., ET AL., Case No. 00-CV-26, District Court, Kansas, Seward County (case filed 2/7/00). In this class action plaintiffs allege that defendants conspired to fix, raise, stabilize, or maintain prices for cigarettes in the State of Kansas. The court granted class certification in November 2001.

ROMERO, ET AL. V. PHILIP MORRIS COMPANIES, INC. ET AL., Case No. D0117 CV-00000972, District Court, Rio Arriba County, New Mexico (case filed 4/10/00). In this class action plaintiffs allege that defendants conspired to fix, raise, stabilize, or maintain prices for cigarettes in the State of New Mexico. Plaintiffs' motion for class certification was granted in April 2003. In February 2005, the New Mexico Supreme Court affirmed the trial court's certification order.