

REYNOLDS AMERICAN INC.

Consolidated Financial Statements

December 31, 2020 and 2019

(With Independent Auditors' Report Thereon)

REYNOLDS AMERICAN INC.
Consolidated Financial Statements

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KPMG LLP
Suite 1000
620 S. Tryon Street
Charlotte, North Carolina 28202-1842

Independent Auditors' Report

The Board of Directors
Reynolds American Inc.:

We have audited the accompanying consolidated financial statements of Reynolds American Inc. and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 2020 and 2019, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Reynolds American Inc. and its subsidiaries as of December 31, 2020 and 2019, and the results of their operations and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Charlotte, North Carolina
February 16, 2021

REYNOLDS AMERICAN INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Millions)

	For the Years Ended December 31,	
	2020	2019
Net sales ⁽¹⁾	\$ 14,695	\$ 13,215
Net sales, related party	41	85
Net sales	14,736	13,300
Costs and expenses:		
Cost of products sold ⁽¹⁾	5,592	4,658
Selling, general and administrative expenses	1,914	2,027
Amortization expense	60	58
Asset impairment charges	6	112
Trademark and other intangibles impairment charges	—	72
Operating income	7,164	6,373
Interest and debt expense	488	533
Interest expense, related party	146	71
Interest income, related party	(3)	(41)
Net periodic benefit income, excluding service cost	(138)	(83)
Other expense, net	67	67
Other expense, related party	322	69
Income before income taxes	6,282	5,757
Provision for income taxes	1,518	1,442
Net income	4,764	4,315
Net loss attributable to noncontrolling interest	—	(35)
Net income attributable to Reynolds American Inc.	\$ 4,764	\$ 4,350

⁽¹⁾ Excludes excise taxes of \$3,706 million and \$3,683 million for the years ended December 31, 2020 and 2019, respectively.

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Millions)

	For the Years Ended December 31,	
	2020	2019
Net income	\$ 4,764	\$ 4,315
Other comprehensive income, net of tax expense:		
Retirement benefits, net of tax expense:		
(2020 — \$43; 2019 — \$42)	131	126
Cumulative translation adjustment and other, net of tax expense:		
(2019 — (\$1))	—	64
Comprehensive income	4,895	4,505
Comprehensive loss attributable to noncontrolling interest	—	(35)
Comprehensive income attributable to Reynolds American Inc.	\$ 4,895	\$ 4,540

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Millions)

	For the Years Ended December 31,	
	2020	2019
Cash flows from (used in) operating activities:		
Net income	\$ 4,764	\$ 4,315
Adjustments to reconcile to net cash flows from operating activities:		
Depreciation and amortization expense	169	183
Asset impairment charges	6	112
Trademark and other intangibles impairment charges	—	72
Deferred income tax expense (benefit)	(158)	48
Other changes that provided (used) cash:		
Accounts and other receivables	22	(17)
Inventories	(5)	179
Related party, net	(32)	74
Accounts payable	95	12
Accrued liabilities, including other working capital	154	(121)
Income taxes	107	(68)
Tobacco settlement accruals	729	(158)
Pension and postretirement	(186)	(136)
Other, net	29	119
Net cash flows from operating activities	5,694	4,614
Cash flows from (used in) investing activities:		
Capital expenditures	(160)	(170)
Acquisition of controlling interest in subsidiary	—	(48)
Collection of note receivable from related party	—	313
Amounts due from related party – cash management agreements	99	(794)
Acquisition of intangibles	(104)	—
Other, net	1	5
Net cash flows used in investing activities	(164)	(694)
Cash flows from (used in) financing activities:		
Dividends paid on common stock	(4,953)	(4,455)
Borrowings under note payable to related party	3,471	2,486
Repayments of note payable to related party	(1,341)	(1,200)
Repayments of long-term notes	(2,679)	(750)
Other, net	(30)	(7)
Net cash flows used in financing activities	(5,532)	(3,926)
Effect of exchange rate changes on cash	—	(1)
Net change in cash	(2)	(7)
Cash at beginning of year	2	9
Cash at end of year	\$ —	\$ 2
Income taxes paid, net of refunds	\$ 1,414	\$ 1,266
Income taxes paid to parent	\$ 174	\$ 158
Interest paid	\$ 504	\$ 579

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

	As of December 31,	
	2020	2019
Assets		
Current assets:		
Cash	\$ —	\$ 2
Accounts receivable	48	69
Accounts receivable, related party	9	19
Other receivables	28	28
Inventories	1,301	1,296
Amounts due from related party – cash management agreements	2,922	3,019
Other current assets	191	142
Total current assets	4,499	4,575
Property, plant and equipment, at cost:		
Land and land improvements	92	89
Buildings and leasehold improvements	730	717
Machinery and equipment	2,233	2,192
Construction-in-process	189	129
Total property, plant and equipment	3,244	3,127
Accumulated depreciation	(1,802)	(1,725)
Property, plant and equipment, net	1,442	1,402
Trademarks and other intangible assets, net of accumulated amortization	29,465	29,393
Goodwill	15,984	15,984
Long-term deferred income taxes	31	30
Other assets and deferred charges	448	85
Total Assets	\$ 51,869	\$ 51,469
Liabilities and shareholders' equity		
Current liabilities:		
Accounts payable	\$ 256	\$ 160
Tobacco settlement accruals	3,139	2,410
Due to related party	50	91
Deferred revenue, related party	—	1
Current maturities of long-term debt	3	1,533
Notes and interest payable to related party	151	2,496
Other current liabilities	1,438	1,077
Total current liabilities	5,037	7,768
Long-term debt (less current maturities)	7,826	8,982
Long-term deferred income taxes	6,202	6,316
Long-term retirement benefits (less current portion)	920	963
Long-term note payable to related party	4,462	4
Other noncurrent liabilities	338	298
Commitments and contingencies		
Shareholders' equity:		
Common stock (shares issued: 2020 and 2019 — 1,426,125,631)	—	—
Paid-in capital	18,329	18,328
Retained earnings	8,791	8,980
Accumulated other comprehensive loss	(36)	(167)
Total Reynolds American Inc. shareholders' equity	27,084	27,141
Noncontrolling interest	—	(3)
Total equity	27,084	27,138
Total liabilities and shareholders' equity	\$ 51,869	\$ 51,469

See Notes to Consolidated Financial Statements

REYNOLDS AMERICAN INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Dollars in Millions, Except Per Share Amounts)

	Common Stock	Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Noncontrolling Interest	Total Equity
Balance at December 31, 2018	\$ —	\$ 18,303	\$ 9,078	\$ (350)	\$ —	\$ 27,031
Net income	—	—	4,350	—	(35)	4,315
Adjustment due to adoption of ASU 2018-02	—	—	7	(7)	—	—
Retirement benefits, net of \$42 tax benefit	—	—	—	126	—	126
Cumulative translation adjustment and other, net of \$1 tax benefit	—	—	—	64	—	64
Noncontrolling interest in acquired subsidiary	—	—	—	—	32	32
Dividends — \$3.12 per share	—	—	(4,455)	—	—	(4,455)
Stock-based compensation	—	25	—	—	—	25
Balance at December 31, 2019	—	18,328	8,980	(167)	(3)	27,138
Net income	—	—	4,764	—	—	4,764
Retirement benefits, net of \$43 tax expense	—	—	—	131	—	131
Deconsolidation of noncontrolling interest in acquired subsidiary	—	—	—	—	3	3
Dividends — \$3.47 per share	—	—	(4,953)	—	—	(4,953)
Stock-based compensation	—	1	—	—	—	1
Balance at December 31, 2020	\$ —	\$ 18,329	\$ 8,791	\$ (36)	\$ —	\$ 27,084

See Notes to Consolidated Financial Statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Note 1 — Business and Summary of Significant Accounting Policies

Overview

The consolidated financial statements include the accounts of Reynolds American Inc., referred to as RAI, and its wholly owned subsidiaries. RAI's wholly owned operating subsidiaries include R.J. Reynolds Tobacco Company; Santa Fe Natural Tobacco Company, Inc., referred to as SFNTC; American Snuff Company, LLC, referred to as American Snuff Co.; R. J. Reynolds Vapor Company, referred to as RJRV and Modoral Brands Inc., referred to as MBI.

On January 16, 2017, RAI, British American Tobacco p.l.c., referred to as BAT, BATUS Holdings Inc., an indirect, wholly owned subsidiary of BAT referred to as BHI, and Flight Acquisition Corporation, an indirect, wholly owned subsidiary of BAT, referred to as Merger Sub, entered into an Agreement and Plan of Merger, as it and the plan of merger contained therein were amended on June 8, 2017, referred to as the Merger Agreement, pursuant to which Merger Sub merged with and into RAI, referred to as the BAT Merger, with RAI surviving as an indirect, wholly owned subsidiary of BAT. Pursuant to the terms of the Merger Agreement, the BAT Merger was completed on July 25, 2017.

RAI elected not to apply pushdown accounting in its separate consolidated financial statements upon completion of the BAT Merger.

RAI was incorporated as a holding company in the State of North Carolina in 2004. RAI was created to facilitate the business combination of the United States, referred to as U.S., business of Brown & Williamson Holdings, Inc., referred to as B&W, an indirect wholly owned subsidiary of BAT, with R. J. Reynolds Tobacco Company, a wholly owned subsidiary of R.J. Reynolds Tobacco Holdings, Inc., referred to as RJR, on July 30, 2004, with such combination referred to as the B&W business combination.

References to RJR Tobacco prior to July 30, 2004, relate to R. J. Reynolds Tobacco Company, a New Jersey corporation. References to RJR Tobacco on and subsequent to July 30, 2004 and until June 12, 2015, relate to the combined U.S. assets, liabilities and operations of B&W and R. J. Reynolds Tobacco Company. Concurrent with the completion of the B&W business combination, RJR Tobacco became a North Carolina corporation. References to RJR Tobacco on and subsequent to June 12, 2015, relate to R. J. Reynolds Tobacco Company, a North Carolina corporation, and reflect the effects of (1) RAI's acquisition, referred to as the Lorillard Merger, on June 12, 2015, of Lorillard, Inc., n/k/a Lorillard LLC, referred to as Lorillard, and (2) the divestiture on June 12, 2015, referred to as the Divestiture, of certain assets including the brands WINSTON, SALEM, KOOL and MAVERICK, referred to as the Acquired Brands by subsidiaries or affiliates of RAI and Lorillard, together with the transfer of certain employees and certain liabilities, to a wholly owned subsidiary of Imperial Brands PLC. Additionally on June 12, 2015, shortly after the completion of the Lorillard Merger, Lorillard Tobacco Company, LLC, a wholly owned subsidiary of Lorillard, referred to as Lorillard Tobacco, merged with and into RJR Tobacco, with RJR Tobacco continuing as the surviving entity, referred to as the Lorillard Tobacco Merger.

Nature of Operations

RAI's primary operating subsidiaries are RJR Tobacco, SFNTC and American Snuff Co. RAI's operating subsidiaries conduct substantially all of their business in the United States and its territories.

RAI's largest operating subsidiary, RJR Tobacco, is the second largest tobacco company in the United States. Its brands include three of the top four best-selling cigarettes in the United States: NEWPORT, CAMEL and PALL MALL. These brands, together with its other brands, including DORAL, MISTY and CAPRI, are manufactured in a variety of styles and marketed in the United States. As part of its total tobacco strategy, RJR Tobacco also offers a smoke-free tobacco product, CAMEL Snus. RJR Tobacco manages the export of tobacco products to U.S. territories, U.S. duty-free shops and U.S. overseas military bases. RJR Tobacco also manages the premium brands, DUNHILL and STATE EXPRESS 555, which are licensed from BAT. For additional information regarding related parties, see Note 11.

SFNTC manufactures and markets premium cigarettes and other tobacco products under the NATURAL AMERICAN SPIRIT brand in the United States.

American Snuff Co. is the second largest smokeless tobacco products manufacturer in the United States. American Snuff Co.'s primary brands include its largest selling moist snuff brands, GRIZZLY and KODIAK.

Other operating subsidiaries are RJRV that markets e-cigarettes, e-pods and e-liquids under the VUSE brand name and MBI that markets modern oral products under the VELO brand name. These subsidiaries operate in the United States.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Major U.S. Customers and Foreign Sales

Sales to McLane Company, Inc., a distributor, constituted approximately 23% of RAI's consolidated revenue in 2020 and 26% in 2019. Sales to Core-Mark International, Inc., a distributor, represented approximately 16% of RAI's consolidated revenue in 2020 and 15% in 2019. McLane Company, Inc. and Core-Mark International, Inc. are customers of RJR Tobacco, SFNTC, American Snuff Co., RJRV and MBI. No other customer accounted for 10% or more of RAI's consolidated net sales during those periods.

Sales by RAI's operating subsidiaries to foreign countries, primarily to related parties, for the years ended December 31, 2020 and 2019 were \$41 million and \$85 million, respectively.

Revenue Recognition

On January 1, 2018, RAI adopted Accounting Standards Codification, referred to as ASC, 606, *Revenue from Contracts with Customers*. RAI operating subsidiaries recognize revenue when they have satisfied their performance obligation under the contract, which occurs at a point in time, by shipment of their product to the customer. At this point, the customer obtains control of the product and ownership of such product and risk of loss transfers to the customer. Revenue is measured as the amount of consideration the RAI operating subsidiary expects to receive in exchange for shipping its product, which includes variable consideration such as estimates of customer sales incentives and trade promotional allowances.

RAI's operating subsidiaries generally receive payment either in advance of the shipment of product to the customer or on the date of expected delivery of product to the customer. When payment from the customer is received prior to the shipment of the product, recognition of revenue is deferred until the product is shipped and the RAI operating subsidiary's performance obligation is satisfied, generally within two days of receiving the payment. For product shipments where payment is not received in advance, amounts due from the customer are billed on shipment date and are included in accounts receivable on the consolidated balance sheets.

For further discussion on revenue recognition, refer to Note 10.

Basis of Presentation

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, referred to as GAAP, requires estimates and assumptions to be made that affect the reported amounts in the consolidated financial statements and accompanying notes. Volatile credit and equity markets, changes to regulatory and legal environments, and consumer spending may affect the uncertainty inherent in such estimates and assumptions. Actual results could materially differ from those estimates. All material intercompany balances have been eliminated.

Certain amounts presented in Note 7 are rounded in the aggregate and may not sum from the individually presented components. All dollar amounts, other than per share amounts, are presented in millions, except for amounts set forth in Note 7 and as otherwise noted.

Leases

On January 1, 2019, RAI adopted ASC 842, *Leases*, using the prospective transition method. RAI did not reassess whether any expired or existing contracts contain a lease, the classification of leases or the initial direct costs. The adoption of ASU 842 did not have a material affect on RAI's consolidated financial statements. RAI has operating leases primarily for automobiles, office space, warehouse space and certain machinery and equipment. RAI has finance leases for certain machinery and equipment. A contract contains a lease if the contract conveys a right to control the use of the identified asset for a period of time in exchange for consideration. Operating leases are included in other assets and deferred charges and other current liabilities and other noncurrent liabilities in the consolidated balance sheet. Finance leases are included in property, plant and equipment, current maturities of long-term debt and long-term debt in the consolidated balance sheet. Lease payments for leases with an original term less than one year that do not contain renewal options which are reasonably certain to renew are recognized on a straight-line basis over the lease term and variable payments are recognized in the period in which the obligation is incurred.

Right-of-use assets represent the right to use an underlying asset for the lease term and lease liabilities represent the obligation to make lease payments arising from the leases. Operating and finance lease assets and liabilities are recognized at the commencement date based on the present value of lease payments over the lease term. RAI uses an implicit interest rate in determining the present value of lease payments when readily determinable, and a collateralized incremental borrowing rate when an implicit rate is not available. Lease terms consider options to extend or terminate based on the determination of whether such renewal or termination options are deemed reasonably certain. Rent expense on operating leases is generally recorded using the straight-line method over the appropriate lease terms.

Lease agreements that contain non-lease components are generally accounted for as a single lease component. Variable costs, such as maintenance expenses, property and sales taxes and index-based rate increases, are expensed as they are incurred.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Cash

Cash balances are recorded net of book overdrafts when a bank right-of-offset exists. All other book overdrafts are recorded in accounts payable.

Fair Value Measurement

RAI's reporting entity determines the fair value of assets and liabilities using a fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity and the reporting entity's own assumptions about market participant assumptions based on the best information available in the circumstances.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, essentially an exit price.

The levels of the fair value hierarchy are:

Level 1: inputs are quoted prices, unadjusted, in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2: inputs are other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. A Level 2 input must be observable for substantially the full term of the asset or liability.

Level 3: inputs are unobservable and reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the asset or liability.

RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries, and invests in debt, equity and other securities and investments, that are carried at fair value, to fund payments required by these retirement obligations. For additional information regarding the fair value of these plan assets, see Note 9.

Inventories

Inventories, other than those accounted for under the last-in, first-out, or LIFO, method are stated at the lower of cost or net realizable value. Inventories accounted for under the LIFO method are stated at the lower of cost or market. The cost of RJR Tobacco's leaf tobacco inventories is determined principally under LIFO and is calculated at the end of each year. The cost of work in process and finished goods includes materials, direct labor, variable costs and overhead and full absorption of fixed manufacturing overhead. Stocks of tobacco, which have an operating cycle that exceeds 12 months due to aging requirements, are classified as current assets, consistent with recognized industry practice. The remaining inventories not valued under LIFO are valued under the first-in, first-out method.

Long-lived Assets

Long-lived assets, such as property, plant and equipment, goodwill, trademarks and other intangible assets, are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. Impairment of the carrying value of long-lived assets would be indicated if the best estimate of future undiscounted cash flows expected to be generated by the asset grouping is less than its carrying value. If an impairment is indicated, any loss is measured as the difference between estimated fair value and carrying value and is recognized as an operating expense.

Property, Plant and Equipment

Property, plant and equipment are recorded at cost and depreciated using the straight-line method over the estimated useful lives of the assets. Useful lives range from 20 to 50 years for buildings and improvements, and from 3 to 30 years for machinery and equipment. The cost and related accumulated depreciation of assets sold or retired are removed from the accounts and the gain or loss on disposition is recognized in operating income. Depreciation expense was \$109 million and \$125 million for the years ended December 31, 2020 and 2019, respectively.

For the year ended December 31, 2020, RAI determined that an impairment had been incurred for the carrying value of certain machinery and equipment used in the production of certain combustible products. For the year ended December 31, 2019, RAI determined that an impairment had been incurred for the carrying value of certain machinery and equipment used in the production of certain non-combustible and e-cigarette products. Forecasts indicated that estimated future cash flows generated from the impaired machinery and equipment were declining. Management assessed that the impaired machinery and equipment had no fair value and, accordingly, recognized pre-tax asset impairment charges of \$6 million and \$112 million, in the consolidated statements of income for 2020 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Intangible Assets

Intangible assets include goodwill, trademarks and other intangible assets and are capitalized when acquired. The determination of fair value involves considerable estimates and judgment. In particular, the fair value of a reporting unit involves, among other things, developing forecasts of future cash flows, determining an appropriate discount rate, and when goodwill impairment is implied, determining the fair value of individual assets and liabilities, including unrecorded intangibles. Goodwill, trademarks and other intangible assets with indefinite lives are not amortized, but are tested for impairment annually, in the fourth quarter, and more frequently if events and circumstances indicate that the asset might be impaired. Trademarks and other intangible assets with finite lives, which are amortized using the straight-line method over their remaining useful lives of 1 to 17 years, consistent with the pattern of economic benefits estimated to be received, are tested for impairment if events and circumstances indicate that the asset is impaired.

Although RAI believes it has based its impairment testing of its intangible assets on reasonable estimates and assumptions, the use of different estimates and assumptions could result in materially different results. If the current legal and regulatory environment, business or competitive climate worsens, or RAI's operating companies' strategic initiatives adversely affect their financial performance, the fair value of goodwill, trademarks and other intangible assets could be impaired in future periods.

RAI adopted ASU 2017-04, *Intangibles—Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment* on January 1, 2019. The ASU simplifies the manner in which an entity tests goodwill for impairment by eliminating Step 2 from the goodwill impairment test. The adoption of ASU 2017-14 did not have a material affect on RAI's consolidated financial statements.

Cost of Products Sold

RJR Tobacco, as an original participating manufacturer, and SFNTC, as a subsequent participating manufacturer, are participants in the Master Settlement Agreement, referred to as the MSA, and RJR Tobacco is a participant in the other state settlement agreements with the states of Mississippi, Florida, Texas and Minnesota, which together with the MSA are collectively referred to as the State Settlement Agreements. RJR Tobacco's and SFNTC's obligations and the related expense charges under these agreements are subject to adjustments based upon, among other things, the volume of cigarettes sold by the operating subsidiaries, their relative market share, their operating profit and inflation. Since relative market share is based on cigarette shipments, the best estimate of the allocation of charges to RJR Tobacco and SFNTC under these agreements is recorded in cost of products sold as the products are shipped. Included in these adjustments is the MSA non-participating manufacturer adjustment, referred to as the NPM Adjustment, that potentially reduces the annual payment obligation of RJR Tobacco, SFNTC and other participating manufacturers, referred to as the PMs. Adjustments to these estimates are recorded in the period that the change becomes probable and the amount can be reasonably estimated. American Snuff Co. is not a participant in the State Settlement Agreements.

Cost of products sold includes, among other expenses, the expenses for the State Settlement Agreements, and the user fees charged by the U.S. Food and Drug Administration, referred to as the FDA. These expenses were as follows for the years ended December 31:

	<u>2020</u>	<u>2019</u>
State Settlement Agreements	\$ 3,572	\$ 2,762
FDA user fees	199	202

In 2012, RJR Tobacco, Lorillard Tobacco, SFNTC and certain other PMs, entered into a term sheet, referred to as the Term Sheet, with 17 states, the District of Columbia and Puerto Rico to settle certain claims related to the NPM Adjustment. The Term Sheet resolved claims related to volume years from 2003 through 2012 and puts in place a revised method to determine future adjustments from 2013 forward. In 2013 and 2014, five additional states joined the Term Sheet, including two states that were found to not have diligently enforced their qualifying statutes in 2003. An additional two states joined the Term Sheet in 2017.

During 2017, the NPM Adjustment Settlement Agreement, referred to as NPM Agreement, a formal agreement incorporating the terms and provisions of the Term Sheet, was executed by the PMs and the states that previously joined the Term Sheet. With execution of the agreement, the PMs and the states settled the 2015 volume year. An additional ten states joined the NPM Agreement in 2018. The parties to the NPM Agreement represent an allocable share of 62.53%. In 2018, the NPM Agreement signatory states and PMs agreed to settle the 2016 and 2017 volume years and in 2020, the NPM Agreement signatory states and PMs agreed to settle 2018 through 2022 volume years.

As a result of meeting the performance requirements associated with the NPM Agreement, RJR Tobacco and SFNTC, collectively, recognized credits of \$166 million and \$160 million for the years ended December 31, 2020 and 2019, respectively.

In October 2015, RJR Tobacco, SFNTC and certain other PMs entered into a settlement agreement, referred to as the NY Settlement Agreement, with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolved NPM Adjustment claims related to payment years from 2004 through 2014, and provided RJR Tobacco and SFNTC, collectively, with credits, of approximately \$290 million, plus interest, subject to meeting various performance obligations. These credits were applied against annual payments under the MSA over a four-year period, which commenced with the April 2016 MSA payment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

In addition, the NY Settlement Agreement put in place a new method to determine future adjustments from 2015 forward as to New York.

In 2020, RJR Tobacco recognized additional expenses in Cost of Products Sold related to claims under the State Settlement Agreements in the states of Mississippi, Florida, Texas and Minnesota. RJR Tobacco recognized \$201 million of expense for payment obligations to the state of Florida for the Acquired Brands from the date of Divestiture as a result of an unfavorable judgment. In addition, RJR Tobacco recognized \$197 million of expense related to a proposed settlement of claims against it in the states of Texas and Minnesota for payment obligations to those states for the Acquired Brands from the date of Divestiture. Finally, RJR Tobacco recorded \$8 million of expense related to a proposed settlement of certain related claims with Philip Morris USA, Inc, referred to as PM USA, under the State Settlement Agreements in the states of Mississippi, Texas and Minnesota.

For additional information related to the NPM Adjustment settlement, see “— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments” in Note 7. For additional information related to the resolution of claims related to the State Settlement Agreements in the states of Mississippi, Florida, Texas and Minnesota, see “— Litigation Affecting the Cigarette Industry — State Settlement Agreements — Enforcement and Validity; Adjustments” in Note 7.

Advertising

Advertising costs, which are expensed as incurred, were \$160 million and \$185 million for the years ended December 31, 2020 and 2019, respectively.

Research and Development

Research and development costs, which are expensed as incurred, were \$103 million and \$116 million for the years ended December 31, 2020 and 2019, respectively.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Interest and penalties related to uncertain tax positions are accounted for as tax expense.

For federal income tax purposes, RAI’s results are included in the consolidated United States federal income tax return of BHI. For state income tax purposes RAI’s results are included in 29 combined state income tax returns that include members of the consolidated United States federal income tax return of BHI. For financial reporting purposes, RAI’s current and deferred income taxes are calculated using the separate return method. All current and deferred tax expense and current and deferred tax liabilities are calculated as if RAI files separate federal and state income tax returns that exclude the income, deductions and tax attributes of BHI.

RAI accounts for uncertain tax positions which require that a position taken or expected to be taken in a tax return be recognized in the financial statements when it is more likely than not (a likelihood of more than 50%) that the position would be sustained upon examination by tax authorities. A recognized tax position is then measured at the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement.

The Tax Cuts and Jobs Act, referred to as the Tax Reform Act, requires a U.S. shareholder of any controlled foreign corporations, referred to as CFC, to include in taxable income its pro rata share of global intangible low-taxed income, referred to as GILTI. GILTI is considered the excess of the shareholder’s net CFC tested income over the shareholder’s net deemed tangible income return. This amount is further reduced by a 50 percent special deduction and foreign tax credits. Although RAI does not expect to have a GILTI inclusion for the foreseeable future, management has made a policy election to treat GILTI income, if applicable, as a current period tax expense.

Stock-Based Compensation

Stock-based compensation expense is recognized for all forms of share-based payment awards, including BAT American Depository shares issued to employees under restricted stock units.

Litigation

RAI discloses information concerning litigation for which an unfavorable outcome is more than remote. RAI and its subsidiaries record their legal expenses and other litigation costs and related administrative costs as selling, general and administrative expenses as these costs are incurred. RAI and its subsidiaries will record any loss related to litigation at such time as an unfavorable outcome becomes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

probable and the amount can be reasonably estimated on an individual case-by-case basis. When the reasonable estimate is a range, the recorded loss will be the best estimate within the range. If no amount in the range is a better estimate than any other amount, the minimum amount of the range will be recorded. For additional information related to litigation, see Note 7.

Pension and Postretirement

Pension and postretirement benefits require balance sheet recognition of the net asset for the overfunded status or net liability for the underfunded status of defined benefit pension and postretirement benefit plans, on a plan-by-plan basis, and recognition of changes in the funded status in the year in which the changes occur.

Actuarial (gains) losses are changes in the amount of either the benefit obligation or the fair value of plan assets resulting from experience different from that assumed or from changes in assumptions. Differences between actual results and actuarial assumptions are accumulated and recognized as a mark-to-market adjustment, referred to as an MTM adjustment, to the extent such accumulated net (gains) losses exceed 10% of the greater of the fair value of plan assets or benefit obligations, referred to as the corridor. Net (gains) losses outside the corridor are generally recognized annually as of December 31, or when a plan is remeasured during an interim period.

Prior service costs (credits) of pension benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the average remaining service period for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees. Prior service costs (credits) of postretirement benefits, which are changes in benefit obligations due to plan amendments, are amortized on a straight-line basis over the expected service period to full eligibility age for active employees, or average remaining life expectancies for inactive employees if most of the plan obligations are due to inactive employees.

Subsequent Events

Subsequent events have been evaluated through February 16, 2021, the date the financial statements were issued. Aside from the matters disclosed in Note 7, the Company has determined that there are no other items to disclose.

Recently Adopted Accounting Pronouncements

Effective January 1, 2020, RAI adopted the following new accounting standard:

- ASU 2018-14, *Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20)—Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans*, which revises the financial statement footnote disclosure requirements of ASC 715-20 for defined benefit plan sponsors. RAI adopted the amended guidance and applied on a retrospective basis to all periods presented. There is no impact on RAI's results of operations, cash flows or financial position.

Recently Issued Accounting Pronouncements

In June 2016, the Financial Accounting Standards Board, referred to as FASB, issued ASU 2016-13, *Financial Instruments—Credit Losses (Topic 326)*, which replaces the current incurred loss impairment methodology for recognizing credit losses for financial instruments with a methodology that reflects expected credit losses and requires consideration for a broader range of reasonable and supportable information for estimating credit losses. The amended guidance is effective for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years. The amended guidance is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

In December 2019, the FASB issued ASU No. 2019-12, *Simplifying the Accounting for Income Taxes (Topic 740)*, which simplifies the accounting for income taxes by, among other things, eliminating certain existing exceptions related to the general approach in ASC 740 and simplifying the accounting for income taxes related to franchise taxes, clarifying the accounting for transactions that result in a step-up in the tax basis of goodwill and requiring that an entity reflect the effect of an enacted change in tax laws or rates in the annual effective tax rate computation in the interim period that includes the enactment date. The transition requirements are primarily prospective and the amended guidance is effective for fiscal years beginning after December 15, 2020, with early adoption permitted. The amended guidance is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

In March 2020, the FASB issued ASU No. 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting* and in January 2021 issued ASU No. 2021-01, *Reference Rate Reform (Topic 848): Scope*. This guidance provides temporary optional expedients and exceptions to existing guidance on contract modifications and hedge accounting to facilitate the market transition from existing reference rates, such as the London Interbank Offered Rate, referred to as LIBOR, which is being phased out beginning at the end of 2021, to alternate reference rates, such as a secured overnight reference rate. These standards were effective upon issuance and allowed application to contract changes as early as January 1, 2020. These provisions may impact the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Company as contract modifications and other changes occur during the LIBOR transition period. RAI and certain subsidiaries have in-house cash agreements with a subsidiary of BAT that utilize LIBOR as the reference rate and will continue its assessment and monitor regulatory developments during the LIBOR transition period. The amended guidance is not expected to have a material impact on RAI's results of operations, cash flows and financial position.

Note 2 — Intangible Assets

The changes in the carrying amounts of goodwill were as follows:

Net goodwill balance as of December 31, 2018	\$ 15,984
Acquisition	25
Impairment	<u>(25)</u>
Net goodwill balance as of December 31, 2019 and 2020	<u>\$ 15,984</u>

The net goodwill balances as of December 31, 2020 and 2019 have been reduced by accumulated impairment charges of \$3,816 million.

The carrying amounts of indefinite-lived intangibles were as follows:

	<u>Trademarks</u>	<u>Other</u>
Balance as of December 31, 2020 and 2019	<u>\$ 28,848</u>	<u>\$ 36</u>

The changes in the carrying amounts of finite-lived intangible assets subject to amortization were as follows:

	<u>Trademarks</u>	<u>Other</u>
Balance as of December 31, 2018	\$ 238	\$ 325
Acquisitions	27	24
Amortization	(19)	(39)
Impairment	<u>(25)</u>	<u>(22)</u>
Balance as of December 31, 2019	221	288
Acquisitions	4	128
Amortization	<u>(16)</u>	<u>(44)</u>
Balance as of December 31, 2020	<u>\$ 209</u>	<u>\$ 372</u>

Details of finite-lived intangible assets at December 31 were as follows:

	<u>2020</u>			<u>2019</u>		
	<u>Gross</u>	<u>Accumulated Amortization</u>	<u>Net</u>	<u>Gross</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Customer lists	\$ 240	\$ (67)	\$ 173	\$ 241	\$ (56)	\$ 185
Trademarks	380	(171)	209	378	(157)	221
Other intangibles	273	(74)	199	146	(43)	103
	<u>\$ 893</u>	<u>\$ (312)</u>	<u>\$ 581</u>	<u>\$ 765</u>	<u>\$ (256)</u>	<u>\$ 509</u>

The remaining annual amortization expense associated with finite-lived intangible assets is expected to be as follows:

<u>Year</u>	<u>Amount</u>
2021	\$ 85
2022	83
2023	76
2024	58
2025	25
Thereafter	254
	<u>\$ 581</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The impairment testing of trademarks in the fourth quarters of 2020 and 2019 assumed a rate of decline in projected net sales of certain brands, comparable with that assumed in RAI's strategic plan. The fair value of trademarks used in impairment testing was determined by an income approach using a discounted cash flow valuation model under a relief-from-royalty methodology. The relief-from-royalty model includes estimates of a royalty rate that a market participant might assume, projected revenues and judgment regarding the discount rate applied to those estimated cash flows, with that discount rate being 8.0% during 2020 and 2019. The determination of the discount rate was based on a cost of equity model, using a risk-free rate, adjusted by a stock beta-adjusted risk premium and a size premium. As a result of these analyses, an impairment charge is recognized if the carrying value of a trademark exceeds its estimated fair value.

For the annual impairment testing of the goodwill of RAI's reporting units, each reporting unit's estimated fair value was compared with its carrying value. A reporting unit is an operating segment or one level below an operating segment. The determination of estimated fair value of each reporting unit was calculated primarily utilizing an income approach model, based on the present value of the estimated future cash flows of the reporting unit assuming a discount rate during 2020 and 2019 of 7.75% for each of RJR Tobacco and American Snuff Co. and 8.25% for SFNTC. The determination of the discount rate was based on a weighted average cost of capital. No impairment charges were recognized in 2020 or 2019 for the RJR Tobacco, American Snuff Co. or SFNTC reporting units.

During 2019, RJRV acquired a majority interest in VapeWild Holdings, LLC, referred to as VapeWild. Management performed purchase accounting and assigned a value of \$51 million to trademarks and other intangibles and \$25 million as goodwill. At December 31, 2019, due to economic and regulatory factors and the impact on VapeWild's future cash flows, it was determined that the carrying value of these intangibles were fully impaired resulting in \$72 million in impairment charges. In December 2020, VapeWild filed for Chapter 7 bankruptcy and control of the entity was turned over to a trustee of the bankruptcy court. As RJRV no longer had control of VapeWild it was deconsolidated from RJRV.

During 2020, RAI entered into an asset purchase agreement with Dryft Sciences, LLC, to acquire certain manufacturing equipment, recipes and manufacturing knowledge for nicotine pouch products and the rights to certain trademarks. In 2020, \$110 million was paid for this acquisition.

Note 3 — Inventories

The major components of inventories at December 31 were as follows:

	2020	2019
Leaf tobacco	\$ 1,000	\$ 1,179
Other raw materials	65	92
Work in process	78	71
Finished products	314	117
Other	15	18
Total	1,472	1,477
LIFO allowance	(171)	(181)
	\$ 1,301	\$ 1,296

Inventories valued under the LIFO method were \$482 million and \$570 million at December 31, 2020 and 2019, respectively, net of the LIFO allowance. The LIFO allowance reflects the excess of the current cost of LIFO inventories at December 31, 2020 and 2019, over the amount at which these inventories were carried on the consolidated balance sheets. RAI recognized income of \$10 million and expense of \$8 million from LIFO inventory changes during 2020 and 2019, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Note 4 — Other Current Liabilities

Other current liabilities at December 31 included the following:

	<u>2020</u>	<u>2019</u>
Payroll and employee benefits	\$ 163	\$ 160
Pension and postretirement benefits	80	80
Marketing and advertising	359	244
Excise, franchise and property taxes	163	155
Litigation	—	38
Leaf	135	6
Interest payable	103	114
Income taxes	173	66
Other	<u>262</u>	<u>214</u>
	<u>\$ 1,438</u>	<u>\$ 1,077</u>

Note 5 — Income Taxes

The components of the provision for income taxes for the years ended December 31 were as follows:

	<u>2020</u>	<u>2019</u>
Current:		
Federal	\$ 1,371	\$ 1,126
State and other	<u>305</u>	<u>268</u>
	<u>1,676</u>	<u>1,394</u>
Deferred:		
Federal	(124)	49
State and other	<u>(34)</u>	<u>(1)</u>
	<u>(158)</u>	<u>48</u>
Provision for income taxes	<u>\$ 1,518</u>	<u>\$ 1,442</u>

Significant components of deferred tax assets and liabilities as of December 31 included the following:

	<u>2020</u>	<u>2019</u>
Deferred tax assets:		
Pension and postretirement liabilities	\$ 181	\$ 267
Tobacco settlement accruals	774	594
Other accrued liabilities	82	82
Other noncurrent liabilities	<u>113</u>	<u>113</u>
Subtotal	1,150	1,056
Less: valuation allowance	<u>(13)</u>	<u>(14)</u>
	<u>1,137</u>	<u>1,042</u>
Deferred tax liabilities:		
Inventories	(113)	(121)
Property and equipment	(203)	(193)
Trademarks and other intangibles	(6,973)	(6,991)
Other	<u>(19)</u>	<u>(23)</u>
	<u>(7,308)</u>	<u>(7,328)</u>
Net deferred tax liability	<u>\$ (6,171)</u>	<u>\$ (6,286)</u>

RAI had no federal capital loss carryforwards at December 31, 2020 and 2019, respectively.

As of December 31, 2020, a valuation allowance of \$13 million was recorded on deferred tax assets related to a partnership interest and state net operating losses. As of December 31, 2019, a valuation allowance of \$14 million was recorded on deferred tax assets

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

related to a partnership interest and state net operating losses. RAI believes it is more likely than not that these deferred tax assets will not be realized.

Pre-tax income for domestic and foreign continuing operations for the years ended December 31 consisted of the following:

	<u>2020</u>	<u>2019</u>
Domestic (includes U.S. exports)	\$ 6,283	\$ 5,758
Foreign	<u>(1)</u>	<u>(1)</u>
	<u>\$ 6,282</u>	<u>\$ 5,757</u>

The differences between the provision for income taxes and income taxes computed at statutory U.S. federal income tax rates for the years ended December 31 were as follows:

	<u>2020</u>	<u>2019</u>
Income taxes computed at the statutory U.S. federal income tax rate	\$ 1,319	\$ 1,209
State and local income taxes, net of federal tax benefits	210	198
Other items, net	<u>(11)</u>	<u>35</u>
Provision for income taxes	<u>\$ 1,518</u>	<u>\$ 1,442</u>
Effective tax rate	<u>24.2%</u>	<u>25.0%</u>

The effective tax rate for 2020 and 2019 was impacted by state income taxes and certain nondeductible items, respectively, in each year.

The component of deferred tax benefits included in accumulated other comprehensive loss as of December 31 was as follows:

	<u>2020</u>	<u>2019</u>
Retirement benefits	<u>\$ 70</u>	<u>\$ 113</u>

RAI applies ASU 2018-02 which permits a reclassification from accumulated other comprehensive income (loss) to retained earnings for stranded tax effects that do not reflect the appropriate tax rates as a result of the Tax Reform Act. In 2019, \$7 million was reclassified from accumulated other comprehensive loss to retained earnings.

The accruals for gross unrecognized income tax benefits, including interest and penalties, reflected in other noncurrent liabilities as of December 31 were as follows:

	<u>2020</u>	<u>2019</u>
Unrecognized tax benefits	\$ 199	\$ 188
Accrued interest	40	34
Accrued penalties	<u>6</u>	<u>6</u>
	<u>\$ 245</u>	<u>\$ 228</u>

A reconciliation of the gross unrecognized income tax benefits as of December 31 was as follows:

	<u>2020</u>	<u>2019</u>
Balance at beginning of year	\$ 188	\$ 163
Gross increases related to current period tax positions	26	23
Gross increases related to tax positions in prior periods	10	14
Gross decreases related to tax positions in prior periods	(5)	(4)
Gross decreases related to audit settlements	—	—
Gross decreases related to lapse of applicable statute of limitations	<u>(20)</u>	<u>(8)</u>
Balance at end of year	<u>\$ 199</u>	<u>\$ 188</u>

At December 31, 2020, \$194 million of unrecognized income tax benefits including interest and penalties, if recognized, would decrease RAI's effective tax rate.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

RAI and its subsidiaries are subject to income taxes in the United States and various state and foreign jurisdictions. Several years may elapse before a tax matter, for which RAI has established an accrual, is audited and finally resolved. The number of years with open tax audits varies depending on the tax jurisdiction.

The federal statute of limitations remains open for the year 2017 and forward. State and foreign jurisdictions have statutes of limitations generally ranging from three to five years. Certain of RAI's state tax returns are currently under examination by various states as part of routine audits conducted in the ordinary course of business.

RAI and its subsidiaries are included in the consolidated United States federal income tax return of BHI. For state income tax purposes RAI's results are included in 29 combined state income tax returns that include members of the consolidated United States federal income tax return of BHI. For financial reporting purposes, RAI's current and deferred income taxes are calculated using the separate return method. All current and deferred tax expense and current and deferred tax liabilities are calculated as if RAI files separate federal and state income tax returns that exclude the income, deductions and tax attributes of BHI.

Note 6 — Long-Term Debt

Information, including a schedule of maturities, regarding RAI's and RJR Tobacco's long-term debt is provided below:

RAI and RJR Tobacco Long-Term Debt

	For the years ended December 31,	
	2020	2019
RAI		
6.875% notes due 05/01/2020	\$ —	\$ 641
3.250% notes due 06/12/2020	—	771
4.000% notes due 06/12/2022	—	1,000
3.250% notes due 11/01/2022	—	158
3.750% notes due 05/20/2023	30	30
4.850% notes due 09/15/2023	550	550
4.450% notes due 06/12/2025	2,500	2,500
5.700% notes due 08/15/2035	750	750
7.250% notes due 06/15/2037	450	450
8.125% notes due 05/01/2040	237	237
7.000% notes due 08/04/2041	240	240
4.750% notes due 11/01/2042	173	173
6.150% notes due 09/15/2043	550	550
5.850% notes due 08/15/2045	2,250	2,250
Total principal	<u>7,730</u>	<u>10,300</u>
Fair value adjustments	108	119
Unamortized discounts	(20)	(22)
Unamortized debt issuance costs	(40)	(48)
Total RAI long-term notes at carrying value	<u>\$ 7,778</u>	<u>\$ 10,349</u>
RJR Tobacco		
6.875% notes due 05/01/2020	\$ —	\$ 109
3.750% notes due 05/20/2023	19	19
8.125% notes due 05/01/2040	13	13
7.000% notes due 08/04/2041	9	9
Total principal	<u>41</u>	<u>150</u>
Fair value adjustments	5	6
Total RJR Tobacco long-term notes at carrying value	<u>\$ 46</u>	<u>\$ 156</u>
 Total long-term notes at carrying value	 <u>\$ 7,824</u>	 <u>\$ 10,505</u>

In 2020, through a series of transactions, RAI completely repaid the outstanding \$1.0 billion of 4.000% notes due 6/12/2022 and the \$158 million of 3.250% notes due 11/1/2022, referred to as the 2022 Notes. In October 2020, RAI completed a cash tender offer for an aggregate purchase price of \$793 million (excluding accrued and unpaid interest to, but not including, the settlement date

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

of October 5, 2020, and excluding related fees and expenses, including a tender offer premium of \$47 million) for the 2022 Notes. For the 2022 Notes not tendered for, RAI exercised a make-whole provision in the 2022 Notes indenture and called the remaining outstanding notes for an aggregate purchase price of \$365 million (excluding accrued and unpaid interest to, but not including, the settlement date of November 5, 2020, and excluding related fees and expenses, including the make-whole amount of \$21 million).

Title of Security	Principal Amount of 2022 Notes Accepted for Purchase	Principal Amount of 2022 Notes Redeemed Under Make-Whole Provision	Total Repaid
4.000% notes due 6/12/2022	\$ 703	\$ 297	\$ 1,000
3.250% notes due 11/1/2022	90	68	158

A reconciliation of the components of long-term debt is as follows:

	For the years ended December 31,	
	2020	2019
Total long-term notes at carrying value	\$ 7,824	\$ 10,505
Total finance leases at carrying value	5	10
Total long-term debt at carrying value	7,829	10,515
Less current maturities of long-term notes at carrying value	—	1,529
Less current maturities of finance leases at carrying value	3	4
Total current maturities of long-term debt	3	1,533
Total long-term debt (less current maturities) at carrying value	\$ 7,826	\$ 8,982

As of December 31, 2020, the maturities of RAI's and RJR Tobacco's notes, excluding fair value adjustments and unamortized discounts and debt issuance costs, were as follows:

Year	RAI	RJR Tobacco	Total
	2021	\$ —	\$ —
2022	—	—	—
2023	580	19	599
2024	—	—	—
2025	2,500	—	2,500
2026 and thereafter	4,650	22	4,672
	\$ 7,730	\$ 41	\$ 7,771

Subsequent to the BAT Merger, RAI terminated the credit agreement entered into in December 2014, referred to as the Credit Agreement, and, in doing so, the related subsidiary guarantees of the Credit Agreement also terminated and were released. The RAI indenture provides that a guarantor that is released from its guarantee of the Credit Agreement (or any successor) also will be released from its guarantee of the RAI notes. Accordingly, in connection with the termination of the Credit Agreement, all of the subsidiary guarantees of the RAI notes were released automatically at the same time. Although RJR's guarantee of the RAI notes also was released automatically, it was replaced simultaneously by a new guarantee in order to comply with a covenant of the RAI indenture. The guarantees by RAI and RJR of the RJR Tobacco notes were not released.

In addition, BAT extended separate guarantees of the outstanding senior notes of RAI and RJR Tobacco.

Fair Value of Debt

The estimated fair value of RAI's outstanding consolidated debt, in the aggregate, was \$9.6 billion and \$11.5 billion as of December 31, 2020 and 2019, respectively, with an effective annual interest rate of approximately 5.5% and 5.2% for the years ended December 31, 2020 and 2019, respectively. The fair value is derived from a third-party pricing source and is classified in Level 2 of the fair value hierarchy.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Note 7 — Commitments and Contingencies

Tobacco Litigation — General

Introduction

Litigation, claims, and other legal proceedings relating to the use of, exposure to, or purchase of tobacco products and/or e-cigarettes are pending or may be instituted in the future against RJR Tobacco (including as successor by merger to Lorillard Tobacco), American Snuff Co., SFNTC, RJRV, RAI, Lorillard, other RAI affiliates, and indemnitees (including but not limited to B&W), sometimes referred to collectively as Reynolds Defendants. These pending legal proceedings include claims relating to cigarette products manufactured by RJR Tobacco, Lorillard Tobacco, SFNTC or certain of their affiliates or indemnitees, smokeless tobacco products manufactured by American Snuff Co., and e-cigarette products manufactured on behalf of and marketed by RJRV. A discussion of the legal proceedings relating to cigarette products (and e-cigarettes) is set forth below under the heading “— Litigation Affecting the Cigarette Industry.” All of the references under that heading to tobacco-related litigation, smoking and health litigation and other similar references are references to legal proceedings relating to cigarette products or e-cigarettes, as the case may be, and are not references to legal proceedings involving smokeless tobacco products, and case numbers under that heading include only cases involving cigarette products and e-cigarettes. The legal proceedings relating to the smokeless tobacco products manufactured by American Snuff Co. are discussed separately under the heading “— Smokeless Tobacco Litigation” below.

In connection with the B&W business combination, RJR Tobacco undertook certain indemnification obligations with respect to B&W and its affiliates, including its indirect parent, BAT. As a result of the BAT Merger, these indemnification obligations are now intercompany obligations. See “— Litigation Affecting the Cigarette Industry — Overview — Introduction” below. In connection with the Lorillard Merger and the Divestiture, as applicable, RAI and RJR Tobacco undertook certain indemnification obligations. See “— Litigation Affecting the Cigarette Industry — Overview — Introduction,” “— Other Contingencies — ITG Indemnity,” and “— Other Contingencies — Loews Indemnity” below. In addition, in connection with the sale of the international tobacco business to JTI pursuant to the 1999 Purchase Agreement, as well as in connection with the sale of the non-U.S. operations and business of the NATURAL AMERICAN SPIRIT brand, several RAI affiliates and JTI agreed to certain indemnities. See “— Other Contingencies — JTI Indemnities” below.

Certain Terms and Phrases

Certain terms and phrases used in this footnote may require some explanation. The term “judgment” or “final judgment” refers to the final decision of the court resolving the dispute and determining the rights and obligations of the parties. At the trial court level, for example, a final judgment generally is entered by the court after a jury verdict and after post-verdict motions have been decided. In most cases, the losing party can appeal only after a final judgment has been entered by the trial court.

The term “damages” refers to the amount of money sought by a plaintiff in a complaint, or awarded to a party by a jury or, in some cases, by a judge. “Compensatory damages” are awarded to compensate the prevailing party for losses suffered, if liability is proved. In cases in which there is a finding that a defendant has acted willfully, maliciously or fraudulently, generally based on a higher burden of proof than is required for a finding of liability for compensatory damages, a plaintiff also may be awarded “punitive damages.” Although damages may be awarded at the trial court stage, a losing party generally may be protected from paying any damages until all appellate avenues have been exhausted by posting a supersedeas bond. The amount of such a bond is governed by the law of the relevant jurisdiction and generally is set at the amount of damages plus some measure of statutory interest, modified at the discretion of the appropriate court or subject to limits set by a court or statute.

The term “*per curiam*” refers to a decision entered by an appellate court that is not signed by an individual judge. In most cases, it is used to indicate that the opinion entered is a brief announcement of the court’s decision and is not accompanied by an explanation of the court’s reasoning.

The term “settlement” refers to certain types of cases in which cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, have agreed to resolve disputes with certain plaintiffs without resolving the cases through trial. The principal terms of certain settlements entered into by RJR Tobacco, B&W and Lorillard Tobacco are explained below under “— Accounting for Tobacco-Related Litigation Contingencies.”

Theories of Recovery

The plaintiffs seek recovery on a variety of legal theories, including negligence, strict liability in tort, design defect, failure to warn, fraud, misrepresentation, violations of unfair and deceptive trade practices statutes, conspiracy, public nuisance, medical monitoring and violations of state and federal antitrust laws. In certain of these cases, the plaintiffs claim that cigarette smoking exacerbated injuries caused by exposure to asbestos or, in the case of certain claims asserted against Lorillard Tobacco, that they were injured by exposure to filters containing asbestos used in one cigarette brand for roughly four years before 1957, the latter cases referred to as Filter Cases.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The plaintiffs seek various forms of relief, including compensatory and, where available, punitive damages, treble or multiple damages and statutory damages and penalties, prejudgment and post judgment interest, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and other equitable relief. Although alleged damages often are not determinable from a complaint, and the law governing the pleading and calculation of damages varies from jurisdiction to jurisdiction, compensatory and punitive damages have been specifically pleaded in a number of cases, sometimes in amounts ranging into the hundreds of millions and even billions of dollars.

Defenses

The defenses raised by Reynolds Defendants include, where applicable and otherwise appropriate, preemption by the Federal Cigarette Labeling and Advertising Act of some or all claims arising after 1969, or by the Comprehensive Smokeless Tobacco Health Education Act for claims arising after 1986, the lack of any defect in the product, assumption of the risk, contributory or comparative fault, lack of proximate cause, remoteness, lack of standing, statutes of limitations or repose and others. RAI, RJR and Lorillard have asserted additional defenses, including jurisdictional defenses, in many of the cases in which they are named.

Accounting for Tobacco-Related Litigation Contingencies

In accordance with GAAP, RAI and its subsidiaries record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis. For the reasons set forth below, RAI's management continues to conclude that the loss of any particular pending tobacco-related litigation claim against the Reynolds Defendants, when viewed on an individual basis, is not probable, except for certain *Engle* Progeny cases noted below.

Reynolds Defendants believe that they have valid defenses to the tobacco-related litigation claims against them, as well as valid bases for appeal of adverse verdicts against them. Reynolds Defendants have, through their counsel, filed pleadings and memoranda in pending tobacco-related litigation that set forth and discuss a number of grounds and defenses that they and their counsel believe have a valid basis in law and fact. With the exception of the *Engle* Progeny cases described below, Reynolds Defendants continue to win the majority of tobacco-related litigation claims that reach trial, and a very high percentage of the tobacco-related litigation claims brought against them, including *Engle* Progeny cases, continue to be dismissed at or before trial. Based on their experience in tobacco-related litigation and the strength of the defenses available to them in such litigation, Reynolds Defendants believe that their successful defense of tobacco-related litigation in the past will continue in the future.

RAI's consolidated balance sheet as of December 31, 2020, contains an accrual for approximately \$69,200 for an *Engle* Progeny case as set forth below under “— Litigation Affecting the Cigarette Industry – *Engle* and *Engle* Progeny Cases.” In 2020, RJR Tobacco paid approximately \$103.5 million in satisfaction of judgments, including attorneys' fees and interest, in *Engle* Progeny Cases. As other cases proceed through the appellate process, RAI will evaluate the need for further accruals on an individual case-by-case basis if an unfavorable outcome becomes probable and the amount can be reasonably estimated.

It is the policy of Reynolds Defendants to defend tobacco-related litigation claims vigorously; generally, Reynolds Defendants and indemnitees do not settle such claims. However, Reynolds Defendants may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. Exceptions to this general approach include, but are not limited to, actions taken pursuant to “offer of judgment” statutes, as described below in “— Litigation Affecting the Cigarette Industry — Overview,” and Filter Cases, as described below in “— Litigation Affecting the Cigarette Industry – Filter Cases,” as well as other historical examples discussed below.

With respect to smoking and health tobacco litigation claims, the only significant settlements reached by RJR Tobacco, Lorillard Tobacco and B&W involved:

- the State Settlement Agreements and the funding by various tobacco companies of a \$5.2 billion trust fund contemplated by the MSA to benefit tobacco growers;
- the original *Broin* flight attendant case discussed below under “— Litigation Affecting the Cigarette Industry — *Broin II* Cases,” and
- most of the *Engle* Progeny cases pending in federal court, after the initial docket of over 4,000 such cases was reduced to approximately 400 cases.

The circumstances surrounding the State Settlement Agreements and the funding of a trust fund to benefit the tobacco growers are readily distinguishable from the current categories of tobacco-related litigation claims involving Reynolds Defendants. In the claims underlying the State Settlement Agreements, the states sought to recover funds paid for health care and medical and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. The State Settlement Agreements settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and contain releases of various additional present and future claims. In accordance with the MSA, various tobacco companies agreed to fund a \$5.2 billion trust fund to be used to address the possible adverse economic impact of the MSA on tobacco growers. A discussion of the State Settlement Agreements, and a table

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

depicting the related payment schedule, is set forth below under “— Litigation Affecting the Cigarette Industry — Health-Care Cost Recovery Cases.”

As with claims that were resolved by the State Settlement Agreements, the other cases settled by RJR Tobacco can be distinguished from existing cases pending against the Reynolds Defendants. The original *Broin* case, discussed below under “— Litigation Affecting the Cigarette Industry — *Broin II* Cases,” was settled in the middle of trial during negotiations concerning a possible nation-wide settlement of claims similar to those underlying the State Settlement Agreements.

The federal *Engle* Progeny cases likewise presented exceptional circumstances not present in the state *Engle* Progeny cases or elsewhere. All of the federal *Engle* Progeny cases subject to the settlement were pending in the same court, were coordinated by the same judge, and involved the same sets of plaintiffs’ lawyers. Moreover, RJR Tobacco settled only after approximately 90% of the federal *Engle* Progeny cases otherwise had been resolved. A discussion of the *Engle* Progeny cases and the settlement of the federal *Engle* Progeny cases is set forth below under “— Litigation Affecting the Cigarette Industry — *Engle* and *Engle* Progeny Cases.”

In 2010, RJR Tobacco entered into a comprehensive agreement with the Canadian federal, provincial and territorial governments, which resolved all civil claims related to the movement of contraband tobacco products in Canada during the period 1985 through 1999 that the Canadian governments could assert against RJR Tobacco and its affiliates. These claims involved different theories of recovery than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Also, in 2004, RJR Tobacco and B&W separately settled the antitrust case *DeLoach v. Philip Morris Cos., Inc.*, which was brought by a unique class of plaintiffs: a class of all tobacco growers and tobacco allotment holders. The plaintiffs asserted that the defendants conspired to fix the price of tobacco leaf and to destroy the federal government’s tobacco quota and price support program. Despite legal defenses they believed to be valid, RJR Tobacco and B&W separately settled this case to avoid a long and contentious trial with the tobacco growers. The *DeLoach* case involved different types of plaintiffs and different theories of recovery under the antitrust laws than the other tobacco-related litigation claims pending against the Reynolds Defendants.

Finally, as discussed under “— Litigation Affecting the Cigarette Industry — State Settlement Agreements—Enforcement and Validity; Adjustments,” RJR Tobacco, B&W and Lorillard Tobacco each has settled certain cases brought by states concerning the enforcement of State Settlement Agreements. Despite legal defenses believed to be valid, these cases were settled to avoid further contentious litigation with the states involved. These enforcement actions involved alleged breaches of State Settlement Agreements based on specific actions taken by particular defendants. Accordingly, any future enforcement actions involving State Settlement Agreements will be reviewed by RJR Tobacco on the merits and should not be affected by the settlement of prior enforcement cases.

Cautionary Statement

Even though RAI’s management continues to believe that the loss of particular pending tobacco-related litigation claims against Reynolds Defendants, when viewed on an individual case-by-case basis, is not probable or estimable (except for certain *Engle* Progeny cases described below), the possibility of material losses related to such litigation is more than remote. Litigation is subject to many uncertainties, and generally, it is not possible to predict the outcome of any particular litigation pending against Reynolds Defendants, or to reasonably estimate the amount or range of any possible loss.

Although Reynolds Defendants believe that they have valid bases for appeals of adverse verdicts in their pending cases and valid defenses to all actions and intend to defend them vigorously as described above, it is possible that there could be further adverse developments in pending cases, and that additional cases could be decided unfavorably against Reynolds Defendants. Determinations of liability or adverse rulings in such cases or in similar cases involving other cigarette manufacturers as defendants, even if such judgments are not final, could have a material adverse effect on the litigation against Reynolds Defendants and could encourage the commencement of additional tobacco-related litigation. Reynolds Defendants also may enter into settlement discussions in some cases, if they believe it is in their best interests to do so. In addition, a number of political, legislative, regulatory and other developments relating to the tobacco industry and cigarette smoking have received wide media attention. These developments may negatively affect the outcomes of tobacco-related legal actions and encourage the commencement of additional similar litigation.

Although it is impossible to predict the outcome of such events on pending litigation and the rate new lawsuits may be filed against Reynolds Defendants, a significant increase in litigation or in adverse outcomes for tobacco defendants, or difficulties in obtaining the bonding required to stay execution of judgments on appeal, could have a material adverse effect on any or all of these entities. Moreover, notwithstanding the quality of defenses available to Reynolds Defendants in litigation matters, it is possible that RAI’s results of operations, cash flows or financial position could be materially adversely affected by the ultimate outcome of certain pending litigation or future claims against Reynolds Defendants.

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Litigation Affecting the Cigarette Industry

Overview

Introduction. In connection with the B&W business combination, RJR Tobacco agreed to indemnify B&W and its affiliates against, among other things, certain litigation liabilities, costs and expenses incurred by B&W or its affiliates arising out of the U.S. cigarette and tobacco business of B&W. Also, in connection with the Lorillard Merger, Lorillard Tobacco was merged into RJR Tobacco with RJR Tobacco being the surviving entity, Lorillard Tobacco ceasing to exist, and RJR Tobacco succeeding to Lorillard Tobacco's liabilities, including Lorillard Tobacco's litigation liabilities, costs and expenses. Although Lorillard Tobacco no longer exists as a result of the Lorillard Tobacco Merger, it will remain as a named party in cases pending on the date of the Lorillard Tobacco Merger until courts grant motions to substitute RJR Tobacco for Lorillard Tobacco or the claims are dismissed. The cases discussed below include cases brought against RJR Tobacco, Lorillard Tobacco and their affiliates and indemnitees, including RAI, RJR, B&W and Lorillard. Cases brought against SFNTC and RJRV also are discussed.

During 2020, 121 tobacco-related cases were served against Reynolds Defendants. On December 31, 2020, there were, subject to the exclusions described immediately below, 291 cases pending against Reynolds Defendants: 274 in the United States and 17 in Canada, as compared with 242 total cases on December 31, 2019. Of the U.S. cases pending on December 31, 2020, 41 are pending in federal court, 232 in state court and one in tribal court, primarily in the following states: Florida (78 cases); Massachusetts (46 cases); New Mexico (37 cases); Illinois (35 cases); California (12 cases); and New York (11 cases). The U.S. case number excludes the 1,400 *Engle* Progeny cases, involving approximately 1,725 individual plaintiffs, and 1,227 *Broin II* cases, pending in the United States against RJR Tobacco, Lorillard Tobacco or certain other Reynolds Defendants.

The following table lists the categories of the U.S. tobacco-related cases pending against Reynolds Defendants as of December 31, 2020, and the change in the number of cases pending against Reynolds Defendants since December 31, 2019, and a cross-reference to the discussion of each case type.

Case Type	U.S. Case Numbers as of December 31, 2020	Change in Number of Cases Since December 31, 2019 Increase/(Decrease)
Individual Smoking and Health Cases	189	54
<i>Engle</i> Progeny Cases (Number of Plaintiffs)**	1,400 (approx. 1,725)	(373) (503)
<i>Broin II</i> Cases	1,227	(1)
Class-Action Suits	20	1
Filter Cases	48	(3)
Health-Care Cost Recovery Cases	2	No change
State Settlement Agreements—Enforcement and Validity; Adjustments	4	No change
Other Litigation and Developments	14	No change

** The *Engle* Progeny cases have been separated from the Individual Smoking and Health cases for reporting purposes. The number of cases will fluctuate as cases are dismissed or if any of the dismissed cases are appealed.

The Florida state court class-action case, *Engle v. R. J. Reynolds Tobacco Co.*, and the related cases commonly referred to as *Engle* Progeny cases have attracted significant attention. After the Florida Supreme Court's 2006 ruling that members of the formerly certified class could file individual actions, roughly 10,000 claims or actions were filed in Florida state or federal courts before the deadline set by the Florida Supreme Court. No new or additional such claims may be filed. As reflected in the table above, 1,400 *Engle* Progeny cases were pending as of December 31, 2020, that included claims asserted on behalf of 1,725 plaintiffs. Following an agreement to settle most *Engle* Progeny cases that remained pending in federal courts in the first quarter of 2015, nearly all *Engle* Progeny cases currently pending are in Florida state courts. Since 2009, there have been over 300 *Engle* Progeny trials in Florida state or federal courts involving RJR Tobacco or Lorillard Tobacco. As described more fully immediately below in “— *Scheduled Trials*” and “— *Trial Results*,” additional *Engle* Progeny cases involving RJR Tobacco are being tried and set for trial on an ongoing basis. Juries in *Engle* Progeny cases have awarded substantial amounts in compensatory and punitive damage awards, many of which currently are at various stages in the appellate process. RJR Tobacco and Lorillard Tobacco also have paid substantial amounts in compensatory and punitive damage awards in *Engle* Progeny cases. For a detailed description of these cases, see “— *Engle* and *Engle* Progeny cases” below.

In November 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the MSA with 46 U.S. states, Washington, D.C. and certain U.S. territories and possessions. These cigarette manufacturers previously

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

settled four other cases, brought on behalf of Mississippi, Florida, Texas and Minnesota, by separate agreements with each state. These State Settlement Agreements:

- settled all health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions;
- released the major U.S. cigarette manufacturers from various additional present and potential future claims;
- imposed future payment obligations in perpetuity on RJR Tobacco, B&W, Lorillard Tobacco and other major U.S. cigarette manufacturers; and
- placed significant restrictions on their ability to market and sell cigarettes and smokeless tobacco products.

Payments under the State Settlement Agreements are subject to various adjustments for, among other things, the volume of cigarettes sold, relative market share, operating profit and inflation. See “— Health-Care Cost Recovery Cases — State Settlement Agreements” below for a detailed discussion of the State Settlement Agreements, including RAI’s operating subsidiaries’ monetary obligations under these agreements. RJR Tobacco records the allocation of settlement charges as products are shipped.

Scheduled Trials. Trial schedules are subject to change, and many cases are dismissed before trial. There are 30 cases, exclusive of *Engle* Progeny cases, scheduled for trial as of December 31, 2020 through December 31, 2021, for RJR Tobacco, B&W, Lorillard Tobacco or their affiliates and indemnitees: 19 individual smoking and health cases, 10 Filter Cases, and one other non-smoking and health case. There are also approximately 112 *Engle* Progeny cases against RJR Tobacco, B&W and/or Lorillard Tobacco set for trial through December 31, 2021. It is not known how many of these cases will actually be tried.

Trial Results. From January 1, 2018 through December 31, 2020, 83 individual smoking and health, *Engle* Progeny, Filter and health-care cost recovery cases in which RJR Tobacco, B&W and/or Lorillard Tobacco were defendants were tried, including nine trials for cases where mistrials were declared in the original proceedings. Verdicts in favor of RJR Tobacco, B&W and Lorillard Tobacco and, in some cases, other defendants, were returned in 26 cases, tried in Florida (24) and Massachusetts (2). There were also 9 mistrials in Florida. Verdicts in favor of the plaintiffs were returned in 36 cases tried in Florida (31), the U.S. Virgin Islands (2), and Massachusetts (3). Eight cases were dismissed during trial. Four cases were punitive damages re-trials.

In 2020, six *Engle* Progeny cases in which RJR Tobacco and/or Lorillard Tobacco was a defendant were tried:

Total number of trials	6
Number of trials resulting in plaintiffs' verdicts	2
Total damages awarded in final judgments against RJR Tobacco	\$25,700,000
Amount of overall damages comprising 'compensatory damages' (approximately)	\$13,700,000 (of overall \$25,700,000)
Amount of overall damages comprising 'punitive damages' (approximately)	\$12,000,000 (of overall \$25,700,000)
Number of adverse judgments appealed by RJR Tobacco	2
Number of adverse judgments (not yet appealed), in which RJR Tobacco still has time to file an appeal	0
Number of adverse judgments in which no appeal was sought	0

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In 2020, one non-*Engle* Progeny individual smoking and health cases, in which RJR Tobacco, B&W and/or Lorillard Tobacco was a defendant, was tried:

- In *Principe v. R. J. Reynolds Tobacco Co.*, jury selection began on January 6, 2020. During jury selection, the parties agreed to resolve the case against RJR Tobacco. The trial continued against another cigarette manufacturer.

In 2020, no Filter cases, in which RJR Tobacco and/or Lorillard Tobacco was a defendant, were tried.

For information on the verdicts in the *Engle* Progeny cases that have been tried and remain pending as of December 31, 2020, in which verdicts have been returned against RJR Tobacco, Lorillard Tobacco or B&W, or all three, see the *Engle* Progeny cases charts at “— *Engle* and *Engle* Progeny Cases” below. The following chart reflects the verdicts in the non-*Engle* Progeny smoking and health cases, health-care cost recovery cases or Filter Cases that have been tried, remain pending as of December 31, 2020 or that were resolved in 2020, where verdicts were returned against RJR Tobacco, B&W or Lorillard Tobacco, or all three.

Date of Verdict	Case Name/Type	Jurisdiction	Verdict	Status
August 17, 2006	United States v. Philip Morris USA, Inc.[Governmental Health-Care Cost Recovery]	U.S. District Court, District of Columbia, (Washington, D.C.)	RJR Tobacco, B&W and Lorillard Tobacco were found liable for civil RICO claims; were enjoined from using certain brand descriptors and from making certain misrepresentations; and were ordered to make corrective communications on five subjects, including smoking and health and addiction, to reimburse the U.S. Department of Justice appropriate costs associated with the lawsuit, and to maintain document web sites.	Compelled public statements began appearing in US newspapers on November 27, 2017 and ran serially over four months. They began appearing on national US broadcast television networks on November 27, 2017 and ran several times per week for one year. The statements also began appearing on RJR Tobacco websites on June 18, 2018 and first appeared on package onserts beginning in November 2018 (the onserts were distributed periodically through 2020). The district court is considering mandating the display of the compelled public statements at retail point of sale and briefing on that issue concluded on September 14, 2018. On May 21, 2019, the court indicated it will hold an evidentiary hearing on point-of-sale. On December 20, 2019, the district court ruled on the scope of the evidentiary hearing but did not rule on various procedural issues related to that hearing, including pre-hearing discovery and the burden of proof. The evidentiary hearing is scheduled for July 2021.
August 23, 2018	Brown v. R. J. Reynolds Tobacco Co. [Individual]	Superior Court, Division of St. Thomas and St. John, Virgin Islands	\$70 million in compensatory damages; 70% of fault assigned to Lorillard; \$12.3 million in punitive damages. Comparative fault did not apply to the final judgment.	Final judgment was entered on December 12, 2018; RJR Tobacco filed post-trial motions on January 10, 2019. The motions were not ruled on by May 10, 2019 (local rules deemed them denied); RJR Tobacco filed a notice of appeal to the VI Supreme Court on June

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Date of Verdict	Case Name/Type	Jurisdiction	Verdict	Status
				6, 2019; RJR Tobacco moved to consolidate the appeal with the appeal in Gerald, described below, which was granted; oral argument occurred on December 8, 2020; a decision is pending.
August 24, 2018	Gerald v. R. J. Reynolds Tobacco Co. [Individual]	Superior Court, Division of St. Thomas and St. John, Virgin Islands	\$1 million in compensatory damages; 60% of fault assigned to Lorillard; \$30 million in punitive damages. Comparative fault did not apply to the final judgment.	Final judgment was entered on December 12, 2018; RJR Tobacco filed post-trial motions on January 10, 2019; RJR Tobacco filed a notice of appeal to the VI Supreme Court on June 6, 2019; RJR Tobacco moved to consolidate the appeal with the appeal in Brown, described above, which was granted; oral argument occurred on December 8, 2020; a decision is pending.
March 28, 2019	Coates v. R. J. Reynolds Tobacco Co. [Individual]	Circuit Court, Orange County, Florida (Orlando, FL)	\$300,000 in compensatory damages; 50% of fault assigned to RJR Tobacco; \$16 million in punitive damages	Final judgment was entered against RJR Tobacco in the amount of \$150,000 in compensatory damages and \$16 million in punitive damages on July 25, 2019; RJR Tobacco filed a notice of appeal to the Fifth DCA and posted a supersedeas bond in the amount of approximately \$18.3 million on August 23, 2019; on October 23, 2020, the Fifth DCA reversed the plaintiff's \$16M punitive award as excessive in light of the \$150K compensatory award and remanded the case to the trial court for remittitur or new trial on punitive damages; on November 23, 2020, plaintiff filed motion for rehearing or certification to the Florida Supreme Court; on January 7, 2021, the Fifth District Court of Appeal denied the plaintiff's motion for rehearing but granted the plaintiff's motion for certification to the Florida Supreme Court. The deadline for the plaintiff to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is February 8, 2021. On February 5, 2021, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court. A decision is pending.

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Date of Verdict	Case Name/Type	Jurisdiction	Verdict	Status
May 31, 2019	Coyne v. R.J. Reynolds Tobacco Co. [Individual]	Superior Court, Middlesex County, Massachusetts (Woburn, MA)	\$6.3 million in compensatory damages; 50.42% of fault assigned to RJR Tobacco; \$11.275 million in punitive damages.	The parties submitted briefing on the plaintiff’s remaining Chapter 93A claim (Massachusetts’ Consumer Protection Act), which was denied on January 14, 2020; final judgment was entered in June 2020 in the amount of approximately \$20.9 million. RJR Tobacco filed post-trial motions and, if they are denied, will appeal.

For information on the post-trial status of individual smoking and health cases, the governmental health-care cost recovery case and the Filter Cases, see “— Individual Smoking and Health Cases,” “— Health-Care Cost Recovery Cases — U.S. Department of Justice Case,” and “— Filter Cases,” respectively, below.

Individual Smoking and Health Cases

As of December 31, 2020, 189 individual cases were pending in the United States against RJR Tobacco, B&W (as RJR Tobacco’s indemnitee), Lorillard Tobacco or all three. This category of cases includes smoking and health cases alleging personal injuries caused by tobacco use or exposure brought by or on behalf of individual plaintiffs based on theories of negligence, strict liability, breach of express or implied warranty, and violations of state deceptive trade practices or consumer protection statutes. The plaintiffs seek to recover compensatory damages, attorneys’ fees and costs, and punitive damages. The category does not include the *Broin II*, *Engle Progeny*, or Filter cases discussed below. One of the individual cases is brought by or on behalf of an individual or his/her survivors alleging personal injury as a result of exposure to environmental tobacco smoke, referred to as ETS.

Engle and Engle Progeny Cases

In July 1998, trial began in *Engle v. R. J. Reynolds Tobacco Co.*, a then-certified class action filed in Circuit Court, Miami-Dade County, Florida, against U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and others. The then-certified class consisted of Florida citizens and residents, and their survivors, who suffered from smoking-related diseases that first manifested between May 5, 1990, and November 21, 1996, and were caused by an addiction to cigarettes. In July 1999, the jury in Phase I found against RJR Tobacco, B&W, Lorillard Tobacco and the other defendants on common issues relating to the defendants’ conduct, general causation, the addictiveness of cigarettes, and entitlement to punitive damages.

On July 14, 2000, the jury in Phase II awarded the class a total of approximately \$145 billion in punitive damages, which were apportioned \$36.3 billion to RJR Tobacco, \$17.6 billion to B&W, and \$16.3 billion to Lorillard Tobacco. The defendants appealed.

On December 21, 2006, the Florida Supreme Court prospectively decertified the class and set aside the jury’s Phase II punitive damages award. But the court preserved certain of the jury’s Phase I findings, including that cigarettes can cause certain diseases, nicotine is addictive, and defendants placed defective cigarettes on the market, breached duties of care, concealed health-related information, and conspired. The court also authorized former class members to file individual lawsuits within one year, and it stated that the preserved findings would have *res judicata* effect in those actions.

In the year after the Florida Supreme Court’s *Engle* decision, putative class members filed thousands of individual actions against RJR Tobacco, B&W, Lorillard Tobacco, Philip Morris USA Inc., and the other *Engle* defendants, which actions commonly are referred to as *Engle Progeny* cases. As of December 31, 2020, 1,398 *Engle Progeny* cases were pending in state courts, and 2 *Engle Progeny* cases were pending in federal court against RJR Tobacco, B&W and/or Lorillard Tobacco. Those cases include claims by or on behalf of approximately 1,725 plaintiffs. As of December 31, 2020, RJR Tobacco also was aware of seven additional *Engle Progeny* cases that have been filed but not served. The number of pending cases fluctuates for a variety of reasons, including voluntary and involuntary dismissals. Voluntary dismissals include cases in which a plaintiff accepts an “offer of judgment,” referred to in Florida statutes as “proposals for settlement,” from RJR Tobacco, Lorillard Tobacco and/or RJR Tobacco’s affiliates and indemnitees. An offer of judgment, if rejected by the plaintiff, in certain circumstances preserves RJR Tobacco’s and Lorillard Tobacco’s right to recover attorneys’ fees under Florida law in the event of a verdict favorable to RJR Tobacco or Lorillard Tobacco. Such offers are sometimes made through court-ordered mediations.

At the beginning of the *Engle Progeny* litigation, a central issue was the proper use of the preserved *Engle* findings. RJR Tobacco has argued that use of the *Engle* findings to establish individual elements of progeny claims (such as defect, negligence and concealment)

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is a violation of federal due process. In 2013, however, both the Florida Supreme Court and the U.S. Court of Appeals for the Eleventh Circuit, referred to as the Eleventh Circuit, rejected that argument. In addition to this global due process argument, RJR Tobacco and Lorillard Tobacco raise many other factual and legal defenses as appropriate in each case. These defenses may include, among other things, arguing that the plaintiff is not a proper member of the *Engle* class, that the plaintiff did not rely on any statements by any tobacco company, that the trial was conducted unfairly, that some or all claims are preempted or barred by applicable statutes of limitation, or that any injury was caused by the smoker’s own conduct. In *Hess v. Philip Morris USA Inc.* and *Russo v. Philip Morris USA Inc.*, decided on April 2, 2015, the Florida Supreme Court held that, in *Engle* Progeny cases, the defendants cannot raise a statute of repose defense to claims for concealment or conspiracy. On April 8, 2015, in *Graham v. R. J. Reynolds Tobacco Co.*, the Eleventh Circuit held that federal law impliedly preempts use of the preserved *Engle* findings to establish claims for strict liability or negligence. On January 21, 2016, the Eleventh Circuit granted the plaintiff’s motion for rehearing *en banc* and vacated the panel decision. On May 18, 2017, the *en banc* Eleventh Circuit rejected RJR Tobacco’s due process and implied preemption arguments. On January 8, 2018, the U.S. Supreme Court denied RJR Tobacco’s petition for writ of certiorari. On January 6, 2016, in *Marotta v. R. J. Reynolds Tobacco Co.*, the Fourth DCA disagreed with the *Graham* panel decision and held that federal law does not impliedly preempt any tort claims against cigarette manufacturers, including those of *Engle* Progeny plaintiffs. The Florida Supreme Court accepted jurisdiction in *Marotta*, heard oral argument, and on April 6, 2017, found that federal law does not preempt the *Engle* Progeny plaintiffs’ claims and remanded for further proceedings on punitive damages.

In June 2009, Florida amended its existing bond cap statute by adding a \$200 million bond cap that applied to all *Engle* Progeny cases in the aggregate. In May 2011, Florida removed the provision that would have allowed the bond cap to expire on December 31, 2012. The bond cap for any given individual *Engle* Progeny case varies depending on the number of judgments on appeal at a given time, but never exceeds \$5 million per case for appeals within the Florida state court system. The legislation, which became effective in June 2009 and 2011, applied to judgments entered after the original 2009 effective date.

During 2015, RJR Tobacco and Lorillard Tobacco, together with Philip Morris USA Inc., settled virtually all of the *Engle* Progeny cases then pending against them in federal district court. The total amount of the settlement was \$100 million divided as follows: RJR Tobacco - \$42.5 million; Philip Morris USA Inc. - \$42.5 million; and Lorillard Tobacco - \$15 million. The settlement covered more than 400 federal progeny cases but did not cover 12 federal progeny cases previously tried to verdict and then pending on post-trial motions or appeal; and 2 federal progeny cases filed by different lawyers from the ones who negotiated the settlement for the plaintiffs.

Seventy-one *Engle* Progeny cases have been tried in Florida state and federal courts since the beginning of 2018 through December 31, 2020, and additional state court trials are scheduled for 2021. Since the beginning of 2018 through December 31, 2020, RJR Tobacco or Lorillard Tobacco has paid judgments in 61 *Engle* Progeny cases. Those payments totaled \$637.7 million and included \$473.7 million for compensatory or punitive damages and \$164 million for attorneys’ fees and statutory interest. The payments made in 2020 are detailed in the following chart:

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Graffeo</i>	70%	—	\$ 4,500,000	\$ 15,000,000	Final judgment was entered against RJR Tobacco in the amount of \$4.5 million in compensatory damages and \$15 million in punitive damages on February 20, 2018; on December 6, 2019, the Second DCA affirmed the judgment of the trial court, per curiam; RJR Tobacco paid approximately \$23.7 million in satisfaction of the judgment on January 3, 2020.
<i>Margaret Brown</i>	65%	—	3,250,000	8,500,000	Final judgment was entered on April 18, 2018; on December 6, 2019, the Fifth DCA affirmed the final judgment of the trial court and dismissed the plaintiff’s cross appeal as moot; RJR Tobacco paid approximately \$14.6 million in satisfaction of the judgment on January 3, 2020.
<i>Moore</i>	15%	—	150,000	1,000,000	On May 16, 2019, the jury returned a verdict in favor of the plaintiff, found the plaintiff 85% at fault and RJR

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Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Theis</i>	15%	—	1,400,000	4,000,000	Tobacco 15% at fault, but awarded \$0 in compensatory damages and found that the plaintiff was entitled to punitive damages; on May 17, 2019, the jury returned a punitive damages award of \$1 million; post-trial motions were denied on October 4, 2019; however, the court granted the plaintiff's motion for additur and added \$150,000 in compensatory damages in response to the motion; on January 10, 2020, the parties executed a confidential settlement agreement and release of all claims as to RJR Tobacco; on January 24, 2020, RJR Tobacco paid \$2.94 million in satisfaction of the judgment. Final judgment was entered against RJR Tobacco and the remaining defendant, jointly and severally, in the amount of approximately \$7 million in compensatory damages and \$4 million in punitive damages against RJR Tobacco and \$10 million in punitive damages against the remaining defendant; on December 27, 2019, the Second DCA affirmed the judgment of the trial court, per curiam; on January 17, 2020, PM USA moved for written reasons and certification of a conflict; which was denied on February 10, 2020. RJR Tobacco paid approximately \$6 million in satisfaction of the judgment on February 28, 2020.
<i>Landi</i>	35%	—	4,000,000	7,000,000	Final judgment was entered on June 17, 2018 against RJR Tobacco and the remaining defendant, jointly and severally in the amount of \$8 million in compensatory damages and \$7 million in punitive damages against RJR Tobacco and \$5 million in punitive damages against the remaining defendant; oral argument occurred on June 9, 2020; on June 11, 2020, the Fourth DCA affirmed the judgment of the trial court, per curiam. RJR Tobacco paid approximately \$12.42 million in satisfaction of the judgment on July 1, 2020.
<i>Rouse</i>	50%	—	5,000,000	2,250,000	Final judgment was entered on December 17, 2018; on July 15, 2020, the Third DCA affirmed the final judgment of the trial court; RJR Tobacco paid approximately \$9.4

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Kerrivan</i>	31%	—	6,046,900	9,600,000	million in satisfaction of the judgment on August 14, 2020. Final judgment was entered on November 13, 2014; on March 24, 2020, the Eleventh Circuit Court of Appeals affirmed the final judgment of the trial court against the defendants in the amount of \$15.8 million in compensatory damages and \$9.5 million in punitive damages against RJR Tobacco and \$15.7 million in punitive damages against PM USA; on April 16, 2020, RJRT and PM USA filed a response in opposition to Plaintiff's motion for suggestion of death requesting the Court enter an order staying further proceedings, including the filing of a petition for rehearing or rehearing <i>en banc</i> , until such time as a personal representative is appointed; on May 5, 2020, the Eleventh Circuit granted the defendants' motion to stay the proceedings; the estate's personal representative subsequently filed an unopposed motion to substitute as plaintiff-appellee, which was granted; the Eleventh Circuit denied rehearing on August 14, 2020; RJR Tobacco paid approximately \$16.1 million in satisfaction of the judgment on August 31, 2020.
<i>Sowers</i>	50%	—	2,125,000	—	Final judgment was entered on February 12, 2015; on September 15, 2020, the Eleventh Circuit affirmed the district court's judgment on compensatory damages and remanded the case to the trial court for retrial on punitive damages; RJR Tobacco paid approximately \$2.2 million in satisfaction of the compensatory damages judgment on September 29, 2020; the plaintiff and RJR Tobacco filed a stipulation of dismissal with prejudice which includes all claims brought or that could have been brought with prejudice.
Totals			<u>\$ 26,471,900</u>	<u>\$ 47,350,000</u>	

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

In addition, as of December 31, 2020, \$50,000 for compensatory damages for the following *Engle* Progeny case was accrued in RAI's consolidated balance sheet as reflected in the following chart:

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status
<i>Starr-Blundell</i>	10%	—	\$ 50,000	\$ —	First DCA, <i>per curiam</i> , reversed and remanded its May 29, 2015 opinion to the trial court for reconsideration in light of the decision in <i>Soffer</i> ; in the punitive damages retrial, on February 27, 2018, the jury did not award punitive damages; the trial court entered final judgment against RJR Tobacco in the amount of \$50,000 on December 19, 2019; the plaintiff filed a notice of appeal to the First DCA on January 21, 2020; oral argument is scheduled for March 10, 2021.
Totals			<u>\$ 50,000</u>	<u>\$ —</u>	

⁽¹⁾ Compensatory damages are adjusted to reflect the reduction that may be required by the allocation of fault. Punitive damages are not adjusted and reflect the amount of the final judgment(s) signed by the trial court judge(s). The amount listed above does not include attorneys' fees or statutory interest of approximately \$19,200 in *Starr-Blundell*.

⁽²⁾ The court did not apply comparative fault in the final judgment.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The following chart lists judgments in all other individual *Engle* Progeny cases pending as of December 31, 2020, in which a verdict or judgment has been returned against RJR Tobacco, B&W, and/or Lorillard Tobacco and the verdict or judgment has not been set aside on appeal. No liability for any of these cases has been recorded in RAI’s consolidated balance sheet as of December 31, 2020. This chart does not include the mistrials or verdicts returned in favor of RJR Tobacco, B&W, and/or Lorillard Tobacco.

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status	
<i>Calloway</i>	—	—	\$	—	\$	— Fourth DCA granted rehearing <i>en banc</i> and substituted a new opinion ordering a new trial based on improper argument; plaintiff filed a petition for writ of certiorari with the U.S. Supreme Court on June 14, 2017, which was denied on October 2, 2017; the new trial was scheduled for August 13, 2018; on July 20, 2018, the defendants moved to disqualify the judge, which was denied; on July 23, 2018, the defendants filed a writ of prohibition in the Fourth DCA asking that court to disqualify the trial judge; on August 6, 2018, the trial judge disqualified himself; the new trial is scheduled to begin September 27, 2021.
<i>Robinson</i>	71%	—		—	\$	— On December 4, 2017, the Florida Supreme Court denied the plaintiff’s petition for review; the new trial began on June 10, 2019; on June 24, 2019, the jury returned a verdict in favor of RJR Tobacco; plaintiff filed a motion for a new trial, which was denied on July 18, 2019; final judgment was entered in favor of RJR Tobacco on July 30, 2019; the plaintiff filed a notice of appeal to the First DCA on August 8, 2019; RJR Tobacco filed a notice of cross appeal on August 20, 2019; briefing is complete; and the first DCA denied oral argument on October 30, 2020 and will decide the appeal on the briefs.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status
<i>Patricia Harris</i>	15%	10%	411,700	—	On April 15, 2019, the trial court denied the defendant’s motion for judgment as a matter of law and new trial, but granted their motion to alter or amend the judgment; an amended judgment was entered on April 29, 2019 in favor of the plaintiff and against PM USA in the amount of \$238,997.50, RJR Tobacco in the amount of \$238,997.50, and Lorillard in the amount of \$172,665; the defendants filed a notice of appeal to the Eleventh Circuit on May 14, 2019; on May 20, 2019, the plaintiff filed a notice of cross appeal; oral argument occurred on October 22, 2020; the Eleventh Circuit reversed the trial court’s judgment in favor of the plaintiff on November 20, 2020; deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is February 18, 2021.
<i>Irimi</i>	—	—	—	—	Florida Supreme Court accepted jurisdiction of the case on July 18, 2018; on February 5, 2019, the Florida Supreme Court dismissed the plaintiff’s petition for review finding that the court had determined that it lacked jurisdiction, and it therefore dismissed the petition as improvidently granted; a case management conference occurred on October 2, 2020 where trial was scheduled for July 6, 2021.
<i>Rintoul (Caprio)</i>	49%	—	4,600,000	74,123,000	In the partially completed verdict, the jury found for the plaintiff on the issues of class membership and product-use causation; and awarded \$559,000 in economic damages. The verdict form indicated that the jury reached a verdict on the plaintiff’s intentional tort claims, but the jury reported in a note to the court that it lacked unanimity on those questions. The jury also made findings on comparative fault that were inconsistent with the rest of its verdict, and it did not answer the verdict form questions relating to noneconomic damages and entitlement to punitive damages; in May 2015, the court denied the defendants’ motion for a mistrial and advised that it accepted the questions answered by the jurors as a partial verdict; defendants appealed, and in January 2017 the parties reached an agreement whereby the defendants dismissed their appeal and the plaintiff agreed to a complete retrial on all issues;

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
					<p>the new trial began on October 10, 2019; on November 13, 2019, the jury returned a verdict in favor of the plaintiff, found RJR Tobacco 49% at fault, PM USA 49% at fault, and the plaintiff 2% at fault, and awarded approximately \$9.2 million in compensatory damages; on November 15, 2019, the jury awarded approximately \$74.1 million in punitive damages against RJR Tobacco and approximately \$74.1 million in punitive damages against PM USA; on March 9, 2020, the trial court denied the defendants’ motions for a new trial and for judgment as a matter of law, granted their motion for stay of execution and for setoff, and took the remittitur motions under advisement; on August 4, 2020, the trial court entered an order on the post-trial motions, which updated the remittitur taken under advisement. The defendants’ motion for a new trial based on the excessiveness of the Phase I damages awards or, in the alternative, for remittitur of the Phase I awards was denied as to non-economic damages and was granted as to economic damages. The economic damages award was reduced from \$200,000 to \$155,866.82. The defendants’ motion for a new trial based on the excessiveness of the punitive damages awards or, in the alternative for remittitur of the punitive damages award was denied; the defendants filed a notice of appeal to the Fourth DCA on September 3, 2020; RJR Tobacco posted a supersedeas bond in the amount of \$2.5 million on September 9, 2020; the plaintiff filed a notice of cross appeal on September 11, 2020; briefing is underway.</p>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Pollari</i>	—	—	—	—	Fourth DCA reversed and remanded the case for a new trial on August 30, 2017; plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on December 6, 2017, but dismissed her notice on January 28, 2019; the new trial began on January 14, 2019; on January 29, 2019, the jury returned a verdict in favor of the defendants, including RJR Tobacco; plaintiff filed a motion for a new trial on February 11, 2019, which was denied on July 24, 2019; the plaintiff filed a notice of appeal to the Fourth DCA on August 16, 2019; the defendants filed a notice of cross appeal on August 23, 2019; oral argument occurred on November 17, 2020; on December 3, 2020, the Fourth DCA affirmed the judgment of the trial court, <i>per curiam</i> ; the deadline for the plaintiff to file a petition for writ of certiorari with the U.S. Supreme Court is March 3, 2021.
<i>Ryan</i>	—	—	—	—	Fourth DCA reversed and remanded the case for a new trial on December 13, 2017; plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on January 3, 2018, which was denied on July 18, 2019; the new trial has not been scheduled.
<i>Hardin</i>	13%	—	100,900	—	Third DCA remanded the case for a new trial on punitive damages for the non-intentional tort claims; punitive damages retrial began February 5, 2018; on February 15, 2018, the court granted RJR Tobacco's motion for directed verdict; on August 5, 2020, the Third DCA affirmed the order granting RJR Tobacco's motion for directed verdict that resulted in the final judgment in RJR Tobacco's favor; the plaintiff filed a motion for rehearing on August 20, 2020; on December 16, 2020, the Third DCA denied the plaintiff's motion for rehearing and affirmed the trial court's order granting a directed verdict in favor of RJR Tobacco due to insufficient evidence; on January 15, 2021, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court; decision is pending.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status
<i>McCoy</i>	—	—	—	—	Fourth DCA reversed and remanded the case for a new trial on November 8, 2017; plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on December 7, 2017, which the plaintiff dismissed on January 28, 2019; the Florida Supreme Court denied the petition for review and declined to accept jurisdiction of the case on November 25, 2019; the new trial is scheduled to begin September 27, 2021.
<i>Blackwood (Cooper)</i>	40%	—	1,200,000	—	On January 10, 2018, the Fourth DCA affirmed judgment on compensatory damages for plaintiff and remanded for a new trial on punitive damages on the non-intentional tort claims; new trial on punitive damages has not been scheduled; on September 29, 2020, the plaintiff obtained writs of garnishment and execution for the amount of judgment on compensatory damages; on October 14, 2020, the trial court dissolved the writs of garnishment and execution, and the time for the plaintiff to appeal has expired.
<i>Duignan</i>	30%	—	1,200,000	12,000,000	Second DCA reversed and remanded for a new trial on November 15, 2017; new trial began on November 26, 2018; the court declared a mistrial on November 28, 2018; the second new trial began on January 27, 2020; on February 18, 2020, the jury returned a verdict in favor of the plaintiff, found the decedent 30% at fault, RJR Tobacco 30% at fault and PM USA 40% at fault, and awarded \$2.75 million in compensatory damages and \$12 million in punitive damages against each defendant; most of the defendants' post-trial motions were denied on August 14, 2020; the defendants' motion regarding excessiveness of Phase II punitive damages was denied on September 2, 2020; the defendants filed a notice of appeal to the Second DCA, and RJR Tobacco posted a supersedeas bond in the amount of \$2.5 million on September 15, 2020; briefing is underway.
<i>Ewing</i>	2%	—	4,800	—	First DCA affirmed the final judgment of the trial court on April 22, 2020; per counsel, the plaintiff did not seek further review.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Oshinsky-Blacker</i>	—	—	—	—	On July 19, 2018, the Fourth DCA affirmed, <i>per curiam</i> , the trial court’s order granting the defendants’ motion for a new trial; new trial has not been scheduled.
<i>Prentice</i>	—	—	—	—	On October 24, 2019, the First DCA reversed the judgment of the trial court and remanded the case for a new trial; plaintiff filed a motion for rehearing, rehearing <i>en banc</i> or certification of conflict with the Second DCA’s decision in <i>Duignan</i> on December 9, 2019; that motion was denied on January 29, 2020; on August 11, 2020, the Florida Supreme Court accepted jurisdiction of the case and briefing is underway.
<i>Konzelman</i>	85%	—	7,476,000	20,000,000	Fourth DCA, on May 19, 2018, held that the pre-1999 version of the punitive damages statute “applies in an Engle Progeny personal injury suit that is converted into a wrongful death action upon the smoker’s death”; on the plaintiff’s cross appeal, the court found that the trial court erred in reducing the compensatory damages award based on comparative fault and remanded for further proceedings consistent with <i>Schoeff</i> ; on August 10, 2018, the Fourth DCA denied RJR Tobacco’s motion for rehearing; RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on September 11, 2018; on May 1, 2019, RJR Tobacco filed a motion to consolidate this case with the <i>Sheffield</i> case, or alternatively, for a stay of the case until the Florida Supreme Court has resolved the <i>Sheffield</i> petition because both cases present the exact same legal issue; the motion to consolidate was denied on July 9, 2019; a decision on jurisdiction remains pending; on August 21, 2020, the Florida Supreme Court entered an order staying proceedings pending the disposition of <i>Sheffield</i> ; plaintiff filed a motion on August 28, 2020 to lift the stay and permit the case to travel with <i>Sheffield</i> , which was denied on September 3, 2020.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Ledo</i>	49%	—	2,940,000	—	On April 10, 2019, the Third DCA affirmed the trial court’s judgment against RJR Tobacco and denial of RJR Tobacco’s motion for a new trial; on the plaintiff’s cross appeal, the Third DCA reversed and remanded the order directing verdict in favor of RJR Tobacco on plaintiff’s punitive damages claim; the Third DCA reinstated the jury’s finding as to liability on that claim and remanded the case for a new trial on the amount of punitive damages; on May 9, 2019, RJR Tobacco filed a motion for rehearing, rehearing <i>en banc</i> or certification to the Florida Supreme Court, which was denied on June 5, 2019; RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on July 5, 2019; which was denied on April 14, 2020; the new trial on punitive damages has not been scheduled..
<i>Santoro</i>	26%	—	417,000	90,000	Post-trial motions were denied on May 14, 2018; defendants filed a notice of appeal to the Fourth DCA on June 6, 2018; RJR Tobacco posted a supersedeas bond in the amount of \$535,000 on June 21, 2018; oral argument occurred on January 28, 2020; on May 6, 2020, the Fourth DCA affirmed in part, and reversed in part finding the trial court did not err in denying Defendants’ motion for directed verdict as to <i>Engle</i> class membership, but did err in granting Defendants’ motion for directed verdict as to the strict liability and negligence claims. The Panel reversed and remanded for reinstatement of the jury verdict on those claims and for entry of an amended final judgment which will include the jury’s award of punitive damages which were based upon the strict liability and negligence claims; the defendants filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on August 28, 2020, which was denied on January 13, 2021; RJR Tobacco paid approximately \$1 million in satisfaction of the judgment on February 4, 2021.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Sheffield</i>	60%	—	1,800,000 ⁽²⁾	—	Fifth DCA, on February 8, 2019, reversed the punitive damages award and remanded the case to the trial court for further proceedings; on March 5, 2019, the plaintiff filed a motion for rehearing and motion for rehearing <i>en banc</i> , which was denied on March 28, 2019; the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court on April 5, 2019; on June 3, 2019, RJR Tobacco filed a motion to consolidate the case with the <i>Konzelman</i> case since both cases present the exact same legal issue; the motion to consolidate was denied on July 9, 2019; on August 13, 2020, the Florida Supreme Court accepted jurisdiction of the case and oral argument is scheduled for April 7, 2021.
<i>Schlefstein</i>	—	—	—	—	Post-trial motions were denied on March 15, 2018; the same day, the court entered an amended final judgment against RJR Tobacco in the amount of approximately \$13.97 million in compensatory damages and \$28 million in punitive damages; on August 28, 2019, the Fourth DCA reversed the judgment of the trial court and remanded the case for a new trial on all issues; the plaintiff filed a motion for rehearing or rehearing <i>en banc</i> on October 14, 2019, which was denied on November 20, 2019; on December 20, 2019, the plaintiff filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court; on April 6, 2020, the Florida Supreme Court declined to accept jurisdiction of the case; the new trial is scheduled for April 12, 2021.
<i>Gloger</i>	57%	—	9,500,000	16,500,000	In the retrial, on November 8, 2019, the jury returned a verdict in favor of the plaintiff, found the plaintiff 10% at fault, RJR Tobacco 57% at fault, and PM USA 33% at fault, and awarded \$15 million in compensatory damages; on November 13, 2019, the jury awarded \$16.5 million in punitive damages against RJR Tobacco and \$11 million in punitive damages against PM USA; the defendants filed a notice of appeal to the Third DCA on January 6, 2020; RJR Tobacco posted a supersedeas bond in the amount of approximately \$2.2 million; briefing is underway.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted) ⁽¹⁾	Punitive Damages	Appeal Status
<i>Rozar</i>	10%	—	57,000	—	Final judgment was entered on August 23, 2018; on March 23, 2020, the First DCA issued an opinion affirming in part and reversing in part the trial court’s final judgment. The court affirmed the trial court’s decision regarding the admission of non-COPD-related medical evidence and future damages awards. The court reversed and remanded the trial court order denying additur or new trial on the zero-damages award for past noneconomic damages and remanded that single issue for proceedings consistent with the opinion; on July 27, 2020, the plaintiff filed an additur motion seeking an additional \$5 million in noneconomic compensatory damages; on November 23, 2020, the plaintiff’s motion for additur was granted in part and denied in part; the plaintiff was awarded an additur of \$68,965.44 for past noneconomic damages. If the plaintiff rejects the additur, there will be a new trial on the amount of past noneconomic damages; on November 30, 2020, the plaintiff rejected the additur and requested a new trial.
<i>Burgess</i>	80%	—	3,000,000	—	Final judgment was entered against RJR Tobacco on June 24, 2018; on February 26, 2020, the Fourth DCA affirmed the final judgment of the trial court; RJR Tobacco filed a notice to invoke the discretionary jurisdiction of the Florida Supreme Court; the Florida Supreme Court stayed the case pending the disposition of <i>Prentice</i> , described above; on September 16, 2020, the Florida Supreme Court denied RJR Tobacco’s motion to lift the stay and have the case travel with <i>Prentice</i> .
<i>Kaplan</i>	—	—	1,100,000	671,000	Final judgment was entered against RJR Tobacco and the remaining defendant in the amount of approximately \$2.1 million in compensatory damages and \$671,000 in punitive damages against RJR Tobacco and \$2.3 million in punitive damages against the remaining defendant on August 30, 2018; defendants filed a joint notice of appeal to the Fourth DCA on September 24, 2018; RJR Tobacco posted a supersedeas bond in the amount of approximately \$1.7 million on September 27, 2018; the plaintiff filed a notice of cross appeal on October 4, 2018; oral argument occurred on September 22, 2020 and was held via

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status
<i>Bessent-Dixon</i>	58%	—	2,000,000	13,500,000	Zoom video conference; on December 9, 2020, the Fourth DCA affirmed the final judgment of the trial court; RJR Tobacco and PM USA filed a motion for rehearing on January 27, 2021; a decision is pending. On August 17, 2018, the court declared a mistrial as to Phase II only; the court deferred entering judgment for Phase I; retrial on punitive damages began on February 4, 2019; on February 7, 2019, the jury awarded \$13.5 million in punitive damages; on January 15, 2021, the First DCA reversed the judgement of the trial court based on improper jury instructions and remanded the case for a new trial; the deadline for the plaintiff to file a notice to invoke the discretionary jurisdiction of the Florida Supreme Court is February 17, 2021.
<i>Margaret Harris</i>	70%	—	4,000,000	6,000,000	Final judgment was entered against RJR Tobacco in the amount of \$4 million in compensatory damages and \$6 million in punitive damages on March 1, 2019; RJR Tobacco filed a notice of appeal to the First DCA on May 3, 2019; oral argument occurred on September 17, 2020, via video conference; a decision is pending.
<i>Mahfuz</i>	45%	—	6,000,000	15,000,000	Final judgment was entered against RJR Tobacco and PM USA in the amount of approximately \$12 million in compensatory damages and \$15 million in punitive damages against RJR Tobacco and \$10 million in punitive damages against PM USA on March 2, 2019; the defendants filed a notice of appeal to the Fourth DCA on July 12, 2019, and RJR Tobacco posted a supersedeas bond in the amount of approximately \$2.8 million; the plaintiff filed a notice of cross appeal on July 17, 2019; briefing is Complete; oral argument has been scheduled for March 9, 2021.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Plaintiff Case Name	RJR Tobacco Allocation of Fault	Lorillard Tobacco Allocation of Fault	Compensatory Damages (as adjusted)⁽¹⁾	Punitive Damages	Appeal Status
<i>Neff</i>	80%	—	2,000,000	4,000,000	Final judgment was entered on March 22, 2019 against RJR Tobacco and PM USA, jointly and severally, in the amount of approximately \$4 million in compensatory damages and \$4 million in punitive damages against RJR Tobacco and \$2 million in punitive damages against PM USA; the defendants filed a notice of appeal to the Fourth DCA on August 20, 2019, and RJR Tobacco posted a supersedeas bond in the amount of approximately \$3 million; plaintiff filed a notice of cross appeal on August 21, 2019; briefing is complete; oral argument has not been scheduled.
<i>Janice Durrance Jones</i>	40%	—	200,000	3,250,000	Final judgment was entered against RJR Tobacco in the amount of \$200,000 in compensatory damages and \$3.25 million in punitive damages on May 22, 2019; RJR Tobacco filed a notice of appeal to the Second DCA and posted a supersedeas bond in the amount of \$3.45 million on September 13, 2019; oral argument occurred on October 20, 2020; a decision is pending.
<i>Robert Hamilton</i>	77.5%	—	6,000,000	4,600,000	Final judgment was entered on July 9, 2019; RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of \$5 million on August 26, 2019; oral argument occurred on January 5, 2021; a decision is pending.
<i>Snyder</i>	70%	—	12,500,000	—	Final judgment was entered against RJR Tobacco on February 21, 2020 in the amount of \$12.5 million; RJR Tobacco filed a notice of appeal to the Fourth DCA and posted a supersedeas bond in the amount of \$5 million on May 26, 2020; briefing is underway.
Totals			<u>\$ 66,507,000</u>	<u>\$ 169,734,000</u>	

⁽¹⁾ Unless otherwise noted, compensatory damages in these cases are adjusted to reflect the jury’s allocation of comparative fault. Punitive damages are not so adjusted. The amounts listed above do not include attorneys’ fees or statutory interest that may apply to the judgments and such fees and interest may be material.

⁽²⁾ The court did not apply comparative fault in the final judgment.

⁽³⁾ Should the pending post-trial motions be denied, RJR Tobacco will likely file a notice of appeal with the appropriate appellate court.

As reflected in the preceding chart, as of December 31, 2020, verdicts or judgments in favor of *Engle* Progeny plaintiffs have been entered and remain outstanding against RJR Tobacco or Lorillard Tobacco totaling \$66.5 million in compensatory damages (as adjusted) and \$169.7 million in punitive damages, which is a combined total of \$236,241,000. These verdicts or judgments are at various stages in the post-trial or appellate process. RJR Tobacco believes that RJR Tobacco and Lorillard Tobacco have valid defenses in these cases, including case-specific issues beyond the due process issue discussed above, and, as described in more detail above in “— Accounting

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

for Tobacco-Related Litigation Contingencies,” RJR Tobacco and its affiliates vigorously defend smoking and health claims, including *Engle* Progeny cases.

Should RJR Tobacco or Lorillard Tobacco not prevail in any particular individual *Engle* Progeny case or determine that in any individual *Engle* Progeny case an unfavorable outcome has become probable and the amount can be reasonably estimated, a loss would be recognized, which could have a material adverse effect on the results of operations, cash flows and financial position of RAI. This position on loss recognition for *Engle* Progeny cases as of December 31, 2020, is consistent with RAI’s and RJR Tobacco’s historic position on loss recognition for other smoking and health litigation. It is the policy of RJR Tobacco to record any loss concerning litigation at such time as an unfavorable outcome becomes probable and the amount can be reasonably estimated on an individual case-by-case basis.

Broin II Cases

Broin v. Philip Morris, Inc. (Cir. Ct. Miami-Dade County, Fla., filed 1991) was a class action brought on behalf of flight attendants alleged to have suffered from diseases or ailments caused by exposure to ETS in airplane cabins. In October 1997, RJR Tobacco, Lorillard Tobacco, B&W and other cigarette manufacturer defendants settled *Broin*, agreeing to pay a total of \$300 million in three annual \$100 million installments, allocated among the companies by market share, to fund research on the early detection and cure of diseases associated with tobacco smoke. It also required those companies to pay a total of \$49 million for the plaintiffs’ counsel’s fees and expenses. RJR Tobacco’s portion of these payments was approximately \$86 million; Lorillard Tobacco’s was approximately \$57 million; and B&W’s was approximately \$31 million. The settlement agreement, among other things, limits the types of claims class members may bring and eliminates claims for punitive damages. The settlement agreement also provides that, in individual cases by class members that are referred to as *Broin II* lawsuits, the defendant will bear the burden of proof with respect to whether ETS can cause certain specifically enumerated diseases, referred to as “general causation.” With respect to all other liability issues, including whether an individual plaintiff’s disease was caused by his or her exposure to ETS in airplane cabins, referred to as “specific causation,” individual plaintiffs will bear the burden of proof. On September 7, 1999, the Florida Supreme Court approved the settlement.

As of December 31, 2020, there were 1,227 *Broin II* lawsuits pending in Florida. There have been no *Broin II* trials since 2007.

Class-Action Suits

Overview. As of December 31, 2020, 20 class-action cases, excluding the shareholder cases described below, were pending in the United States against Reynolds Defendants. These class actions seek recovery for personal injuries allegedly caused by cigarette smoking or, in some cases, for economic damages allegedly incurred by cigarette or e-cigarette consumers.

In 1996, the Fifth Circuit Court of Appeals in *Castano v. American Tobacco Co.* overturned the certification of a nation-wide class of persons whose claims related to alleged addiction to tobacco products, finding that the district court failed to properly assess variations in the governing state laws and whether common issues predominated over individual issues. Since the Fifth Circuit’s ruling in *Castano*, few smoker class-action complaints have been certified or, if certified, have survived on appeal. Eighteen federal courts, including two courts of appeals, and most state courts that have considered the issue have rejected class certification in such cases. Apart from *Castano*, only two smoker class actions have been certified by a federal court – *In re Simon (II) Litigation* and *Schwab [McLaughlin] v. Philip Morris USA Inc.*, both of which were filed in the U.S. District Court for the Eastern District of New York and were later decertified.

Class-action suits based on claims that class members are at a greater risk of injury or were injured by the use of tobacco or exposure to ETS, or claims that seek primarily economic damages were pending against RJR Tobacco, Lorillard Tobacco, or their affiliates or indemnitees in state or federal courts in California, District of Columbia, Florida, Illinois, Louisiana, Missouri, New Mexico, New York, North Carolina, West Virginia and the U.S. Virgin Islands. All pending class-action cases are discussed below.

Several class actions relating to claims in advertising and promotional materials for SFNTC’s NATURAL AMERICAN SPIRIT brand cigarettes are pending in federal courts. In general, these plaintiffs allege that use of the words “natural,” “additive-free,” “organic” or “tobacco and water” in NATURAL AMERICAN SPIRIT advertising and promotional materials suggests that those cigarettes are less harmful than other cigarettes and, for that reason, violated state consumer protection statutes or amounted to fraud or a negligent or intentional misrepresentation. These cases are discussed below under “— No Additive/Natural Claim Cases.”

Additional class actions relating to alleged personal injuries purportedly caused by use of cigarettes or exposure to ETS are pending. These cases are discussed below under “— Other Class Actions.”

Finally, certain third-party payers have filed health-care cost recovery actions in the form of class actions. These cases are discussed separately below under “— Health-Care Cost Recovery Cases.”

“Lights” Cases

Beginning in roughly 2000, several class action lawsuits were filed against RJR Tobacco, its affiliates or indemnitees, and other cigarette manufacturers alleging that the use of the term “lights” constituted an unfair and deceptive trade practice under state law and violated federal RICO. The seminal “lights” class action was *Price v. Philip Morris, Inc.* (Cir. Ct. Madison County, Ill. filed 2000),

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

where the trial court awarded \$7.1 billion in compensatory damages and \$3 billion in punitive damages. The Illinois Supreme Court later reversed the trial court's judgment and directed that the case be dismissed. No "lights" class actions are pending against RJR Tobacco, its affiliates, or its indemnitees.

No Additive/Natural/Organic Claim Cases

Following the FDA's August 27, 2015, warning letter to SFNTC relating to the use of the words "natural" and "additive-free" in the labeling, advertising and promotional materials for NATURAL AMERICAN SPIRIT brand cigarettes, plaintiffs purporting to bring claims on behalf of themselves and others have filed putative nationwide and/or state-specific class actions against SFNTC and, in some instances, RAI. A total of 17 such actions have been filed in nine U.S. district courts. In various combinations, plaintiffs in these cases generally allege violations of state deceptive and unfair trade practice statutes, and claim state common law fraud, negligent misrepresentation, and unjust enrichment based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. The actions seek various categories of recovery, including economic damages, injunctive relief (including medical monitoring and cessation programs), interest, restitution, disgorgement, treble and punitive damages, and attorneys' fees and costs.

On January 6, 2016, the plaintiffs in one action filed a motion before the U.S. Judicial Panel on Multidistrict Litigation ("JPML") to consolidate these actions before one district court for pre-trial purposes. On April 11, 2016, the JPML ordered that these cases be consolidated for pre-trial purposes before Judge James O. Browning in the U.S. District Court for the District of New Mexico, referred to as the transferee court, and the then-pending and later-filed cases now are consolidated for pre-trial purposes in that court. The transferee court entered a scheduling order requiring the plaintiffs to file a consolidated amended complaint. On September 19, 2016, the plaintiffs filed a consolidated amended complaint naming SFNTC, RAI, and RJR Tobacco as defendants. That complaint alleges violations of 12 states' deceptive and unfair trade practices statutes – California, Colorado, Florida, Illinois, Massachusetts, Michigan, North Carolina, New Jersey, New Mexico, New York, Ohio, and West Virginia – based on the use of descriptors such as "natural," "organic" and "100% additive-free" in the marketing, labeling, advertising, and promotion of SFNTC's NATURAL AMERICAN SPIRIT brand cigarettes. It also asserts unjust enrichment claims under those 12 states' laws and asserts breach of express warranty claims on behalf of a national class of NATURAL AMERICAN SPIRIT menthol purchasers. The state deceptive and unfair trade practice statutory and unjust enrichment claims are brought on behalf of state-specific classes in the 12 states listed above and, in some instances, state-specific subclasses. The consolidated amended complaint sought class certification, payment for class notice, injunctive relief, monetary damages, prejudgment interest, statutory damages, restitution, and attorneys' fees and costs. On January 12, 2017, the plaintiffs filed a second amended class action complaint seeking essentially the same relief as the initial consolidated complaint. On February 23, 2017, the defendants moved to dismiss the second amended class action complaint. On December 21, 2017, the transferee court granted the motion to dismiss in part, dismissing a number of claims with prejudice, and denied the motion in part. On December 14-18, 2020, the district court conducted a hearing on the motion for class certification and on the parties' *Daubert* motion. Post-hearing briefing is complete. A decision is pending.

Other Class Actions

In *April Young v. American Tobacco Co., Inc.* (Cir. Ct. Orleans Parish, La., filed 1997), the plaintiff brought a class action against U.S. cigarette manufacturers, including RJR Tobacco and B&W, and parent companies of U.S. cigarette manufacturers, including RJR, on behalf of a putative class of Louisiana residents who, though not themselves cigarette smokers, allegedly suffered injury as a result of exposure to ETS from cigarettes manufactured by defendants. The plaintiffs seek to recover an unspecified amount of compensatory and punitive damages. In March 2016, the court entered an order staying the case, including all discovery, pending the completion of the smoking cessation program ordered by the court in *Scott v. The American Tobacco Co.*

In *Diana Jones v. American Tobacco Co., Inc.* (Cir. Ct., Jackson County, Mo., filed 1998), the plaintiff filed a class action against the major U.S. cigarette manufacturers, including RJR Tobacco, B&W, Lorillard Tobacco, and parent companies of U.S. cigarette manufacturers, including RJR and Lorillard, on behalf of a putative class of Missouri tobacco product users and purchasers who allegedly became addicted to nicotine. The plaintiffs seek an unspecified amount of compensatory and punitive damages. There is currently no activity in this case.

On October 13, 2020, Harold Hoffman filed a putative class action against RJR Vapor Co., LLC, in New Jersey Superior Court, alleging on behalf of a class of New Jersey consumers that, via its e-commerce website, RJRV LLC fraudulently offered but failed to provide free standard shipping in New Jersey on orders exceeding \$39.99. The complaint asserts claims under the New Jersey Consumer Fraud Act. The case was resolved for a nominal amount and dismissed.

Filter Cases

Claims have been brought against Lorillard Tobacco and Lorillard by individuals who seek damages for injuries resulting from their alleged exposure to asbestos fibers that were incorporated into filter material used in one brand of cigarettes manufactured by a predecessor to Lorillard Tobacco for a limited period of time ending more than 50 years ago. As of December 31, 2020, Lorillard

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Tobacco and/or Lorillard was a defendant in 48 Filter Cases. Since January 1, 2018, Lorillard Tobacco and RJR Tobacco have paid, or have reached agreement to pay, a total of approximately \$31.3 million in settlements to resolve 124 Filter Cases.

Pursuant to the terms of a 1952 agreement between P. Lorillard Company and H&V Specialties Co., Inc. (the manufacturer of the filter material), Lorillard Tobacco is required to indemnify Hollingsworth & Vose for legal fees, expenses, judgments and resolutions in cases and claims alleging injury from finished products sold by P. Lorillard Company that contained the filter material.

Health-Care Cost Recovery Cases

Health-care cost recovery cases have been brought by a variety of plaintiffs. Other than certain governmental actions, these cases largely have been unsuccessful on remoteness grounds, which means that one who pays an injured person’s medical expenses is legally too remote to maintain an action against the person allegedly responsible for the injury.

As of December 31, 2020, two health-care cost recovery cases were pending in the United States against RJR Tobacco, B&W, Lorillard Tobacco, or all three, as discussed below after the discussion of the State Settlement Agreements. A limited number of claimants have filed suit against RJR Tobacco, one of its affiliates, and other tobacco industry defendants to recover funds for health care, medical and other assistance paid by foreign provincial governments in treating their citizens. For additional information on these cases, see “— International Cases” below.

State Settlement Agreements. In June 1994, the Mississippi Attorney General brought an action, *Moore v. American Tobacco Co.*, against various industry members, including RJR Tobacco, B&W and Lorillard Tobacco. This case was brought on behalf of the state to recover state funds paid for health care and other assistance to state citizens suffering from diseases and conditions allegedly related to tobacco use. Most other states, through their attorneys general or other state agencies, sued RJR Tobacco, B&W, Lorillard Tobacco and other U.S. cigarette manufacturers based on similar theories. The cigarette manufacturer defendants, including RJR Tobacco, B&W and Lorillard Tobacco, settled the first four of these cases scheduled for trial — Mississippi, Florida, Texas and Minnesota — by separate agreements with each such state.

On November 23, 1998, the major U.S. cigarette manufacturers, including RJR Tobacco, B&W and Lorillard Tobacco, entered into the Master Settlement Agreement with attorneys general representing the remaining 46 states, the District of Columbia, Puerto Rico, Guam, the Virgin Islands, American Samoa and the Northern Marianas. Effective on November 12, 1999, the MSA settled all the health-care cost recovery actions brought by, or on behalf of, the settling jurisdictions and released various additional present and future claims.

In the settling jurisdictions, the MSA released RJR Tobacco, B&W, Lorillard Tobacco, and their affiliates and indemnitees, including RAI and Lorillard, from:

- all claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to past conduct arising out of the use, sale, distribution, manufacture, development, advertising, marketing or health effects of, the exposure to, or research, statements or warnings about, tobacco products; and
- all monetary claims of the settling states and their respective political subdivisions and other recipients of state health-care funds, relating to future conduct arising out of the use of or exposure to, tobacco products that have been manufactured in the ordinary course of business.

RAI’s operating subsidiaries expenses and payments under the State Settlement Agreements for 2019, 2020 and the projected expenses and payments for 2021 and thereafter (in millions) are set forth below. Such payments are subject to adjustments for changes in sales volume, inflation, operating profit and other factors. Payments are allocated among the companies on the basis of relative market share or other methods. The 2019 cash payments include a \$210 million partial prepayment related to the April 2020 annual payment. For further information, see “— State Settlement Agreements—Enforcement and Validity; Adjustments” below.⁽¹⁾

	2019	2020	2021	2022 and thereafter
Settlement expenses	\$ 2,762	\$3,572		—
Settlement cash payments	\$ 2,918	\$2,848		—
Projected settlement expenses			\$>3,300	\$>3,300
Projected settlement cash payments			\$>3,600	\$>3,300

⁽¹⁾ The amounts above reflect the impact of the NPM Settlement and the NY State Settlement described below under “— State Settlement Agreements—Enforcement and Validity; Adjustments — Partial Settlement of Certain NPM Adjustment Claims.”

The State Settlement Agreements also contain provisions restricting the marketing of tobacco products. Among these provisions are restrictions or prohibitions on the use of cartoon characters, brand-name sponsorships, apparel and other merchandise, outdoor and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

transit advertising, payments for product placement, free sampling and lobbying. Furthermore, the State Settlement Agreements required the dissolution of three industry-sponsored research and trade organizations.

The State Settlement Agreements have materially adversely affected RJR Tobacco's shipment volumes. RAI believes that these settlement obligations may materially adversely affect the results of operations, cash flows or financial position of RAI and RJR Tobacco in future periods. The degree of the adverse impact will depend, among other things, on the rate of decline in U.S. cigarette sales in the premium and value categories, RJR Tobacco's share of the domestic premium and value cigarette categories, and the effect of any resulting cost advantage of manufacturers not subject to the State Settlement Agreements.

U.S. Department of Justice Case

In *United States v. Philip Morris USA Inc.* (U.S.D.C. D.D.C., filed 1999), the U.S. Department of Justice brought an action against RJR Tobacco, B&W, Lorillard Tobacco and other tobacco companies seeking (1) recovery of federal funds expended in providing health care to smokers who developed alleged smoking-related diseases pursuant to the Medical Care Recovery Act and Medicare Secondary Payer provisions of the Social Security Act and (2) equitable relief under the civil provisions of RICO, including disgorgement of roughly \$280 billion in profits the government contended were earned as a consequence of a purported racketeering "enterprise." In September 2000, the district court dismissed the government's Medical Care Recovery Act and Medicare Secondary Payer claims. In February 2005, the U.S. Court of Appeals for the D.C. Circuit, referred to as the D.C. Circuit, ruled that disgorgement was not an available remedy.

On August 17, 2006, after a non-jury bench trial, the district court found certain defendants, including RJR Tobacco, B&W and Lorillard Tobacco, had violated RICO, but did not impose any direct financial penalties. The district court instead enjoined RJR Tobacco, Lorillard Tobacco and the other defendants from committing future racketeering acts, participating in certain trade organizations, making misrepresentations concerning smoking and health and youth marketing, and using certain brand descriptors such as "low tar," "light," "ultra light," "mild" and "natural." The district court also ordered RJR Tobacco, Lorillard Tobacco and the other defendants to issue "corrective communications" on five subjects, including smoking and health and addiction, and to comply with further undertakings, including maintaining web sites of historical corporate documents and disseminating certain marketing information on a confidential basis to the government. In addition, the district court placed restrictions on the defendants' ability to dispose of certain assets for use in the United States, unless the transferee agrees to abide by the terms of the district court's order, and ordered certain defendants to reimburse the U.S. Department of Justice its taxable costs incurred in connection with the case.

Defendants, including RJR Tobacco, B&W, and Lorillard Tobacco, appealed, the government cross appealed, and the defendants moved in the district court for clarification and a stay pending appeal. After the district court denied the defendants' motion to stay, the D.C. Circuit granted a stay in October 2006.

The district court then granted the motion for clarification in part and denied it in part. With respect to the meaning and applicability of the general injunctive relief of the August 2006 order, the district court denied the motion for clarification. With respect to the request for clarification as to the scope of the provisions in the order prohibiting the use of descriptors and requiring corrective statements at retail point of sale, the district court granted the motion and also ruled that the provisions prohibiting the use of express or implied health messages or descriptors do apply to the actions of the defendants taken outside of the United States.

In May 2009, the D.C. Circuit largely affirmed both the finding of liability against the tobacco defendants and the remedial order, including the denial of additional remedies, but vacated the order and remanded for further proceedings as to the following four discrete issues:

- the issue of the extent of B&W's control over tobacco operations was remanded for further fact finding and clarification;
- the remedial order was vacated to the extent that it binds all defendants' subsidiaries and was remanded to the district court for determination as to whether inclusion of the subsidiaries and which of the subsidiaries satisfy Rule 65(d) of the Federal Rules of Civil Procedure;
- the D.C. Circuit held that the provision found in paragraph four of the injunction, concerning the use of any express or implied health message or health descriptor for any cigarette brand, should not be read to govern overseas sales. The issue was remanded to the district court with instructions to reformulate it so as to exempt foreign activities that have no substantial, direct and foreseeable domestic effects; and
- the remedial order was vacated regarding "point of sale" displays and remanded for the district court to evaluate and make due provisions for the rights of innocent persons, either by abandoning this part of the remedial order or re-crafting a new version reflecting the rights of third parties.

In June 2010, the U.S. Supreme Court denied all parties' petitions for writs of certiorari.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

On December 22, 2010, the district court dismissed B&W from the litigation. In November 2012, the trial court entered an order setting forth the text of the corrective statements and directed the parties to engage in discussions with the Special Master to implement them. After extensive mediation led the parties to an implementation agreement, the district court entered an implementation order on June 2, 2014. The defendants filed a consolidated appeal challenging both the content of the court-ordered statements and the requirement that those statements be published in redundant media. On May 22, 2015, the D.C. Circuit reversed the corrective statements order in part, affirmed in part, and remanded to the district court for further proceedings. On October 1, 2015, the district court ordered the parties to propose new corrective-statements preambles. On February 8, 2016, the district court entered an order adopting the government's proposed corrective-statements preamble. The parties then mediated, per the district court's order, changes to the implementation order necessitated by the new preamble. On April 19, 2016, the district court accepted the parties' mediated agreement on implementation and entered a superseding consent order with respect to implementation. The superseding consent order stayed implementation of the corrective statements until the exhaustion of appeals from the orders establishing the text of those statements and governing implementation details. On April 7, 2016, the defendants and the post-judgment parties regarding remedies appealed to the D.C. Circuit from the district court's order adopting the government's proposed corrective-statement preambles. On May 6, 2016, the defendants and post-judgment parties regarding remedies appealed to the D.C. Circuit from the superseding consent order, and the D.C. Circuit then consolidated the two appeals. On April 25, 2017, the D.C. Circuit affirmed in part, reversed in part, and remanded for further proceedings. Additionally, RJR Tobacco appealed the district court's May 28, 2015, order requiring RJR Tobacco to televise an additional set of corrective statements on behalf of B&W, which order the D.C. Circuit upheld on November 1, 2016. The compelled public statements began appearing in US newspapers on November 24, 2017 and ran serially over four months. They began appearing on national US broadcast television networks on November 27, 2017 and ran several times per week for one year. The statements also began appearing on RJR Tobacco's website in June 2018 and in package onserts beginning in November 2018 and concluded in late 2020. The district court is considering requiring the statements to be displayed at retail point of sale (after the D.C. Circuit vacated the prior point of sale remedy in 2009); the most recent round of briefing on this issue concluded on September 14, 2018. On December 20, 2019, the district court ruled on the scope of the issues to be addressed in an evidentiary hearing. On January 29, 2020, the parties submitted a status report addressing procedural issues relating to that hearing such as the scope of pre-hearing discovery. The evidentiary hearing is scheduled for July 12, 2021. In light of the then required corrective-statements implementation requirements, \$20 million was accrued in the fourth quarter of 2013 for the estimated costs of the corrective communications, of which substantially all amounts were utilized by December 31, 2018.

Native American Tribe Case.

As of December 31, 2020, one Native American tribe case was pending before a tribal court against RJR Tobacco, B&W and Lorillard Tobacco, *Crow Creek Sioux Tribe v. American Tobacco Co.* (Tribal Ct., Crow Creek Sioux, S.D., filed 1997). The plaintiffs seek to recover actual and punitive damages, restitution, funding of a clinical cessation program, funding of a corrective public education program, and disgorgement of unjust profits from sales to minors. The plaintiffs claim that the defendants are liable under the following theories: unlawful marketing and targeting of minors, contributing to the delinquency of minors, unfair and deceptive acts or practices, unreasonable restraint of trade and unfair method of competition, negligence, negligence per se, conspiracy and restitution of unjust enrichment. The case is dormant.

International Cases.

Each of the ten Canadian provinces has filed a health-care cost recovery action against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates. In these actions, which are described below, each of the Canadian provinces seeks to recover for health care, medical and other assistance paid and to be paid for treating tobacco-related disease. Pursuant to the terms of the 1999 sale of RJR Tobacco's international tobacco business, RJR Tobacco has tendered the defense of these actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its affiliate in these actions. In the wake of Canadian bankruptcy proceedings involving the three principal Canadian cigarette manufacturers (none of which is a RAI company), all activity in these cases, as well as the class action cases discussed below, has been stayed through March 31, 2021. The stay may be further extended. During the stay, negotiations, under the auspices of the Canadian bankruptcy court, are proceeding regarding a potential resolution of all these cases against all defendants, not just the three principal Canadian cigarette manufacturers that have sought bankruptcy protection.

- *British Columbia* (British Columbia Sup. Ct., Vancouver Registry, filed 1997) - In 1997, British Columbia enacted a statute creating a civil cause of action against tobacco-related entities for the provincial government to recover the costs of health-care benefits incurred for insured British Columbia residents resulting from tobacco-related disease. An initial action brought pursuant to the statute against Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and certain of its affiliates, was dismissed in February 2000 when the British Columbia Supreme Court ruled that the legislation was unconstitutional. British Columbia then enacted a revised statute, pursuant to which an action was filed in January 2001 against many of the same defendants, including RJR Tobacco and one of its affiliates. In that action, the British Columbia government seeks to recover the present value of its total expenditures for health-care benefits provided for insured persons resulting from

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tobacco-related disease or the risk of tobacco-related disease caused by alleged breaches of duty by the manufacturers, the present value of its estimated total expenditures for health-care benefits that reasonably could be expected to be provided for those insured persons resulting from tobacco-related disease or the risk of tobacco-related disease in the future, court ordered interest, and costs, or in the alternative, special or increased costs. The government alleges that the defendants are liable under the British Columbia statute by reason of their “tobacco related wrongs,” which are alleged to include: selling defective products, failure to warn, sale of cigarettes to children and adolescents, strict liability, deceit and misrepresentation, violation of trade practice and competition acts, concerted action, and joint liability. RJR Tobacco and its affiliate filed statements of defense in January 2007. Pre-trial discovery was ongoing, but the case is subject to the stay referenced above.

- *New Brunswick* (Ct. of Queen’s Bench of New Brunswick, Jud. Dist. Fredericton, filed 2008) - This claim is brought pursuant to New Brunswick legislation enacted in 2008 that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2010. Pre-trial discovery is ongoing. Trial was set to begin on November 4, 2019, however, on March 7, 2019, the New Brunswick Court of Queen’s Bench released a decision which requires the Province to produce a substantial amount of additional documentation and data to the defendants. As a result, the original trial date of November 4, 2019 was delayed. No new trial date has been set, and the case is subject to the stay referenced above.
- *Ontario* (Ontario Super. Ct. Justice, Toronto, filed 2009) - This claim is brought pursuant to Ontario legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability, although the government also asserted claims based on the illegal importation of cigarettes, which claims were deleted in an amended statement of claim filed in August 2010. RJR Tobacco and its affiliate filed statements of defense in April 2016. Pretrial discovery was ongoing. No trial date has been set, and the case is subject to the stay referenced above.
- *Newfoundland and Labrador* (Sup. Ct. Newfoundland and Labrador, St. John’s, filed 2011) - This claim is brought pursuant to Newfoundland and Labrador legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in May 2016. Pretrial discovery was ongoing. No trial date has been set, and the case is subject to the stay referenced above.
- *Manitoba* (Ct. of Queen’s Bench, Winnipeg Jud. Centre, filed 2012) - This claim is brought pursuant to Manitoba legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in September 2014. No trial date has been set, and the case is subject to the stay referenced above.
- *Quebec* (Super. Ct. Quebec, Dist. Montreal, filed 2012) - This claim is brought pursuant to Quebec legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages being sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed defenses in December 2014. Pre-trial discovery was ongoing. No trial date has been set, and the case is subject to the stay referenced above.
- *Saskatchewan* (Ct. of Queen’s Bench, Jud. Centre Saskatoon filed 2012) - This claim is brought pursuant to Saskatchewan legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in February 2015. No trial date has been set, and the case is subject to the stay referenced above.
- *Alberta* (Ct. of Queen’s Bench, Alberta Jud. Centre of Calgary filed 2012) - This claim is brought pursuant to Alberta legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in March 2016. No trial date has been set, and the case is subject to the stay referenced above.
- *Prince Edward Island* (Sup. Ct. P.E.I., Charlottetown, filed 2012) - This claim is brought pursuant to Prince Edward Island legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

its affiliate filed statements of defense in February 2015. No trial date has been set, and the case is subject to the stay referenced above.

- *Nova Scotia* (Sup. Ct. Nova Scotia, Halifax, filed 2015) - This claim is brought pursuant to Nova Scotia legislation that is substantially similar to the revised British Columbia statute described above. It seeks recovery of essentially the same types of damages sought in the British Columbia action based on analogous theories of liability. RJR Tobacco and its affiliate filed statements of defense in July 2015. No trial date has been set, and the case is subject to the stay referenced above.

Seven putative class actions, which are described below, have been filed against various Canadian and non-Canadian tobacco-related entities, including RJR Tobacco and one of its affiliates, in Canadian provincial courts. In these cases, the plaintiffs allege claims based on fraud, fraudulent concealment, breach of warranty, breach of warranty of merchantability, and of fitness for a particular purpose, failure to warn, design defects, negligence, breach of a “special duty” to children and adolescents, conspiracy, concert of action, unjust enrichment, market share liability, and violations of various trade practices and competition statutes. The plaintiffs seek recovery on behalf of proposed classes of persons allegedly suffering from tobacco-related disease as a result of smoking defendants’ cigarettes and seek recovery of compensatory and punitive damages, restitution, recovery of government health-care benefits, interest, and costs. Pursuant to the terms of the 1999 sale of RJR Tobacco’s international tobacco business, RJR Tobacco has tendered the defense of these seven actions to JTI. Subject to a reservation of rights, JTI has assumed the defense of RJR Tobacco and its current or former affiliates in these actions.

As noted previously, these cases, too, have been stayed pending efforts to negotiate a resolution under the auspices of the Canadian bankruptcy court. Here, too, the status of the cases reported below is as of the entry of the original stay. Before the stay, plaintiffs’ counsel had been actively pursuing only *Bourassa*, the action pending in British Columbia.

- In *Kunka v. Canadian Tobacco Manufacturers’ Council* (Ct. of Queen’s Bench, Winnipeg Jud. Centre, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants’ cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Dorion v. Canadian Tobacco Manufacturers’ Council* (Ct. of Queen’s Bench, Alberta Jud. Centre of Calgary – filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who purchased or smoked defendants’ cigarettes and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.
- In *Semple v. Canadian Tobacco Manufacturers’ Council* (Sup. Ct. Nova Scotia, Halifax, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class comprised of persons who purchased or smoked defendants’ cigarettes for the period from January 1, 1954, to the expiry of the opt-out period as set by the court and suffered, or currently suffer, from tobacco-related disease, as well as restitution of profits and reimbursement of government expenditure for health-care costs allegedly caused by the use of tobacco products.
- In *Adams v. Canadian Tobacco Manufacturers’ Council* (Ct. of Queen’s Bench, Jud. Centre of Regina, filed 2009), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on July 10, 2009, and suffered, or currently suffer, from chronic obstructive pulmonary disease, emphysema, heart disease or cancer, after having smoked a minimum of 25,000 of defendants’ cigarettes, as well as disgorgement of revenues earned by the defendants. RJR Tobacco and its affiliate have brought a motion challenging the jurisdiction of the Saskatchewan court.
- In *Bourassa v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic respiratory diseases, after having smoked a minimum of 25,000 of defendants’ cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court. The plaintiff filed a motion for certification in April 2012 and filed affidavits in support in August 2013. An amended claim was filed in December 2014.
- In *McDermid v. Imperial Tobacco Canada Ltd.* (Sup. Ct. of British Columbia, Victoria Registry, filed 2010), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from heart disease, after having smoked a minimum of 25,000 of defendants’ cigarettes, as well as disgorgement of revenues earned by the defendants from January 1, 1954, to the date the claim was filed. RJR Tobacco and its affiliate have filed a challenge to the jurisdiction of the British Columbia court.

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- In *Jacklin v. Canadian Tobacco Manufacturers' Council* (Ontario Super. Ct. of Justice, St. Catherines, filed 2012), the plaintiff seeks compensatory and punitive damages on behalf of a proposed class of persons who were alive on June 12, 2007, and suffered, or currently suffer, from chronic obstructive pulmonary disease, heart disease, or cancer, after having smoked a minimum of 25,000 of defendants' cigarettes, as well as restitution of profits, and reimbursement of government expenditure for health-care benefits allegedly caused by the use of tobacco products.

State Settlement Agreements—Enforcement and Validity; Adjustments

As of December 31, 2020, there were four cases concerning the enforcement, validity or interpretation of the State Settlement Agreements in which RJR Tobacco, B&W or Lorillard Tobacco is a party. This number includes the motion to enforce, discussed below, relating to disputed payments under the State Settlement Agreements.

In May 2006, the State of Florida filed a motion, in the Circuit Court of the Fifteenth Judicial Circuit, in and for Palm Beach County, Florida, to enforce the Florida settlement agreement, referred to as the Florida Settlement Agreement, for an accounting by B&W and for an Order of Contempt. The State asserted that B&W failed to report in its net operating profit on its shipments, cigarettes manufactured by B&W under contract for Star Tobacco or its parent, Star Scientific, Inc. The State is seeking approximately \$12.4 million in additional payments under the Florida Settlement Agreement, as well as \$17.0 million in interest payments. This matter was in the discovery phase.

Subsequently, on January 18, 2017, the State of Florida filed a motion to join ITG Brands, LLC (“ITG”) as a defendant and to enforce the Florida Settlement Agreement. The State’s motion sought payment under the Florida Settlement Agreement with respect to the four brands (WINSTON, SALEM, KOOL and MAVERICK) that were sold to ITG in the Divestiture, referred to as the Acquired Brands. Under the asset purchase agreement relating to the Divestiture (and related documents), ITG was to assume responsibility with respect to these brands. Since the closing of the Divestiture and the transfer of these brands to it, ITG has not made settlement payments to the State with respect to these brands. The State’s motion asserts that it “is presently owed more than \$45 million and will continue to suffer annual losses of approximately \$30 million absent the Court’s enforcement of the Settlement Agreement....” The State’s motion sought, among other things, an order from the court declaring that RJR Tobacco and ITG breached of the Florida Settlement Agreement and were required, jointly and severally, to make annual payments to the State under the Florida Settlement Agreement with respect to the Acquired Brands.

Also, on January 18, 2017, Philip Morris USA, Inc. filed a motion to enforce the Florida Settlement Agreement. Philip Morris USA, Inc.’s motion asserted, among other things, that RJR Tobacco and ITG breached the Florida Settlement Agreement by failing to comply with the obligations under the Florida Settlement Agreement with respect to the Acquired Brands, which Philip Morris USA asserted improperly shifted settlement payment obligations to Philip Morris USA.

On January 27, 2017, RJR Tobacco sought leave to file a supplemental pleading for breach by ITG of its obligations regarding joinder into the Florida Settlement Agreement asserting that ITG failed to use its reasonable best efforts to join the Florida Settlement Agreement and breached the asset purchase agreement relating to the Divestiture. On March 30, 2017, the Florida court ruled that ITG should be joined into the enforcement action.

On December 18, 2017 through December 20, 2017, a three-day bench trial was held on the State’s and PM USA’s Motions to Enforce the Settlement Agreement (excluding the issues relating to Profit Adjustment). On December 27, 2017, the Court entered an order holding that RJR Tobacco (not ITG) is liable for annual settlement payments for the Acquired Brands. The court found that ITG did not assume liability for annual settlement payments under the terms of the asset purchase agreement relating to the Divestiture and RJR Tobacco’s liability for payments under the Florida Settlement Agreement continues with regard to the Acquired Brands. In January 2018, the auditor of the Florida State Settlements Agreement adjusted the final 2017 invoice for the annual payment and amended the 2015 and 2016 invoices for the respective annual payment and the net operating profit penalty for each of those years under the Florida Settlement Agreement, based on the auditor's interpretation of the court's order. The adjusted invoices reflected amounts due to both the State of Florida and PM USA. In total, the estimated additional amounts due were \$99 million with \$84 million to the State of Florida and \$16 million to PM USA. RJR Tobacco advised the auditor that it disputed these amounts, and therefore no further amounts were due or would be paid for those years pending the final resolution of RJR Tobacco's appeal of the court's order. On February 1, 2018, PM USA and the State filed a joint motion for the entry of final judgment. On August 15, 2018, the Court entered a Final Judgment in the action. In August and September 2018, RJR Tobacco and PM USA filed notice of appeal of the final judgment, which were consolidated on October 1, 2018. The appeals were fully briefed on February 6, 2020. Oral argument was held on June 9, 2020. On July 29, 2020, Florida’s Fourth District Court of Appeal affirmed the Final Judgment. On August 12, 2020, RJR Tobacco filed a motion for rehearing or for certification to the Florida Supreme Court of the July 29, 2020 decision. On June 10, 2020, RJR Tobacco posted an additional bond in the amount of \$84,102,984.75, over the \$103,694,155.08 bond initially posted, to cover additional disputed amounts plus two years of statutory interest. The total amount RJR Tobacco bonded for its appeal was \$187,797,139.83. RJR Tobacco’s motion for rehearing or certification to the Florida Supreme Court was denied on September 8, 2020 and its motion for rehearing was denied by the Florida Supreme Court on December 18, 2020. On October 5, 2020, RJR Tobacco satisfied the Final Judgment of \$192,869,589.86 and paid approximately \$3.1 million of Florida’s attorneys’ fees but continues to litigate over the remaining approximately \$300,000 in

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attorneys' fees. RJR Tobacco's appellate bonds were released to RJR Tobacco by order dated November 5, 2020. RJR Tobacco will seek indemnification from ITG.

On February 17, 2017, ITG filed a complaint in the Court of Chancery of the State of Delaware seeking declaratory relief and a motion for a temporary restraining order against RAI and RJR Tobacco. In its complaint, ITG asked the court to declare various matters related to its rights and obligations under the asset purchase agreement (and related documents) relating to the Divestiture. In its motion, ITG asked for an injunction barring RAI and/or RJR Tobacco from alleging in the Florida enforcement litigation that ITG had breached the asset purchase agreement and requiring these companies to litigate issues under the asset purchase agreement in Delaware. A hearing was held on ITG's complaint and motion on March 1, 2017. After argument, the court entered a temporary restraining order that enjoined RAI and RJR Tobacco from "taking offensive action to assert claims against ITG Brands" in the Florida enforcement action, but the order does not prevent RJR Tobacco from making arguments in response to claims asserted by the State of Florida, Philip Morris USA, Inc. or ITG in the Florida enforcement litigation. On March 24, 2017, RAI and RJR Tobacco answered the ITG complaint and filed a motion to stay proceedings in Delaware pending the outcome of the Florida enforcement litigation. The motion for stay filed by RAI and RJR Tobacco was denied on May 18, 2017. Cross motions for partial judgment on the pleadings were filed focusing on whether ITG's obligation to use "reasonable best efforts" to join the Florida Settlement continued after the June 12, 2015 closing. On November 30, 2017, following argument, the Delaware court entered a ruling in favor of RJR Tobacco, holding that ITG's obligation under Section 2.2 of the Agreed Assumption Terms to use its reasonable best efforts to join the Florida Settlement Agreement did not terminate due to the closing of the asset purchase agreement relating to the Divestiture. On January 4, 2019, RJR Tobacco filed another motion for partial judgment on the pleadings, requesting that the Delaware court find that (1) to the extent that RJR Tobacco is found liable for settlement payments on ITG's post-closing sales of the four acquired brands, that is a liability that ITG assumed under the asset purchase agreement; and (2) ITG is not entitled to unique protection from non-existent equity fee statutes under the asset purchase agreement's provisions requiring ITG to use reasonable best efforts to join certain State settlement agreements. ITG filed a cross-motion for partial judgment on the pleadings as to the first issue. Argument on RJR Tobacco's motion for partial judgment was heard on June 4, 2019. On September 23, 2019, the Delaware Chancery court declined to resolve, at this time, whether ITG had assumed any liability imposed on RJR Tobacco for making settlement payments on the Acquired Brands. The court concluded that both sides had presented reasonable interpretations of the asset purchase agreement, which was therefore ambiguous, so the court would require an evidentiary hearing to interpret the intent of the asset purchase agreement on assumed liabilities. The court also granted RJR Tobacco's motion on the second issue, ruling ITG could not refuse to join the Florida State Settlement Agreement unless a joinder exempted it from a future equity-fee statute. On October 1, 2019, the Court of Chancery entered an order on these latest motions for partial judgment on the pleadings, granting RJR Tobacco's motion on the second issue and denying both parties' motions on the first issue, deferring resolution of the first issue until after the court receives evidence related to the parties' intent in their contract. On October 11, 2019, ITG filed in the Chancery Court a motion to seek interlocutory appeal in the Delaware Supreme Court, which was denied on October 31, 2019. On October 31, 2019, ITG filed a notice of interlocutory appeal directly to the Delaware Supreme Court, which was denied on November 7, 2019. Discovery is currently ongoing with respect to the hearing to interpret the intent of the asset purchase agreement on assumed liabilities.

On June 8, 2015, RJR Tobacco, ITG and the State of Mississippi filed with the state court overseeing the Mississippi State Settlement Agreement a motion with respect to ITG's joinder to the Mississippi State Settlement Agreement. The motion was granted. PM USA then moved to vacate the order, alleging that the joinder had the effect of modifying the method of allocating among the settling manufacturers a component of their annual payments to Mississippi in a way that adversely impacts Philip Morris. The court denied the motion, and PM USA appealed. On June 13, 2017, the appeal was dismissed on joint motion by PM USA and Mississippi. On December 26, 2018, PM USA filed a motion to enforce against RJR Tobacco and ITG with respect to the calculation of the base-year net operating profits for the Acquired Brands. PM USA claims damages of approximately \$6 million through 2017. PM USA also seeks a declaration that RJR Tobacco and ITG breached the Mississippi Settlement Agreement and seeks an accounting to determine the appropriate amount of base-year profits attributable to the Acquired Brands. A status conference occurred on February 21, 2019. A hearing on the Motion to Enforce Settlement Agreement is scheduled for May 3-6, 2021. Settlement discussions are ongoing. Under the settlement framework, RJR Tobacco and PM USA would resolve the outstanding payment calculation. On December 3, 2019, the State of Mississippi filed a Notice of Violation and Motion to Enforce Settlement Agreement in the Chancery Court of Jackson County, Mississippi against RJR Tobacco, PM USA and ITG, seeking a declaration that the base year 1997 net operating profit to be used in calculating the Net Operating Profit Adjustment was not affected by the change in the federal corporate tax rate in 2018 from 35% to 21%, and an order requiring RJR Tobacco to pay the approximately \$5 million difference in its 2018 payment because of this issue. Determination of this issue may affect RJR Tobacco's annual payment thereafter. A hearing on Mississippi's motion to enforce settlement agreement is scheduled for October 6-7, 2021.

On March 26, 2018, the State of Minnesota filed a motion against RJR Tobacco to enforce the Minnesota State Settlement Agreement, which motion seeks payments under the Minnesota State Settlement Agreement of approximately \$40 million with respect to the Acquired Brands. The motion also claims future annual losses of approximately \$15 million absent the court's enforcement of the Minnesota State Settlement Agreement. The State of Minnesota also filed a separate complaint against ITG, which complaint seeks the same payments. The State's motion against RJR Tobacco and complaint against ITG seek, among other things, an order declaring that RJR Tobacco and ITG are in breach of the Minnesota State Settlement Agreement and are jointly and severally liable to make annual payments to the State of Minnesota under the Minnesota State Settlement Agreement with respect to the Acquired Brands. In addition,

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on March 28, 2018, PM USA filed a motion to enforce the Minnesota State Settlement Agreement, asserting among other things, that RJR Tobacco and ITG breached the Minnesota State Settlement Agreement by failing to make settlement payments as to the Acquired Brands, which PM USA asserts has improperly shifted settlement payment obligations to PM USA. On March 27, 2018, the Minnesota court consolidated the motions to enforce and complaint against ITG into one proceeding captioned *In re Petition of the State of Minnesota for an Order Compelling Payments of Settlement Proceeds Related to ITG Brands LLC*, Court File No. 62-CV-18-1912. On June 11, 2018, the court held a scheduling conference in the case and by order dated June 21, 2018, set a discovery schedule for the case, under which discovery is complete. A hearing on the motions to enforce to determine if RJR Tobacco and/or ITG are liable to make payments on the Acquired Brands was held on June 26, 2019. On September 24, 2019, the Minnesota District Court issued an Order and Memorandum, holding RJR Tobacco liable for settlement payments on the Acquired Brands, and determining the issue of whether ITG is a “successor or assign” of RJR Tobacco under the Minnesota State Settlement Agreement is unresolved, reasoning ITG’s status depends on whether it satisfied its post-closing obligation to expend its reasonable best efforts to join the Minnesota State Settlement Agreement. On December 23, 2019, ITG filed a motion in the Minnesota District Court seeking certification of an appeal of certain questions arising from the September 24, 2019 order. On January 14, 2020, RJR Tobacco and the State of Minnesota filed responses in opposition to ITG’s motion for certification, and on January 17, 2020, ITG filed its reply. On January 21, 2020, a hearing was held on ITG’s motion seeking certification of an appeal. On February 19, 2020, the Minnesota District Court entered an Order and Memorandum denying ITG’s motion for certification. A multi-day hearing to determine whether ITG is liable for settlement payments was completed on September 9, 2020. The parties filed post-hearing briefs on November 13, 2020; a decision is pending. RJR Tobacco owes approximately \$102.7 million in past payments under the judgment through 2020. Settlement discussions are ongoing. Under the settlement framework, ITG and RJR Tobacco would split the 2015-2019 payments, ITG would join the settlement agreement and make all payments from 2020 forward, and RJR Tobacco and PM USA would resolve outstanding payment calculation issues.

On January 28, 2019, the State of Texas filed motions to join ITG as a defendant and to enforce the Texas State Settlement Agreement against RJR Tobacco and ITG, seeking payment under the Texas State Settlement Agreement of approximately \$125 million with respect to the Acquired Brands that were sold to ITG in the Divestiture. The motion also claimed future annual losses of an unspecified amount absent the court's enforcement of the Texas State Settlement Agreement. The State's motion sought, among other things, an order declaring that RJR Tobacco, or in the alternative, ITG, is in breach of the Texas Settlement Agreement and is required to make annual payments to the State under the Texas State Settlement Agreement with respect to the Acquired Brands. In addition, on January 29, 2019, PM USA filed a motion to enforce the Texas State Settlement Agreement, asserting among other things that RJR Tobacco and ITG breached that agreement by failing to make settlement payments as to the Acquired Brands, which PM USA asserts has improperly shifted settlement payment obligations to PM USA. On March 3, 2019, RJR Tobacco filed a motion for leave to conduct discovery and for entry of a proposed discovery and briefing schedule, to which ITG joined on March 14, 2019. On June 28, 2019, the Court issued an opinion and order in which the Court scheduled discovery to be completed by August 15, 2019 and scheduled a hearing on the motions to enforce for September 19, 2019. On July 26, 2019, the Court entered an order rescheduling certain deadlines; discovery was completed on September 15, 2019. A hearing on the motions to enforce was held on October 30, 2019. On February 25, 2020, the Court entered a Memorandum Opinion and Order holding that RJRT remains liable for settlement payments on the Acquired Brands under the Texas Settlement Agreement. The Court further held that, although ITG is unambiguously an assign within the meaning of the Texas Settlement Agreement, a final determination of the scope of ITG’s obligations under the APA is to be determined in the litigation pending before the Delaware Court. Pursuant to the Court’s direction, on March 9, 2020 the parties submitted a status report indicating the remaining issues before the Court include Reynolds’ position that the Court should subtract the equity fee payments made on the Acquired Brands by ITG’s distributors from the settlement payments due by Reynolds after including the Acquired Brands in calculating damages, whether a final judgment should be entered in favour of ITG, whether a partial final judgment should be entered against Reynolds and the State’s request for an award of attorneys’ fees and costs against Reynolds and/or ITG. On 5 May 2020 the Court entered final judgment (later clarified in an August 14, 2020 amended judgment) on the State’s motion, ordering RJRT to pay all settlement amounts due on the Acquired Brands under the Texas Settlement Agreement; granting RJR Tobacco a full dollar-for-dollar credit for all equity fee payments made on the Acquired Brands by ITG or its distributors, but holding RJRT liable for any equity fee payments that are lawfully refunded; and ordering the case closed, to be reopened after ITG’s liability under the APA is determined by the Delaware Court. ITG’s equity fee payments to Texas for the Acquired Brands currently equal approximately 90 percent of the annual Texas settlement payments for those brands. Thus, the settlement payments for those Acquired Brands exceed ITG’s equity fee payments by approximately \$3 million per year. As such, RJR Tobacco would owe approximately \$3 million a year after an equity fee credit. Due to how the profit penalty is allocated, RJR Tobacco will pay approximately \$10 million less in 2019 in Texas payments than it would have paid had ITG joined, with that trend continuing in future years. However, because ITG made equity fee payments at a substantially lower rate before 2019, and because of how the profit penalty was calculated before now, RJR Tobacco owes approximately \$260.4 million (before interest and netting of equity fees) in past payments under the judgment through 2020. On June 3 and 4, 2020, respectively, RJR Tobacco and ITG filed notices of appeal of the May 5, 2020 judgment. In August 2020, RJR Tobacco filed a notice of appeal, and in September 2020, the State and ITG filed notices of appeal from the portion of the judgment denying the motion to remove the equity fee credit. RJR Tobacco moved to dismiss ITG’s appeal for lack of jurisdiction, which motion was ordered by the Fifth Circuit Court of Appeals to be argued with ITG’s appeal. On November 2, 2020 RJRT filed its appellate brief. On January 19, 2020 the parties filed their responses. Settlement discussions are ongoing. Under the settlement framework, ITG and RJR Tobacco

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would split the 2015-2019 payments, ITG would join the settlement agreement and make all payments from 2020 forward, and RJR Tobacco and PM USA would resolve outstanding payment calculation issues.

NPM Adjustment Claims. The MSA includes an adjustment that potentially reduces the annual payment obligations of RJR Tobacco, Lorillard Tobacco and the other PMs. Certain requirements, collectively referred to as the Adjustment Requirements, must be satisfied before the NPM Adjustment for a given year is available:

- an Independent Auditor must determine that the PMs have experienced a market share loss, beyond a triggering threshold, to those manufacturers that do not participate in the MSA, such non-participating manufacturers referred to as NPMs; and
- in a binding arbitration proceeding, a firm of independent economic consultants must find that the disadvantages of the MSA were a significant factor contributing to the loss of market share. This finding is known as a significant factor determination.

When the Adjustment Requirements are satisfied, the MSA provides that the NPM Adjustment applies to reduce the annual payment obligation of the PMs. However, an individual settling state may avoid its share of the NPM Adjustment if it had in place and diligently enforced during the entirety of the relevant year a “Qualifying Statute” that imposes escrow obligations on NPMs that are comparable to what the NPMs would have owed if they had joined the MSA. In such event, the state’s share of the NPM Adjustment is reallocated to other settling states, if any, that did not have in place and diligently enforce a Qualifying Statute.

NPM Adjustment Claims for 2004-2019. From 2006 to 2008, proceedings (including significant factor arbitrations before an independent economic consulting firm) were initiated with respect to the NPM Adjustment for 2004, 2005 and 2006. Ultimately, the Adjustment Requirements were satisfied with respect to each of these NPM Adjustments.

In subsequent years, RJR Tobacco, Lorillard Tobacco, certain other PMs and the settling states entered into four separate agreements, covering fiscal years 2007 to 2009, fiscal years 2010 to 2012, fiscal years 2013 to 2014, fiscal years 2015 to 2017, and fiscal year 2018 to 2019, respectively, wherein the settling states would not contest that the disadvantages of the MSA were “a significant factor contributing to” the market share loss experienced by the PMs in those years. The stipulation pertaining to each of the years covered by the four agreements became effective in February of the year a final determination by the firm of independent economic consultants would otherwise have been expected if the issue had been arbitrated on the merits. For fiscal year 2018, RJR Tobacco and PM USA paid certain amounts to certain of the settling states for each year covered by these agreements, with RJR Tobacco paying approximately 67% of such amounts.

Based on the payment calculations of the Independent Auditor and the agreements described above regarding the significant factor determinations, the Adjustment Requirements have been satisfied with respect to the NPM Adjustments for fiscal years 2007 to 2019. The approximate maximum principal amounts of RJR Tobacco’s and Lorillard Tobacco’s shares of the disputed NPM Adjustments for the years 2004 through 2019 (in millions), as currently calculated by the Independent Auditor, and the remaining amounts after the settlements of certain NPM Adjustments claims (see below), under certain assumptions, are as follows ⁽¹⁾:

Volume Year	RJR Tobacco		Lorillard Tobacco	
	Disputed	Remaining after settlements	Disputed	Remaining after settlements
2004	\$ 562	\$ 136	\$ 111	\$ 27
2005	445	110	76	19
2006	419	102	73	18
2007	435	107	83	20
2008	468	115	104	26
2009	472	116	107	26
2010	470	115	119	29
2011	422	103	88	22
2012	430	105	97	24
2013	457	112	92	23
2014	438	107	95	24
2015	494	121	44	11
2016	511	126	—	—
2017	509	124	—	—
2018	546	133	—	—
2019	618	150	—	—

⁽¹⁾ The amounts do not include the interest or earnings thereon to which RJR Tobacco and Lorillard Tobacco believe they would be entitled under the MSA.

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In addition to the above, SFNTC's portion of the disputed NPM Adjustments for the years 2004 through 2019 is approximately \$200 million and the remaining amount after the settlements is approximately \$50 million.

The 2004 NPM Adjustment proceeding is underway before four overlapping panels. A revised case management order governing the arbitration was entered on January 4, 2017. Under the timing established by that case management order, discovery in the arbitration proceedings was completed by the end of the second quarter of 2017. A hearing on common issues took place starting in June 2017. State specific evidentiary hearings began in November 2017 and all scheduled state-specific hearings (except one) are complete. Diligent enforcement rulings from the panels are likely by the end of the second quarter of 2021. RJR Tobacco's and Lorillard Tobacco's remaining claim with respect to 2004 is approximately \$163 million collectively, under certain assumptions.

Missouri obtained an order from the Missouri court of appeals for a separate state specific arbitration of the diligent enforcement issue, but on appeal, the Missouri Supreme Court ordered Missouri to participate in the nationwide arbitration of the 2004 NPM Adjustment. The Missouri state-specific hearing was completed on July 8, 2019. Also, in the context of the 2003 NPM Adjustment proceedings, Montana obtained a ruling from the Montana Supreme Court that the issue of diligent enforcement under the MSA must be heard before that state's MSA court. In June 2018, the PMs and the State of Montana filed an Agreement in Principle in which the PMs agreed not to contest Montana's diligent enforcement of its Qualifying Statute during 2004, and Montana shall not be subject to the 2004 NPM Adjustment. In addition, the State of New Mexico appealed the District Court of New Mexico's order requiring New Mexico to join the 2004 NPM Adjustment Arbitration, which appeal was denied by the Court of Appeals for the State of New Mexico on September 25, 2019. On November 27, 2019, the Supreme Court for the State of New Mexico denied the State's appeal of the September 25, 2019 ruling, and on December 26, 2019, denied New Mexico's motion for rehearing. A New Mexico-specific case management order was entered in August 2020; discovery is currently underway. The New Mexico state-specific hearing is scheduled for June 21-25, 2021. Finally, the four U.S. territories have been asked to join the 2004 NPM Adjustment Arbitration but have not yet done so. America Samoa has, however, been ordered by its courts to participate in the nationwide arbitration, although it is appealing the orders.

The 2005-2007 NPM Adjustment proceeding is underway. On September 18, 2020, a panel of three-arbitrators was formed pursuant to a May 2020 Agreement Regarding Procedures for Panel Formation signed by all parties. Status conferences were held on October 16, November 16, and December 16, 2020. The parties are negotiating the procedures for the arbitration including the terms of discovery.

Due to the uncertainty over the final resolution of the 2004-2019 NPM Adjustment claims asserted by RJR Tobacco (including Lorillard Tobacco claims) and SFNTC, no assurances can be made related to the amounts, if any, that will be realized or any amounts (including interest) that will be owed, except as described below related to the partial settlement of certain NPM Adjustment claims. RAI has not recognized any credits related to the 2004-2019 NPM Adjustment in its consolidated financial statements.

Settlement/Partial Settlement of Certain NPM Adjustment Claims. In 2012, RJR Tobacco, Lorillard Tobacco, SFNTC and certain other participating manufacturers, referred to as the PMs, entered into a term sheet, referred to as the Term Sheet, with 17 states, the District of Columbia and Puerto Rico to settle certain claims related to the NPM Adjustment. The Term Sheet resolved claims related to volume years from 2003 through 2012 and puts in place a revised method to determine future adjustments from 2013 forward. In 2013 and 2014, five additional states joined the Term Sheet, including two states that were found to not have diligently enforced their qualifying statutes in 2003. In the fourth quarter of 2017, the NPM Agreement, a formal agreement incorporating the terms and provisions of the Term Sheet, was executed by the PMs and the states that previously joined the Term Sheet. With execution of the agreement, the PMs and the states settled the 2015 volume year. Since the NPM Adjustment Settlement Agreement was executed, an additional ten states joined the Agreement. Thirty-six jurisdictions have now joined the Term Sheet settlement representing approximately 62.53% allocable share. The PMs and the states that previously joined the Term Sheet executed a settlement agreement in August 2018 settling NPM Adjustment disputes for sales years 2016 through 2017, and in August 2020 settling for sales years 2018 through 2022.

On October 20, 2015, RJR Tobacco and certain other PMs (including SFNTC) entered into the NY Settlement Agreement with the State of New York to settle certain claims related to the NPM Adjustment. The NY Settlement Agreement resolves NPM Adjustment claims related to payment years from 2004 through 2014 and puts in place a new method whereby the parties jointly select an Investigator to determine future adjustments from 2015 forward as to New York. For years 2015 and 2016, the Investigator determined 175 million Tribal NPM Packs were sold to New York consumers on which the PMs should receive credits, and the parties agreed to use this number for 2017 and 2018. The parties have presented evidence to the Investigator regarding the years 2019 and 2020, and the Investigator will issue its decision in the first quarter of 2021. With the addition of New York's allocable share of 12.76%, RJR Tobacco has resolved the 2004 through 2022 NPM Adjustments with 37 jurisdictions, representing approximately 75.29% allocable share.

In April 2020, Montana filed a Motion to Enforce the MSA in the First Judicial District Court of Montana against RJR Tobacco, Philip Morris USA, and certain Subsequent Participating Manufacturers (the PMs), alleging the PMs conspired to improperly withhold and deposit the NPM Adjustment amounts from 2006 to present in a Disputed Payments Account (DPA), and seeking damages of approximately \$43 million, as well as treble and punitive damages. Historically, the PMs have taken the position they are entitled to deposit a portion of their annual MSA payments to Montana into the DPA and that the claims are arbitrable. In response to Montana's

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motion to enforce, the PMs filed a Motion to Compel Arbitration and to Dismiss or Stay Proceedings Pending Arbitration, which was denied in June 2020. The PMs appealed and filed a motion for stay pending appeal, which was granted in July 2020. The parties participated in court-ordered mediation on October 20-21, 2020. A Consent Decree was entered by the court on November 25, 2020, which included RJR Tobacco's release of the DPA funds (approx. \$32M) and payment of \$11 million in exchange for dismissal of Montana's claims and the lawsuit and resolves NPM years through 2030. The Independent Auditor released the DPA funds on December 16, 2020, and RJR Tobacco paid the remaining \$11 million on December 24, 2020.

On November 29, 2017, the parties filed in the Circuit Court of Kentucky an agreed order withdrawing the Commonwealth of Kentucky's motion to vacate and/or modify partial and final arbitration awards and for declaration of MSA violations. A status conference was held on February 12, 2018, at which time the agreed order was taken under advisement by the court. On May 18, 2018, the Court issued an Order reserving ruling on the agreed order and raising various issues. Following a status conference on May 29, 2018, the Court issued an Order on June 4, 2018 directing the parties to file a memorandum setting forth background information and a narrative explanation of the NPM Adjustment Settlement Agreement. On July 5, 2018, the parties filed a joint memorandum reiterating their request that the Court enter the agreed order. On July 5, 2018, the Kentucky Department of Revenue filed a Response to the Court's June 4 Order stating that it had no additional, helpful information to provide to the Court, and the Office of State Budget Director and Governor's Office of Policy and Management filed a Response stating that they have no objection to the agreed order. The Court never acted on the agreed order.

Other Litigation and Developments

JTI Claims for Indemnification. By a purchase agreement dated March 9, 1999, amended and restated as of May 11, 1999, referred to as the 1999 Purchase Agreement, RJR and RJR Tobacco sold its international tobacco business to JTI. Under the 1999 Purchase Agreement, RJR and RJR Tobacco retained certain liabilities relating to the international tobacco business sold to JTI. Under its reading of the indemnification provisions of the 1999 Purchase Agreement, JTI has requested indemnification for damages allegedly arising out of these retained liabilities. As previously reported, a number of the indemnification claims between the parties relating to the activities of Northern Brands in Canada have been resolved. The other matters for which JTI has requested indemnification for damages under the indemnification provisions of the 1999 Purchase Agreement are described below:

- In a letter dated March 31, 2006, counsel for JTI stated that JTI would be seeking indemnification under the 1999 Purchase Agreement for any damages it may incur or may have incurred arising out of a Southern District of New York grand jury investigation, a now-terminated Eastern District of North Carolina grand jury investigation, and various actions filed by the European Community and others in the U.S. District Court for the Eastern District of New York, referred to as the EDNY, against RJR Tobacco and certain of its affiliates on November 3, 2000, August 6, 2001, and (as discussed in greater detail below) October 30, 2002, and against JTI on January 11, 2002.
- JTI also has sought indemnification relating to a Statement of Claim filed on April 23, 2010, in the Ontario Superior Court of Justice, London, against JTI Macdonald Corp., referred to as JTI-MC, by the Ontario Flue-Cured Tobacco Growers' Marketing Board, referred to as the Board, Andy J. Jacko, Brian Baswick, Ron Kichler, and Aprad Dobrenty, proceeding on their own behalf and on behalf of a putative class of Ontario tobacco producers that sold tobacco to JTI-MC during the period between January 1, 1986 and December 31, 1996, referred to as the Class Period, through the Board pursuant to certain agreements. The Statement of Claim seeks recovery for damages allegedly incurred by the class representatives and the putative class for tobacco sales during the Class Period made at the contract price for duty free or export cigarettes with respect to cigarettes that, rather than being sold duty free or for export, purportedly were sold in Canada, which allegedly breached one or more of a series of contracts dated between June 4, 1986, and July 3, 1996. Appeals taken from an unsuccessful motion to dismiss the action as barred by the statute of limitations were ultimately denied on November 4, 2016. Certification proceedings are pending.
- Finally, JTI has advised RJR and RJR Tobacco of its view that, under the terms of the 1999 Purchase Agreement, RJR and RJR Tobacco are liable for approximately \$1.85 million related to a judgment entered in 1998, plus interest and costs, in an action filed in Brazil by Lutz Hanneman, a former employee of a former RJR Tobacco subsidiary. RJR and RJR Tobacco deny that they are liable for this judgment under the terms of the 1999 Purchase Agreement.

Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have these and other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree with JTI as to (1) what circumstances relating to any such matters may give rise to indemnification obligations by RJR and RJR Tobacco, and (2) the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later time.

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Fuma Patent Litigation. On March 6, 2019, a case was filed in federal court, *Fuma International LLC v. R.J. Reynolds Vapor Company* (M.D.N.C.) (Civ. No. 1:19-cv-260), which alleges that the VUSE SOLO and CIRO products infringe certain claims of U.S. Patent No. 9,532,604. On April 29, 2019, RJRV filed an Answer and Counterclaim alleging that the asserted claims of this are not infringed, invalid, and unenforceable for inequitable conduct. On July 2, 2019, Fuma filed a second complaint (Civ. No. 1:19-cv-660) asserting that the VUSE SOLO and CIRO products infringe certain claims of U.S. Patent No. 10,334,881. The two Fuma actions were consolidated by consent on August 30, 2019. On December 19, 2019, RJRV filed a motion for summary judgment on its counterclaim for inequitable conduct, which was denied and dismissed on March 6, 2020 (and denied on reconsideration). The Court issued its claim construction order on March 23, 2020, which, on the balance, is generally favorable to RJRV. In particular, the claim construction order solidified RJRV's non-infringement position for VUSE Ciro and preserved non-infringement arguments for VUSE Solo. Fact discovery concluded on July 15, 2020. Expert discovery concluded on October 2, 2020. Two mediation sessions have been held (in January and October 2020) without significant movement between the parties. The parties have briefed dispositive motions on infringement and non-infringement and are awaiting an order. Trial was anticipated (but not scheduled) in late March/early April 2021 based on the Court's Scheduling Order, but COVID has delayed all scheduled trials and thus trial is not expected until mid-2021 at the earliest.

VUSE Litigation. RAI Strategic Holdings, Inc., RJRV, and R.J. Reynolds Tobacco Company (collectively referred to as "Reynolds") filed a complaint with the International Trade Commission ("ITC") on April 9, 2020 accusing Altria Client Services LLC, Philip Morris USA, Inc., Altria Group, Inc., Philip Morris International, Inc., and Philip Morris Products S.A. (collectively referred to as "PM") for infringement of three patents owned by RAI Strategic Holdings, Inc. based on the importation to the United States of IQOS. On May 11, 2020, the ITC instituted an investigation with a 16-month target date for completion of September 15, 2021. PM responded to the complaint on June 1, 2020, asserting affirmative defenses of non-infringement, invalidity, and that relief was not in the public interest. The court held a Markman hearing on September 17, 2020. At the conclusion of the hearing, the Administrative Law Judge provided his preliminary constructions, all of which were in Reynolds' favor. The Court issued a claim construction order to this effect on January 6, 2021. Fact depositions were completed on September 25, 2020, and expert discovery was completed on November 13, 2020. On November 20, 2020, Reynolds filed a partially unopposed motion for summary determination that they had satisfied the economic prong of the Domestic Industry requirement. On December 2, 2020, the ITC Staff filed a response to the summary determination motion supporting Reynolds' positions. On January 4, 2021, ITC Staff filed its pre-hearing brief supporting Reynolds' positions on two of the three asserted patents. Trial occurred on January 25-29 and February 1, 2021. The judge's initial determination is due May 14, 2021 and a final determination due on September 15, 2021.

Reynolds filed a complaint in April 2020 in the U.S. District Court, Eastern District of Virginia, accusing PM of infringement of six patents owned by RAI Strategic Holdings Inc. based on the importation and commercialization within the United States of IQOS. In June 2020, PM filed an Answer and Counterclaims that asserted five patents against Reynolds. In July 2020, RJR filed an amended complaint as of right. On June 12, 2020, PM filed a motion under 28 USC § 1659 seeking to stay the case as to the three patents that are also in the ITC investigation, which was granted. On November 24, 2020, the Court issued a claim construction order that determined each disputed term would have its plain and ordinary meaning. The Magistrate Judge issued an order on December 4, 2020 that stayed both Reynolds' and PM's patent claims pending a decision on *Inter Partes* review petitions filed by PM on Reynolds patents not stayed by the ITC proceeding. At the time of the stay, fact and expert discovery was ongoing and concluded January 26, 2021. If the stay is lifted, fact and expert discovery will resume and it is expected that the date for close of fact and expert discovery will be rescheduled based on the date the stay is lifted (i.e., approximately 8 weeks after the date the stay is lifted). Local counsel believes that the trial (which was initially scheduled for 4-8 weeks past a now-cancelled January 15, 2021 pre-hearing conference) will likely be delayed until Q4 2021 or later due to the pandemic.

Altria Client Services LLC and U.S. Smokeless Tobacco Company LLC (collectively referred to as "Altria") filed a complaint in the U.S. District Court, Middle District of North Carolina in May 2020 accusing RJRV of infringement of nine patents owned by Altria based on the commercialization of RJRV's VUSE Alto, VUSE Vibe and VUSE Velo products. In July 2020, RJRV filed an Answer to the Complaint and Counterclaims for non-infringement and invalidity of each asserted patent. Altria answered the counterclaims in August 2020. On January 5, 2021, Altria filed an Amended Complaint that adds MBI as a defendant with respect to the Velo product claims. Fact discovery is proceeding. The parties have agreed on a mediator but have not set a date for mediation. The parties have also submitted a Joint Claim Construction statement and the claim construction hearing is tentatively scheduled for the week of March 22, 2021. Fact discovery is scheduled to conclude June 23, 2021. A trial date has not been set but would not be anticipated until at least Q1 2022.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

In July 2020, Nicholas Bernston filed a personal injury action in the U.S. District Court, Northern District of Oklahoma against JUUL Labs Inc., referred to as JUUL, Altria Client Services, LLC, RJRV, RAI, and others. The complaint seeks damages for personal injuries (including pneumonia and acute respiratory failure) allegedly resulting from vaping and asserts several theories of liability, including strict liability, negligence, and breach of implied warranty of merchantability. In August 2020, the Judicial Panel on Multidistrict Litigation transferred the case to the Northern District of California for consolidated pretrial proceedings as part of the JUUL multidistrict litigation (“MDL”). On October 13, 2020, RJRV and RAI moved to dismiss the complaint or, in the alternative, for a stay or a suggestion of remand to the Northern District of Oklahoma. On October 16, 2020, the JUUL MDL judge ordered that RAI and RJRV’s motions will be stayed. Though the case remains pending, RAI and RJRV will not be subject to discovery or other pretrial obligations (at least until further order of the court) while the MDL proceeds against JUUL.

On December 14, 2020, MBI, filed an action for declaratory judgment in the United States District Court for the District of Delaware against Swedish Match North America and related entities seeking judgments that Swedish Match’s U.S. Pat. No. 9,161,908 is invalid and has not been infringed and that MBI has not misappropriated any Swedish Match trade secrets, as a result of MBI’s recent acquisition of the nicotine pouch business assets from Dryft Sciences, LLC and commercialization of the acquired formulations under the Velo brand. On January 4, 2021, the Court granted a stipulation to extend the response of Swedish Match and Pinkerton until February 4, 2021, and NYZ AB until April 28, 2021. On February 4, Swedish Match and Pinkerton filed (1) a motion to Dismiss Count 1 of the Declaratory Judgment Action related to trade secret misappropriation and to transfer the Action to Central District of California or, in the alternative, stay the action; and (2) a motion for extension of time to file a responsive pleading until after the Court has ruled on the first motion.

Environmental Matters

RAI and its subsidiaries are subject to federal, state and local environmental laws and regulations concerning the discharge, storage, handling and disposal of hazardous or toxic substances. Such laws and regulations provide for significant fines, penalties and liabilities, sometimes without regard to whether the owner or operator of the property or facility knew of, or was responsible for, the release or presence of hazardous or toxic substances. In addition, third parties may make claims against owners or operators of properties for personal injuries and property damage associated with releases of hazardous or toxic substances. In the past, RJR Tobacco has been named a potentially responsible party with third parties under the Comprehensive Environmental Response, Compensation and Liability Act with respect to several superfund sites. RAI and its subsidiaries are not aware of any current environmental matters that are expected to have a material adverse effect on the business, results of operations or financial position of RAI or its subsidiaries.

RAI and its operating subsidiaries believe that climate change is an environmental issue primarily driven by carbon dioxide emissions from the use of energy. RAI’s operating subsidiaries are working to reduce carbon dioxide emissions by minimizing the use of energy where cost effective, minimizing waste to landfills and increasing recycling. Climate change is not viewed by RAI’s operating subsidiaries as a significant direct economic risk to their businesses, but rather an indirect risk involving the potential for a longer-term general increase in the cost of doing business. Regulatory changes are difficult to predict, but the current regulatory risks to the business of RAI’s operating subsidiaries with respect to climate change are relatively low. Financial impacts will be driven more by the cost of natural gas and electricity. Efforts are made to anticipate the effect of increases in fuel costs directly impacting RAI’s operating subsidiaries by evaluating natural gas usage and market conditions. Occasionally forward contracts are purchased, limited to a two-year period, for natural gas. In addition, RAI’s operating subsidiaries are continually evaluating energy conservation measures and energy efficient equipment to mitigate impacts of increases in energy costs and adopting or utilizing such measures and equipment where appropriate.

Regulations promulgated by the EPA and other governmental agencies under various statutes have resulted in, and likely will continue to result in, substantial expenditures for pollution control, waste treatment or handling, facility modification and similar activities. RAI and its subsidiaries are engaged in a continuing program to comply with federal, state and local environmental laws and regulations, and dependent upon the probability of occurrence and reasonable estimation of cost, accrue or disclose any material liability. Although it is difficult to reasonably estimate the portion of capital expenditures or other costs attributable to compliance with environmental laws and regulations, RAI does not expect such expenditures or other costs to have a material adverse effect on the business, results of operations, cash flows or financial position of RAI or its subsidiaries.

Shareholder Cases

BAT Transaction. In connection with the Merger Agreement, two putative class action lawsuits were filed in the U.S. District Court for the Middle District of North Carolina against RAI and the members of the RAI board of directors.

RAI believed that the claims asserted in these cases were without merit and that no supplemental disclosure was required under applicable law. Nevertheless, in order to avoid the risk of the Merger Litigation delaying or otherwise adversely affecting the BAT Merger and to minimize the costs, risks and uncertainties inherent in litigation, and without admitting any liability or wrongdoing, on July 11, 2017, RAI filed supplemental disclosures to the RAI Proxy Statement with certain additional information relating to the BAT Merger and the cases were dismissed.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Following BAT's acquisition of the remaining 57.8% of RAI in July 2017, pursuant to North Carolina law, under which RAI was incorporated, a number of RAI shareholders dissented and asserted their rights to a judicial appraisal of the value of their RAI stock. On November 29, 2017, RAI filed a complaint for judicial appraisal in North Carolina state court against 20 dissenting shareholders, comprised of three groups of affiliated entities. The complaint asks the court to determine the fair value of the dissenting shareholders' shares of RAI stock and any accrued interest. A trial was held in June 2019, at which the dissenters sought \$92.17 per share plus interest. On April 27, 2020, the court issued its final judgment upholding RAI's proposed valuation of \$59.64 per share and concluding that no further payment is due to the dissenters for their shares. Dissenting shareholders holding an aggregate of approximately 6.52 million shares filed a notice of appeal to the North Carolina Supreme Court on May 21, 2020 and briefing of the appeal concluded on December 14, 2020. A decision is pending.

Other Commitments and Contingencies

JTI Indemnities. In connection with the sale of the international tobacco business to JTI, pursuant to the 1999 Purchase Agreement, RJR and RJR Tobacco agreed to indemnify JTI against:

- any liabilities, costs and expenses arising out of the imposition or assessment of any tax with respect to the international tobacco business arising prior to the sale, other than as reflected on the closing balance sheet;
- any liabilities, costs and expenses that JTI or any of its affiliates, including the acquired entities, may incur after the sale with respect to any of RJR's or RJR Tobacco's employee benefit and welfare plans; and
- any liabilities, costs and expenses incurred by JTI or any of its affiliates arising out of certain activities of Northern Brands.

As described above in “— Litigation Affecting the Cigarette Industry — Other Litigation and Developments — JTI Claims for Indemnification,” RJR Tobacco has received claims for indemnification from JTI, and several of these have been resolved. Although RJR and RJR Tobacco recognize that, under certain circumstances, they may have other unresolved indemnification obligations to JTI under the 1999 Purchase Agreement, RJR and RJR Tobacco disagree what circumstances described in such claims give rise to any indemnification obligations by RJR and RJR Tobacco and the nature and extent of any such obligation. RJR and RJR Tobacco have conveyed their position to JTI, and the parties have agreed to resolve their differences at a later date.

In connection with the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks to JTI Holding, along with the international companies that distribute and market the brand outside the United States, pursuant to the 2015 Purchase Agreement, SFNTC, R. J. Reynolds Global Products, Inc., and R. J. Reynolds Tobacco B.V. agreed to indemnify JTI Holding against, among other things, any liabilities, costs, and expenses relating to actions:

- commenced on or before (1) January 13, 2019, to the extent relating to alleged personal injuries, and (2) in all other cases, January 13, 2021;
- brought by (1) a governmental authority to enforce legislation implementing European Union Directive 2001/37/EC or European Directive 2014/40/EU or (2) consumers or a consumer association; and
- arising out of any statement or claim (1) made on or before January 13, 2016, (2) by any company sold to JTI Holding in the transaction, (3) concerning NATURAL AMERICAN SPIRIT brand products consumed or intended to be consumed outside of the United States and (4) that the NATURAL AMERICAN SPIRIT brand product is natural, organic, or additive free.

In connection with the indemnity in connection with the sale of the international rights to the NATURAL AMERICAN SPIRIT brand name and associated trademarks, JTI has requested indemnification in connection with an audit of Santa Fe Natural Tobacco Company Germany GmbH, referred to as SFNTCG, relating to transfer pricing for the tax years 2007 to 2010 and 2012 to 2015. For the tax years 2007 to 2010, SFNTCG appealed the audit assessment. The appeal was rejected, and the assessment will be further appealed in court. The amount in issue is approximately 15 million Euros plus interest. For the tax years 2012 to 2015, SFNTCG is appealing an audit assessment of approximately 6 million Euros plus interest, but the appeals process is on hold until the dispute for the tax years 2007 to 2010 is resolved.

ITG Indemnity. In the purchase agreement relating to the Divestiture, RAI agreed to defend and indemnify, subject to certain conditions and limitations, ITG in connection with claims relating to the purchase or use of one or more of the WINSTON, KOOL, SALEM, or MAVERICK cigarette brands on or before June 12, 2015, as well as in actions filed before June 13, 2023. Further, ITG agreed to indemnify RAI and its affiliates in connection with claims relating to the blu e-cigarette brand that was manufactured by a Lorillard affiliate on and before June 12, 2015. ITG has tendered the defense of several actions asserting claims relating to the purchase or use of WINSTON, KOOL, SALEM, and/or MAVERICK brand cigarettes to RJR Tobacco, and RJR Tobacco has assumed the defense of those actions subject to a reservation of rights. RAI also has tendered the defense of an action relating to the purchase and use of blu

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

e-cigarettes to ITG, and ITG has assumed the defense of that action subject to a reservation of rights. The claims asserted against ITG are substantially similar in nature and extent to claims asserted against RJR Tobacco in those actions.

Loews Indemnity. In 2008, Loews Corporation, referred to as Loews, entered into an agreement with Lorillard, Lorillard Tobacco, and certain of their affiliates, which agreement is referred to as the Separation Agreement. In the Separation Agreement, Lorillard agreed to indemnify Loews and its officers, directors, employees and agents against all costs and expenses arising out of third party claims (including, without limitation, attorneys' fees, interest, penalties and costs of investigation or preparation of defense), judgments, fines, losses, claims, damages, liabilities, taxes, demands, assessments, and amounts paid in settlement based on, arising out of or resulting from, among other things, Loews's ownership of or the operation of Lorillard and its assets and properties, and its operation or conduct of its businesses at any time prior to or following the separation of Lorillard and Loews (including with respect to any product liability claims). Loews is a defendant in three pending product liability actions, each of which is a putative class action. Pursuant to the Separation Agreement, Lorillard is required to indemnify Loews for the amount of any losses and any legal or other fees with respect to such cases. Following the closing of the Lorillard Merger, RJR Tobacco assumed Lorillard's obligations under the Separation Agreement as was required under the Separation Agreement.

Indemnification of Distributors and Retailers. RJR Tobacco, Lorillard Tobacco, SFNTC, American Snuff Co. and RJRV have entered into agreements to indemnify certain distributors and retailers from liability and related defense costs arising out of the sale or distribution of their products. Additionally, SFNTC has entered into an agreement to indemnify a supplier from liability and related defense costs arising out of the sale or use of SFNTC's products. The cost has been, and is expected to be, insignificant. RJR Tobacco, SFNTC, American Snuff Co. and RJRV believe that the indemnified claims are substantially similar in nature and extent to the claims that they are already exposed to by virtue of their having manufactured those products. Except as otherwise noted above, RAI is not able to estimate the maximum potential amount of future payments, if any, related to these indemnification obligations.

Other Guarantees

EMTN Guarantee. RAI guarantees all debt securities outstanding, or which may be issued in the future, under BAT's £25 billion Euro Medium Term Note program, referred to as EMTN. At December 31, 2020, there were multiple series of EMTN securities denominated in Euros, British pounds, Swiss francs and United States dollars, with maturities ranging from 2021 to 2055 for a U.S. dollar equivalent of approximately \$20.1 billion. EMTN securities may be issued by several subsidiaries of BAT and are guaranteed by BAT and certain BAT subsidiaries. RAI's guarantee of the EMTN securities is unconditional and irrevocable, joint and several with the other guarantors and is triggered when the issuer of the EMTN securities defaults in payment. If RAI is required by law to withhold any U.S. taxes (or taxes of any of its political subdivisions) from payments it makes under its guarantee, RAI is required to pay additional amounts so that security holders receive the same payment they would receive absent such withholding, subject to exceptions. RAI will be automatically and unconditionally released from its EMTN guarantee if at any time the aggregate amount of indebtedness for borrowed money for which RAI is an obligor does not exceed 10% of the outstanding long-term debt of BAT. For these purposes, the amount of RAI's indebtedness for borrowed money does not include (1) RAI's guarantee of the EMTN securities; (2) any other debt guaranteed by RAI, the terms of which permit the termination of such guarantee under similar circumstances, as long as RAI's obligations in respect of such other debt are terminated at substantially the same time as its guarantee of the EMTN securities; (3) any debt issued or guaranteed by RAI that is being refinanced at substantially the same time as the release of the guarantee, provided that any obligations of RAI in respect of debt that is incurred in any such refinancing shall be included in the calculation of RAI's indebtedness for borrowed money; and (4) intercompany debt.

Rule 144A/Regulation S Guarantee. At December 31, 2020, RAI guaranteed \$14.3 billion in aggregate principal amount of debt securities in multiple series issued by two BAT subsidiaries prior to 2019 pursuant to Rule 144A and Regulation S, with maturities ranging from 2022 to 2047. The Rule 144A/Regulation S securities are guaranteed by BAT and certain BAT subsidiaries. RAI's guarantee of the Rule 144A/Regulation S securities is full and unconditional, joint and several with the other guarantors and is triggered when the issuer of the Rule 144A/Regulation S securities defaults in payment. The guarantee is an unsubordinated obligation of RAI and ranks *pari passu* in right of payment with all other direct, unsecured and unsubordinated obligations of RAI (except those obligations preferred by law). RAI's obligations under the guarantee are limited to the maximum amount resulting in its obligations not constituting a fraudulent conveyance or fraudulent transfer under any applicable law. If RAI is required by law to withhold any U.S. taxes (or taxes of any of its political subdivisions) from payments it makes under its guarantee, RAI is required to pay additional amounts so that security holders receive the same payment they would receive absent such withholding, subject to exceptions. During 2019, BAT filed a registration statement with the U.S. Securities and Exchange Commission to allow two of its subsidiaries to offer and sell from time to time debt securities up to an aggregate amount of \$10.0 billion over the next three years. In 2020, the registration statement was amended to increase the aggregate amount that could be issued to \$20.0 billion. RAI has fully and unconditionally guaranteed on a joint and several and senior and unsecured any obligations issued under this registration statement. In September 2019, one of the BAT subsidiaries issued \$3.5 billion in aggregate principal amount of debt securities under this facility with maturities ranging from 2024 to 2049. In April 2020 and September 2020, these BAT subsidiaries issued \$2.4 billion and \$6.25 billion, respectively, in aggregate principal amount of debt securities under this facility with maturities ranging from 2027 to 2050.

Note 8 — Shareholders' Equity

RAI's authorized capital stock at December 31, 2020 and 2019, consisted of 100 million shares of preferred stock, par value \$.01 per share, and 3.2 billion shares of common stock, par value \$.0001 per share. Four million shares of the preferred stock are designated as Series A Junior Participating Preferred Stock, none of which is issued or outstanding. The Series A Junior Participating Preferred Stock will rank junior as to dividends and upon liquidation to all other series of RAI preferred stock, unless specified otherwise. Also,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

of the preferred stock, one million shares are designated as Series B Preferred Stock, all of which are issued and outstanding. The Series B Preferred Stock ranks senior upon liquidation, but not with respect to dividends, to all other series of RAI capital stock, unless specified otherwise. As a part of the B&W business combination, RJR is the holder of the outstanding Series B Preferred Stock. RAI declared and paid \$43 million in dividends to RJR with respect to the Series B Preferred Stock in both 2020 and 2019.

RAI paid dividends to certain BAT subsidiaries that hold RAI's common stock totaling \$4,953 million and \$4,455 million in 2020 and 2019, respectively.

Accumulated Other Comprehensive Loss

The components of accumulated other comprehensive loss, net of tax, were as follows:

	<u>Retirement Benefits</u>	<u>Cumulative Translations Adjustment and Other</u>	<u>Total</u>
Balance at December 31, 2018	\$ (293)	\$ (57)	\$ (350)
Other comprehensive income before reclassifications	142	64	206
Amounts reclassified from accumulated other comprehensive income (loss)	<u>(16)</u>	<u>—</u>	<u>(16)</u>
Net current-period other comprehensive income	<u>126</u>	<u>64</u>	<u>190</u>
Adjustment due to adoption of ASU 2018-02	<u>—</u>	<u>(7)</u>	<u>(7)</u>
Balance at December 31, 2019	<u>(167)</u>	<u>—</u>	<u>(167)</u>
Other comprehensive income before reclassifications	123	—	123
Amounts reclassified from accumulated other comprehensive income (loss)	<u>8</u>	<u>—</u>	<u>8</u>
Net current-period other comprehensive income	<u>131</u>	<u>—</u>	<u>131</u>
Balance at December 31, 2020	<u>\$ (36)</u>	<u>\$ —</u>	<u>\$ (36)</u>

Details about the reclassifications out of accumulated other comprehensive loss and the affected line items in the consolidated statements of income for the years ended December 31, 2020 and 2019, were as follows:

<u>Components</u>	<u>Amounts Reclassified</u>		<u>Affected Line Item</u>
	<u>2020</u>	<u>2019</u>	
Retirement benefits:			
Amortization of prior service credit	\$ (1)	\$ (27)	Other expenses, net
MTM adjustment	<u>12</u>	<u>6</u>	Other expenses, net
	11	(21)	Other expenses, net
Deferred taxes	<u>(3)</u>	<u>5</u>	Provision for income taxes
Total reclassifications	<u>\$ 8</u>	<u>\$ (16)</u>	Net income

Note 9 — Retirement Benefits

Pension and Postretirement Benefit Plans

RAI sponsors a number of non-contributory defined benefit pension plans covering certain employees of RAI and its subsidiaries. RAI and a subsidiary provide health and life insurance benefits for certain retired employees of RAI and its subsidiaries and their dependents. These benefits are generally no longer provided to employees hired on or after January 1, 2004.

RAI has both funded and unfunded pension and postretirement plans. The measurement date used for all plans is December 31.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The changes in benefit obligations and plan assets, as well as the funded status of these plans at December 31 were as follows:

	Pension Benefits		Postretirement Benefits	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Change in benefit obligations:				
Obligations at beginning of year	\$ 6,614	\$ 6,212	\$ 970	\$ 977
Service cost	15	14	1	1
Interest cost	214	260	30	38
Actuarial loss	502	568	20	26
Benefits paid	<u>(432)</u>	<u>(440)</u>	<u>(67)</u>	<u>(72)</u>
Obligations at end of year	<u>\$ 6,913</u>	<u>\$ 6,614</u>	<u>\$ 954</u>	<u>\$ 970</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	\$ 6,323	\$ 5,633	\$ 218	\$ 209
Actual return on plan assets	1,059	1,115	19	28
Employer contributions	15	15	49	53
Benefits paid	<u>(432)</u>	<u>(440)</u>	<u>(67)</u>	<u>(72)</u>
Fair value of plan assets at end of year	<u>\$ 6,965</u>	<u>\$ 6,323</u>	<u>\$ 219</u>	<u>\$ 218</u>
Funded status	<u>\$ 52</u>	<u>\$ (291)</u>	<u>\$ (735)</u>	<u>\$ (752)</u>

Amounts recognized in the consolidated balance sheets consist of:

	Pension Benefits		Postretirement Benefits	
	<u>2020</u>	<u>2019</u>	<u>2020</u>	<u>2019</u>
Other assets	\$ 317	\$ —	\$ —	\$ —
Other current liabilities	(15)	(15)	(65)	(65)
Long-term retirement benefits	<u>(250)</u>	<u>(276)</u>	<u>(670)</u>	<u>(687)</u>
Funded status	<u>\$ 52</u>	<u>\$ (291)</u>	<u>\$ (735)</u>	<u>\$ (752)</u>

The sum of other current liabilities and long-term retirement benefits consists of the amount of underfunded and unfunded pension benefits or postretirement benefits.

The accumulated benefit obligation for pension plans was \$6,873 million and \$6,576 million at December 31, 2020 and 2019, respectively.

Pension plans with accumulated benefit obligations, which represent benefits earned to date, in excess of plan assets are summarized below:

	December 31,	
	<u>2020</u>	<u>2019</u>
Accumulated benefit obligation	\$ 289	\$ 3,662
Plan assets	29	3,394

Pension plans with projected benefit obligations in excess of plan assets are summarized below:

	December 31,	
	<u>2020</u>	<u>2019</u>
Projected benefit obligation	\$ 293	\$ 3,671
Plan assets	29	3,394

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The net amount of projected benefit obligations and plan assets for underfunded and unfunded pension plans was \$265 million and \$291 million at December 31, 2020 and 2019, respectively.

Information for postretirement plans with an accumulated postretirement benefit obligation in excess of plan assets have been disclosed in the changes in obligations and plan assets table because all postretirement plans are underfunded or unfunded.

Amounts included in accumulated other comprehensive loss were as follows as of December 31:

	2020			2019		
	Pension Benefits	Postretirement Benefits	Total	Pension Benefits	Postretirement Benefits	Total
Prior service cost	\$ —	\$ 8	\$ 8	\$ 2	\$ 5	\$ 7
Net actuarial (gain) loss	155	(57)	98	352	(79)	273
Accumulated other comprehensive loss	<u>\$ 155</u>	<u>\$ (49)</u>	<u>\$ 106</u>	<u>\$ 354</u>	<u>\$ (74)</u>	<u>\$ 280</u>

The components of net periodic benefit cost (income) are set forth below:

	Pension Benefits		Postretirement Benefits	
	2020	2019	2020	2019
Service cost	\$ 15	\$ 14	\$ 1	\$ 1
Interest cost	214	260	30	38
Expected return on plan assets	(384)	(352)	(9)	(8)
Amortization of prior service cost (credit)	2	3	(3)	(30)
MTM adjustment	24	19	(12)	(13)
Net periodic benefit (income) expense	<u>\$ (129)</u>	<u>\$ (56)</u>	<u>\$ 7</u>	<u>\$ (12)</u>

Other changes in plan assets and benefit obligations recognized in other comprehensive income are set forth below:

	Pension Benefits		Postretirement Benefits	
	2020	2019	2020	2019
Net actuarial (gain) loss	\$ (173)	\$ (195)	\$ 10	\$ 6
Amortization of prior service (cost) credit	(2)	(3)	3	30
MTM adjustment	(24)	(19)	12	13
Total recognized in other comprehensive income	<u>(199)</u>	<u>(217)</u>	<u>25</u>	<u>49</u>
Total recognized in net periodic benefit income and other comprehensive income	<u>\$ (328)</u>	<u>\$ (273)</u>	<u>\$ 32</u>	<u>\$ 37</u>

As of December 31, 2020, the improvement in pension benefits funded status is primarily due to updated mortality assumptions and higher return on plan assets offset by a decrease in the discount rate. As of December 31, 2020, the improvement in postretirement benefits funded status is primarily due to updated mortality and other assumptions and higher return on plan assets offset by a decrease in the discount rate.

As of December 31, 2019, the improvement in pension benefits funded status and postretirement benefits funded status is primarily due to updated mortality assumptions and higher return on plan assets offset by a decrease in the discount rate.

In March 2010, the Patient Protection Affordable Care Act, referred to as the PPACA, as amended by the Health Care and Reconciliation Act of 2010, was signed into law. The PPACA mandates health-care reforms with staggered effective dates from 2010 to 2018. The additional postretirement liability resulting from the material impacts of the PPACA have been included in the accumulated postretirement benefit obligation at December 31, 2020 and 2019.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

The changes in net actuarial (gain) loss impacted the funded status and MTM adjustment as follows:

	Pension Benefits		Postretirement Benefits	
	2020	2019	2020	2019
Net actuarial (gain) loss:				
Change in discount rate	\$ 546	\$ 644	\$ 69	\$ 82
Change in mortality table	(59)	(89)	(6)	(9)
Actual return on plan assets	(1,059)	(1,115)	(19)	(28)
Expected return on plan assets	384	352	9	8
Other	15	13	(43)	(47)
Net actuarial (gain) loss	<u>\$ (173)</u>	<u>\$ (195)</u>	<u>\$ 10</u>	<u>\$ 6</u>

Assumptions

Weighted-average assumptions used to determine benefit obligations as of December 31:

	Pension Benefits		Postretirement Benefits	
	2020	2019	2020	2019
Discount rate	2.59%	3.35%	2.51%	3.32%
Rate of compensation increase	3.50%	3.50%	—	—
Interest crediting rate applicable to certain plans	4.75%	4.75%	—	—

Weighted-average assumptions used to determine net periodic benefit cost for years ended December 31:

	Pension Benefits		Postretirement Benefits	
	2020	2019	2020	2019
Discount rate	3.35%	4.33%	3.32%	4.31%
Expected long-term return on plan assets	6.28%	6.48%	4.30%	4.55%
Rate of compensation increase	3.50%	4.00%	—	—
Interest crediting rate applicable to certain plans	4.75%	4.75%	—	—

Additional information relating to RAI's significant postretirement plans is as follows:

	2020	2019
Weighted-average health-care cost trend rate assumed for the following year	6.00%	6.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2025	2025

During 2021, RAI expects to contribute \$15 million to its pension plans and \$65 million to its postretirement plans.

Estimated future benefit payments:

Year	Pension Benefits	Postretirement Benefits		
		Gross Projected Benefit Payments Before Medicare Part D Subsidies	Expected Medicare Part D Subsidies	Net Projected Benefit Payments After Medicare Part D Subsidies
2021	\$ 435	\$ 83	\$ (1)	\$ 82
2022	430	70	(2)	68
2023	426	68	(2)	66
2024	420	66	(1)	65
2025	414	65	(2)	63
2026-2030	1,945	298	(9)	289

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Pension and Postretirement Assets

RAI generally uses a hypothetical bond matching analysis to determine the discount rate. The discount rate modeling process involves selecting a portfolio of high-quality corporate bonds whose cash flows, via coupons and maturities, match the projected cash flows of the obligations.

The overall expected long-term rate of return on asset assumptions for pension and postretirement assets are based on: (1) the target asset allocation for plan assets, (2) long-term capital markets forecasts for asset classes employed, and (3) excess return expectations of active management.

Plan assets are invested using active investment strategies and multiple investment management firms. Managers within each asset class cover a range of investment styles and approaches and are combined in a way that controls for capitalization, style bias, and interest rate exposures, while focusing primarily on security selection as a means to add value. Risk is controlled through diversification among asset classes, managers, investment styles and securities. Risk is further controlled both at the manager and asset class level by assigning excess return and tracking error targets against related benchmark indices. Investment manager performance is evaluated against these targets.

RAI employs a risk mitigation strategy, which seeks to balance pension plan returns with a reasonable level of funded status volatility. Based on this framework, the asset allocation has two primary components. The first component is the “hedging portfolio,” which uses extended duration fixed income holdings and derivatives to match a portion of the interest rate risk associated with the benefit obligations, thereby reducing expected funded status volatility. The second component is the “return seeking portfolio,” which is designed to enhance portfolio returns. The return seeking portfolio is broadly diversified across asset classes.

Allowable investment types include global equity, fixed income, real assets, private equity and absolute return. The range of allowable investment types utilized for pension assets provides enhanced returns and more widely diversifies the plan. Global equity is comprised of the common stocks of large, medium and small companies domiciled inside and outside the United States, including those in less developed, fast growing emerging countries. Fixed income includes corporate debt obligations, fixed income securities issued or guaranteed by the U.S. government, and to a lesser extent by non-U.S. governments, mortgage backed securities, high yield securities, asset backed securities, municipal bonds and dollar-denominated obligations issued in the United States by non-U.S. banks and corporations. Real assets consist of publicly traded real estate investment trust securities, private real estate investments and private energy investments. Private equity consists of the unregistered securities of private and public companies. Absolute return investments are diversified portfolios utilizing multiple strategies that invest in both public and private securities, including equities and fixed income.

For pension assets, futures and forward contracts are used for portfolio rebalancing and to approach fully invested portfolio positions. Otherwise, a small number of investment managers employ limited use of derivatives, including futures contracts, options on futures, forward contracts and interest rate swaps in place of direct investment in securities to gain efficient exposure to markets.

RAI’s pension and postretirement plans asset allocations at December 31, 2020 and 2019, by asset category were as follows:

Asset Category:	Pension Plans			
	<u>2020 Target ⁽¹⁾</u>	<u>2020</u>	<u>2019 Target ⁽¹⁾</u>	<u>2019</u>
Global equities	10%	10%	16%	16%
Fixed income	64%	64%	57%	57%
Absolute return	16%	16%	14%	14%
Private equity	6%	6%	8%	8%
Real assets	4%	4%	5%	5%
Total	100%	100%	100%	100%
Asset Category:	Postretirement Plans			
	<u>2020 Target ⁽¹⁾</u>	<u>2020</u>	<u>2019 Target ⁽¹⁾</u>	<u>2019</u>
Global equities	43%	45%	42%	43%
Fixed income	52%	47%	53%	49%
Cash and other	5%	8%	5%	8%
Total	100%	100%	100%	100%

(1) Allows for a rebalancing range of up to 5 percentage points around target asset allocations.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

RAI's pension and postretirement plan assets, excluding uninvested cash and unsettled trades, carried at fair value on a recurring basis as of December 31, 2020 and 2019, were as follows ⁽¹⁾:

Pension Plans	2020				2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Asset Category:								
Global equities	\$ 514	\$ 215	\$ —	\$ 729	\$ 585	\$ 149	\$ —	\$ 734
Real assets	23	—	—	23	29	—	—	29
Asset backed securities	—	27	—	27	—	49	—	49
Corporate bonds	—	3,090	—	3,090	—	2,256	1	2,257
Government bonds	—	129	—	129	—	121	—	121
High yield fixed income	—	—	—	—	—	5	—	5
Mortgage backed securities	—	55	—	55	—	165	—	165
Municipal bonds	—	149	—	149	—	149	—	149
Treasuries	—	807	—	807	—	1,134	—	1,134
Cash equivalents and other	30	223	1	254	21	240	1	262
Total investments in the fair value hierarchy	<u>\$ 567</u>	<u>\$ 4,695</u>	<u>\$ 1</u>	<u>5,263</u>	<u>\$ 635</u>	<u>\$ 4,268</u>	<u>\$ 2</u>	<u>4,905</u>
Investments measured at net asset value				1,672				1,538
Total				<u>\$ 6,935</u>				<u>\$ 6,443</u>
Postretirement Plans	2020				2019			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Asset Category:								
Short-term bonds	\$ —	\$ —	\$ —	\$ —	\$ 3	\$ —	\$ —	\$ 3
Cash equivalents and other	—	8	—	8	—	8	—	8
Total investments in the fair value hierarchy	<u>\$ —</u>	<u>\$ 8</u>	<u>\$ —</u>	<u>8</u>	<u>\$ 3</u>	<u>\$ 8</u>	<u>\$ —</u>	<u>11</u>
Investments measured at net asset value				192				190
Total				<u>\$ 200</u>				<u>\$ 201</u>

⁽¹⁾ See Note 1 for additional information on the fair value hierarchy.

For the years ended December 31, 2020 and 2019, there were no transfers among the fair value hierarchy levels, including transfers and purchases of level 3 assets.

At December 31, 2020 and 2019, the fair value of pension and postretirement assets classified as Level 1 and Level 2 was determined using multiple third-party pricing services for global equities, real assets, asset backed securities, corporate bonds, government bonds, high yield fixed income, mortgage backed securities, municipal bonds, treasuries and cash equivalents and other.

The fair value of assets categorized as corporate bonds and other, classified as Level 3, was determined primarily using an income approach that utilized cash flow models and benchmarking strategies. This approach utilized observable inputs, including market-based interest rate curves, corporate credit spreads and corporate ratings. Additionally, unobservable factors incorporated into these models included default probability assumptions, potential recovery, discount rates and other entity specific factors.

In instances where the plans have invested in commingled pools, the net asset value was used as the practical expedient and no adjustments were made to the provided fair value.

Defined Contribution Plans

RAI sponsors qualified defined contribution plans. The expense related to these plans was \$41 million and \$40 million in 2020 and 2019, respectively. Included in the plans is a non-leveraged employee stock ownership plan, which holds shares of the BAT Stock Fund. Participants can elect to contribute to the fund.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Note 10 — Revenue Recognition

RAI has adopted ASC 606, *Contracts with Customers*, for which this accounting standard establishes principles for reporting information about the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers entered into by RAI's operating subsidiaries.

Substantially all of RAI's net sales come from sales of tobacco and e-cigarette products by its operating subsidiaries under the terms of contracts with their customers. Although each RAI operating subsidiary enters into separate contracts with its customers, the contracts used by RAI's operating subsidiaries are similarly constructed. Per the terms of these contracts, upon acceptance of a customer order, RAI's operating subsidiary has a performance obligation to ship the products ordered in the quantities accepted at the list price in the contract. RAI has determined that a customer obtains control of the product when it is shipped and ownership of such product and risk of loss transfers to the customer at that time. Accordingly, the performance obligation of RAI's operating subsidiary is satisfied upon shipment and revenue is recognized at that point in time. All performance obligations are satisfied within one year and, therefore, costs to obtain contracts are expensed as incurred and unsatisfied performance obligations are not disclosed.

Net sales reported on the accompanying consolidated statements of income primarily consist of sales to customers less cash discounts for payments made within terms, payments to customers under certain sales incentive agreements and other promotional allowance programs, coupons and customer product returns. RAI's reported sales are also net of federal excise taxes that are passed through to the appropriate governmental authority. Freight costs incurred to ship the product to the customer are accounted for as fulfillment costs and expensed in cost of products sold at the time of shipment.

RAI disaggregates net revenues of its most significant operating subsidiaries as follows:

	<u>2020</u>	<u>2019</u>
Net sales:		
RJR Tobacco	\$ 11,504	\$ 10,575
SFNTC	1,419	1,236
American Snuff Co.	1,307	1,211
All Other	<u>506</u>	<u>278</u>
Consolidated net sales	<u>\$ 14,736</u>	<u>\$ 13,300</u>

RAI's operating subsidiaries promote their products with customer sales incentives and trade promotional allowance programs that require variable payments to their customers. These incentives and programs include discounts, coupons and volume-based incentives, among others, and are recorded as a reduction of revenues. Payments under these incentive and promotion programs are made primarily to wholesalers and retailers and are variable consideration under ASC 606. The accrual of these incentive payments requires estimates and judgment by the operating subsidiaries including estimated wholesale to retail sales and historical acceptance rates. Estimates are accrued at the time of shipment and are included in other accrued liabilities on RAI's consolidated balance sheets. The actual payments made under these programs may differ from RAI's estimates and such differences are recorded in the period when the actual payments are made. These differences, if any, have not had a material impact on RAI's reported income, financial condition or cash flows.

Certain tobacco products sold by RAI's operating subsidiaries have freshness dates printed on the product packaging. Smokeless tobacco products sold by American Snuff Co., CAMEL Snus products sold by RJR Tobacco, and e-cigarettes and other vapor products sold by RJRV have limited shelf lives. These operating subsidiaries have policies to accept authorized product returns from their customers for products that have passed the freshness date. RAI records an estimate for sales returns, which are based principally on historical volume and return rates, as a reduction to revenues. Actual sales returns will differ from estimated sales returns. These differences between actual and estimated sales returns are recorded in the period in which the actual amounts become known. These differences, if any, have not had a material impact on RAI's reported income, financial condition or cash flows. All returned goods are destroyed upon return and not returned to inventory. Consequently, no asset for the right to recover product from customers upon return is recognized.

RAI's operating subsidiaries generally receive payment either in advance of the shipment of product to the customer or on the date of expected delivery of product to the customer. When payment from the customer is received prior to the shipment of the product, recognition of revenue is deferred until the product is shipped and the RAI operating subsidiary's performance obligation is satisfied, generally within two days of receiving the payment. Deferred revenue for advance payments included in other current liabilities on the accompanying consolidated balance sheets at December 31, 2020 and 2019 was \$10 million and \$21 million, respectively. For product shipments where payment is not received in advance, amounts due from the customer are included in accounts receivable on the consolidated balance sheets. Accounts receivable from product sales are generally not material resulting in an insignificant amount of bad debt expense annually, therefore RAI has not provided an estimate for an allowance for bad debts.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

Note 11 — Related Party Transactions

The following is a summary of balances and transactions with such BAT affiliates as of and for the years ended December 31:

	<u>2020</u>		<u>2019</u>
Current Balances:			
Accounts receivable, related party	\$ 9	\$	19
Amounts due from related party – cash management agreements:			
In-house cash agreements	2,922		3,019
Note and interest payable to related party	4,613		2,500
Due to related party	50		91
Deferred revenue, related party	—		1
	<u>2020</u>		<u>2019</u>
Significant Transactions:			
Net sales	\$ 41	\$	85
Leaf purchases	104		148
Allocation of technical, advisory, information technology and integration fee	67		48
Interest income	3		41
Interest expense	146		71
Financing reimbursements	322		69

Net sales to BAT affiliates primarily relate to RJR Tobacco's sales of tobacco leaf and processed tobacco under various agreements. Net sales to BAT affiliates represented less than 1% of RAI's total net sales in 2020 and 2019.

RJR Tobacco recorded deferred sales revenue relating to leaf sold to BAT affiliates that had not been delivered as of December 31, 2019, given that RJR Tobacco has a legal right to bill the BAT affiliates. Leaf sales revenue to BAT affiliates is recognized when the product is shipped to the customer.

RJR Tobacco purchases cigarettes at prices not to exceed manufacturing costs plus 10% from BAT affiliates. After the BAT Merger in July 2017, RJR Tobacco and BAT GLP Ltd., a BAT affiliate, signed a Leaf Management and Supply Agreement, in which RJR Tobacco purchases offshore leaf from BAT GLP Ltd. at cost plus approximately 11%. The 11% markup applies to the leaf base price only and excludes freight, storage, insurance, admin, etc. included in the transfer price. The Leaf Management and Supply Agreement governs leaf planning, purchases, logistics, transfer pricing and payment terms. A separate Service Level Agreement between RJR Tobacco and BAT GLP Ltd. covers planning and execution details.

RAI participates in an income tax arrangement with its parent, BHI, and the net amount owed to BHI was \$13 million at December 31, 2019. There were no income tax amounts owed to BHI at December 31, 2020.

A subsidiary of RAI entered into a one-year €300 million uncommitted revolving credit facility on July 26, 2017 with B.A.T. International Finance p.l.c., referred to as BATIF, an indirect, wholly owned subsidiary of BAT, as borrower. The credit facility agreement was subsequently extended to July 25, 2019. Interest was based on the LIBOR, plus a margin and was paid at maturity. A €263 million draw down against the credit facility was made on July 26, 2017 by BATIF. On October 31, 2018, an additional €1.9 million draw was made by BATIF. On June 13, 2019, BATIF repaid the outstanding amount and the credit facility was terminated.

RAI and certain of its subsidiaries have in-house cash, referred to as IHC, agreements with B.A.T. Capital Corporation, referred to as BATCAP. Under the terms of these IHC agreements, positive daily cash balances for RAI and its subsidiaries are automatically swept to BATCAP. Cash swept to BATCAP is payable to each entity on demand and bears interest at a rate of 0.275% under the overnight LIBOR. If RAI or one of its subsidiaries is in an overdraft position, advances may not exceed the overdraft limits set forth in the IHC agreements. Overdraft advances bear interest at a rate of 0.75% over the overnight LIBOR. Among others, RAI has an overdraft facility of \$900 million and RJR Tobacco has an overdraft facility of \$700 million at December 31, 2020. The IHC will remain in effect until cancelled and has no maturity date specified. The net amount owed to RAI and its subsidiaries was \$2,922 million and \$3,019 million at December 31, 2020 and 2019, respectively.

On September 28, 2018, RAI entered into a one-year term loan agreement with BATCAP for a principal amount of \$1.2 billion, referred to as RAI Term Loan. The RAI Term Loan bore a floating interest rate based on the three-month U.S. dollar LIBOR plus a margin of 1.14%, per annum. Interest was payable on the term loan quarterly. On May 31, 2019, the term was extended to May 1, 2020

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS – continued

and an additional \$1.2 billion was borrowed under the RAI Term Loan. At the same time, RJR Tobacco entered into a one-year term loan agreement with BATCAP for a principal amount of \$82 million due on May 1, 2020, referred to as RJRT Term Loan. All terms are the same as the RAI Term Loan. The amount outstanding, including interest, under these various term loans was \$2,496 million at December 31, 2019.

On December 20, 2019, RAI entered into a \$1.25 billion long-term installment term loan with BATCAP, effective January 2, 2020 with a maturity date of September 2049, referred to as the RAI Installment Note. The installment term loan bears an interest rate of 3.582% and is payable semi-annually. This interest rate may be adjusted to reflect changes to BATCAP's changes to its weighted average cost of borrowing as agreed. RAI had no amounts outstanding under the RAI Installment Note as of December 31, 2019.

On January 2, 2020, using the proceeds of the RAI Installment Note, RAI repaid \$1.25 billion of the \$2.4 billion outstanding under the RAI Term Loan.

In May 2020, BATCAP advanced an additional \$1.4 billion to RAI under the RAI Installment Note and the maturities of the RAI Term Loan and RJRT Term Loan were extended to June 2022. The RJR Term Loan was increased from \$82 million to \$190.5 million. In addition, in May 2020, the interest rate on the RAI Term Loan and RJRT Term Loan was amended to the three-month U.S. dollar LIBOR plus a margin of 5.86% with interest payable quarterly.

In September 2020, RJRT entered into an installment term loan with BATCAP, referred to as the RJRT Installment Note, under which BATCAP advanced \$242.8 million to RJRT. As of September 2020, the RAI Installment Note and the RJRT Installment Note each were amended to extend the maturity date to September 2050 and change the fixed interest rate at 3.6% payable semi-annually. In September 2020, RAI repaid the remaining \$1.15 billion on the RAI Term Loan and RJRT repaid the remaining \$190.5 million on the RJRT Term Loan and no amounts were outstanding on the various term loans at December 31, 2020.

The amounts outstanding for the installment loans was \$4.613 billion at December 31, 2020. As of December 31, 2020, the maturities for the RAI Installment Note and the RJRT Installment Note were as follows:

<u>Year</u>	<u>RAI Installment Note</u>	<u>RJRT Installment Note</u>	<u>Total</u>
2021	\$ 151	\$ —	\$ 151
2022	233	13	246
2023	152	9	161
2024	604	35	639
2025	101	6	107
2026 and thereafter	3,129	180	3,309
	<u>\$ 4,370</u>	<u>\$ 243</u>	<u>\$ 4,613</u>

In addition to the above, on December 20, 2019, RAI entered into a reimbursement agreement with BATCAP related to BATCAP's fees and expenses it incurs in connection with capital market debt issued by BATCAP for financing for the benefit of RAI. RJR Tobacco entered into a substantially similar reimbursement agreement with BATCAP in November 2020 for its proportionate share of fees and expenses on financing benefitting RJR Tobacco. In 2020 and 2019, the \$322 million and \$69 million reimbursements, respectively, include guarantee fees, derivative transactions and early debt redemption fees.

On July 19, 2019, VapeWild entered into a \$5.5 million three-year amortizing term loan agreement with BATCAP. This term loan is drawable in one or more tranches and bears a floating interest rate based on the three-month U.S. dollar LIBOR plus a margin of 2.12%, per annum. An initial draw of \$2.5 million was made on July 24, 2019. The total amount outstanding at December 31, 2019 was \$3.6 million and as of December 31, 2020, is fully reserved due to the bankruptcy filing of VapeWild.

The allocation of technical, advisory, information technology and integration fees represent an allocation of certain BAT subsidiaries' centralized services per intercompany agreements.

RAI Services Company provides certain accounting and tax services for certain BAT U.S. affiliates under the terms of a services agreement with Louisville Corporate Services, Inc.