

ALTRIA GROUP, INC.  
Form 10-Q  
October 28, 2010  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended September 30, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-8940

Altria Group, Inc.

(Exact name of registrant as specified in its charter)

Virginia  
(State or other jurisdiction of  
incorporation or organization)

13-3260245  
(I.R.S. Employer  
Identification No.)

6601 West Broad Street, Richmond, Virginia  
(Address of principal executive offices)

23230  
(Zip Code)

Registrant's telephone number, including area code (804) 274-2200

Former name, former address and former fiscal year, if changed since last report

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

At October 20, 2010, there were 2,087,827,398 shares outstanding of the registrant's common stock, par value \$0.33 1/3 per share.

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ALTRIA GROUP, INC.

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements.

Altria Group, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in millions of dollars)

(Unaudited)

	September 30, 2010	December 31, 2009
<b>ASSETS</b>		
<b>Consumer products</b>		
Cash and cash equivalents	\$ 1,700	\$ 1,871
Receivables (less allowances of \$2 in 2010 and \$3 in 2009)	82	96
<b>Inventories:</b>		
Leaf tobacco	834	993
Other raw materials	169	157
Work in process	225	293
Finished product	390	367
	1,618	1,810
Deferred income taxes	1,264	1,336
Other current assets	842	660
<b>Total current assets</b>	<b>5,506</b>	<b>5,773</b>
Property, plant and equipment, at cost	5,177	6,144
Less accumulated depreciation	2,755	3,460
	2,422	2,684
Goodwill	5,174	5,174
Other intangible assets, net	12,122	12,138
Investment in SABMiller	5,374	4,980
Other assets	1,837	1,097
<b>Total consumer products assets</b>	<b>32,435</b>	<b>31,846</b>
<b>Financial services</b>		
Finance assets, net	4,647	4,803
Other assets	28	28
<b>Total financial services assets</b>	<b>4,675</b>	<b>4,831</b>

TOTAL ASSETS

\$ 37,110

\$ 36,677

See notes to condensed consolidated financial statements.

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## Altria Group, Inc. and Subsidiaries

## Condensed Consolidated Balance Sheets (Continued)

(in millions of dollars, except share and per share data)

(Unaudited)

	September 30, 2010	December 31, 2009
<b>LIABILITIES</b>		
<b>Consumer products</b>		
Current portion of long-term debt	\$ -	\$ 775
Accounts payable	320	494
Accrued liabilities:		
Marketing	484	467
Taxes, except income taxes	132	318
Employment costs	180	239
Settlement charges	3,226	3,635
Other	1,211	1,354
Dividends payable	796	710
Total current liabilities	6,349	7,992
Long-term debt	12,194	11,185
Deferred income taxes	4,779	4,383
Accrued pension costs	1,143	1,157
Accrued postretirement health care costs	2,373	2,326
Other liabilities	960	1,248
Total consumer products liabilities	27,798	28,291
<b>Financial services</b>		
Deferred income taxes	3,992	4,180
Other liabilities	135	102
Total financial services liabilities	4,127	4,282
Total liabilities	31,925	32,573
Contingencies (Note 12)		
Redeemable noncontrolling interest	33	32
<b>STOCKHOLDERS EQUITY</b>		
Common stock, par value \$0.33 1/3 per share (2,805,961,317 shares issued)	935	935
Additional paid-in capital	5,760	5,997
Earnings reinvested in the business	23,334	22,599
Accumulated other comprehensive losses	(1,369)	(1,561)
Cost of repurchased stock (718,442,416 shares in 2010 and 729,932,673 shares in 2009)	(23,510)	(23,901)
Total stockholders equity attributable to Altria Group, Inc.	5,150	4,069
Noncontrolling interests	2	3

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Total stockholders' equity	5,152	4,072
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 37,110</b>	<b>\$ 36,677</b>

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Earnings  
(in millions of dollars, except per share data)  
(Unaudited)

	For the Nine Months Ended September 30,	
	2010	2009
Net revenues	\$ 18,436	\$ 17,542
Cost of sales	5,819	5,941
Excise taxes on products	5,683	4,818
Gross profit	6,934	6,783
Marketing, administration and research costs	1,983	2,118
Reduction of Kraft and PMI tax-related receivables	169	88
Asset impairment and exit costs	31	299
Amortization of intangibles	16	16
Operating income	4,735	4,262
Interest and other debt expense, net	856	902
Earnings from equity investment in SABMiller	(437)	(442)
Earnings before income taxes	4,316	3,802
Provision for income taxes	1,329	1,320
Net earnings	2,987	2,482
Net earnings attributable to noncontrolling interests	(1)	(1)
Net earnings attributable to Altria Group, Inc.	\$ 2,986	\$ 2,481
<b>Per share data:</b>		
Basic earnings per share attributable to Altria Group, Inc.	\$ 1.43	\$ 1.20
Diluted earnings per share attributable to Altria Group, Inc.	\$ 1.43	\$ 1.19
Dividends declared	\$ 1.08	\$ 0.98

See notes to condensed consolidated financial statements.



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Altria Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Earnings  
(in millions of dollars, except per share data)  
(Unaudited)

	For the Three Months Ended September 30,	
	2010	2009
Net revenues	\$ 6,402	\$ 6,300
Cost of sales	1,985	2,033
Excise taxes on products	1,941	1,982
Gross profit	2,476	2,285
Marketing, administration and research costs	691	663
Reduction of Kraft tax-related receivable		88
Exit costs	3	133
Amortization of intangibles	6	7
Operating income	1,776	1,394
Interest and other debt expense, net	279	279
Earnings from equity investment in SABMiller	(186)	(119)
Earnings before income taxes	1,683	1,234
Provision for income taxes	552	352
Net earnings attributable to Altria Group, Inc.	\$ 1,131	\$ 882
Per share data:		
Basic earnings per share attributable to Altria Group, Inc.	\$ 0.54	\$ 0.43
Diluted earnings per share attributable to Altria Group, Inc.	\$ 0.54	\$ 0.42
Dividends declared	\$ 0.38	\$ 0.34

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Stockholders' Equity

for the Year Ended December 31, 2009 and

the Nine Months Ended September 30, 2010

(in millions of dollars, except per share data)

(Unaudited)

	Attributable to Altria Group, Inc.							Total
	Earnings Accumulated							
	Additional	Reinvested	Other	Cost of	Non-	Total		
	Common	Paid-in	in the	Comprehensive	Repurchased	Comprehensive	controlling	Stockholders
	<u>Stock</u>	<u>Capital</u>	<u>Business</u>	<u>Losses</u>	<u>Stock</u>	<u>Earnings</u>	<u>Interests</u>	<u>Equity</u>
Balances, December 31, 2008	\$ 935	\$ 6,350	\$ 22,131	\$ (2,181)	\$ (24,407)	\$ -	\$ -	\$ 2,828
Comprehensive earnings:								
Net earnings			3,206			3,206	1	3,207
Other comprehensive earnings, net of income taxes:								
Currency translation adjustments				3		3		3
Change in net loss and prior service cost				375		375		375
Ownership share of SABMiller other comprehensive earnings				242		242		242
Total other comprehensive earnings						620	-	620
Total comprehensive earnings (1)						3,826	1	3,827
Exercise of stock options and other stock award activity		(353)			506			153
Cash dividends declared (\$1.32 per share)			(2,738)					(2,738)
Other							2	2
Balances, December 31, 2009	935	5,997	22,599	(1,561)	(23,901)		3	4,072
Comprehensive earnings:								
Net earnings (2)			2,986			2,986		2,986
Other comprehensive earnings, net of income taxes:								
Currency translation adjustments				1		1		1
Change in net loss and prior service cost				77		77		77
Ownership share of SABMiller other comprehensive losses				114		114		114

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Total other comprehensive earnings						192	-	192
<b>Total comprehensive earnings (1)</b>						<b>3,178</b>	<b>-</b>	<b>3,178</b>
Exercise of stock options and other stock award activity	(237)					391		154
Cash dividends declared (\$1.08 per share)		(2,251)						(2,251)
Other							(1)	(1)
<b>Balances, September 30, 2010</b>	<b>\$ 935</b>	<b>\$ 5,760</b>	<b>\$ 23,334</b>	<b>\$ (1,369)</b>	<b>\$ (23,510)</b>	<b>\$ 2</b>	<b>\$ 5,152</b>	

(1) Total comprehensive earnings were \$1,338 million for the quarter ended September 30, 2010, all of which were comprehensive earnings attributable to Altria Group, Inc. Total comprehensive earnings were \$1,063 million for the quarter ended September 30, 2009, all of which were comprehensive earnings attributable to Altria Group, Inc. Total comprehensive earnings were \$2,829 million for the nine months ended September 30, 2009, which consisted of total comprehensive earnings attributable to Altria Group, Inc. and noncontrolling interests of \$2,828 million and \$1 million, respectively.

(2) Net earnings attributable to noncontrolling interests exclude \$1 million due to the redeemable noncontrolling interest related to *Stag s Leap Wine Cellars*, which is reported in the mezzanine equity section in the condensed consolidated balance sheet at September 30, 2010. See Note 12.

See notes to condensed consolidated financial statements.

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Altria Group, Inc. and Subsidiaries  
Condensed Consolidated Statements of Cash Flows  
(in millions of dollars)  
(Unaudited)

	For the Nine Months Ended September 30,	
	2010	2009
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>		
Net earnings - Consumer products	\$ 2,941	\$ 2,325
- Financial services	46	157
Net earnings	2,987	2,482
Adjustments to reconcile net earnings to operating cash flows:		
<b>Consumer products</b>		
Depreciation and amortization	208	218
Deferred income tax provision	197	486
Earnings from equity investment in SABMiller	(437)	(442)
Dividends from SABMiller	219	181
Asset impairment and exit costs, net of cash paid	(166)	1
IRS payment related to LILO and SILO transactions	(945)	
Cash effects of changes, net of the effects from acquired companies:		
Receivables, net	19	1
Inventories	192	99
Accounts payable	6	(40)
Income taxes	5	16
Accrued liabilities and other current assets	(181)	(16)
Accrued settlement charges	(409)	(714)
Pension plan contributions	(23)	(46)
Pension provisions and postretirement, net	151	65
Other	17	114
<b>Financial services</b>		
Deferred income tax benefit	(188)	(502)
Other	70	104
Net cash provided by operating activities	1,722	2,007

See notes to condensed consolidated financial statements.

Continued



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Altria Group, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows (Continued)

(in millions of dollars)

(Unaudited)

	For the Nine Months Ended September 30,	
	2010	2009
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>		
<b>Consumer products</b>		
Capital expenditures	\$ (116)	\$ (172)
Acquisition of UST, net of acquired cash		(10,244)
Other	80	(47)
<b>Financial services</b>		
Investments in finance assets		(9)
Proceeds from finance assets	119	767
Net cash provided by (used in) investing activities	83	(9,705)
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>		
<b>Consumer products</b>		
Net issuance of short-term borrowings		(205)
Long-term debt issued	1,007	4,221
Long-term debt repaid	(775)	(375)
<b>Financial services</b>		
Long-term debt repaid		(500)
Dividends paid	(2,165)	(1,987)
Issuance of common stock	89	57
Financing fees and debt issuance costs	(6)	(132)
Other	(126)	(267)
Net cash (used in) provided by financing activities	(1,976)	812
Cash and cash equivalents:		
Decrease	(171)	(6,886)
Balance at beginning of period	1,871	7,916
Balance at end of period	\$ 1,700	\$ 1,030

See notes to condensed consolidated financial statements.



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Altria Group, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(Unaudited)

**Note 1. Background and Basis of Presentation:**

*Background*

At September 30, 2010, Altria Group, Inc.'s wholly-owned subsidiaries included Philip Morris USA Inc. ( PM USA ), which is engaged in the manufacture and sale of cigarettes and certain smokeless products in the United States; UST LLC ( UST ), which through its subsidiaries is engaged in the manufacture and sale of smokeless products and wine; and John Middleton Co. ( Middleton ), which is engaged in the manufacture and sale of machine-made large cigars and pipe tobacco. Philip Morris Capital Corporation ( PMCC ), another wholly-owned subsidiary of Altria Group, Inc., maintains a portfolio of leveraged and direct finance leases. In addition, Altria Group, Inc. held a 27.1% economic and voting interest in SABMiller plc ( SABMiller ) at September 30, 2010. Altria Group, Inc.'s access to the operating cash flows of its subsidiaries consists of cash received from the payment of dividends and distributions, and the payment of interest on intercompany loans by its subsidiaries.

As discussed in Note 2. *UST Acquisition*, on January 6, 2009, Altria Group, Inc. acquired all of the outstanding common stock of UST, whose direct and indirect wholly-owned subsidiaries include U.S. Smokeless Tobacco Company LLC ( USSTC ) and Ste. Michelle Wine Estates Ltd. ( Ste. Michelle ). As a result of the acquisition, UST has become an indirect wholly-owned subsidiary of Altria Group, Inc.

On February 24, 2010, Altria Group, Inc.'s Board of Directors approved a 2.9% increase in the quarterly dividend to \$0.35 per common share from \$0.34 per common share. On August 27, 2010, Altria Group, Inc.'s Board of Directors approved an additional 8.6% increase in the quarterly dividend to \$0.38 per common share, resulting in an overall quarterly dividend rate increase of 11.8% since the beginning of 2010. The current annualized dividend rate is \$1.52 per Altria Group, Inc. common share. Future dividend payments remain subject to the discretion of Altria Group, Inc.'s Board of Directors.

*Basis of Presentation*

The interim condensed consolidated financial statements of Altria Group, Inc. are unaudited. It is the opinion of Altria Group, Inc.'s management that all adjustments necessary for a fair statement of the interim results presented have been reflected therein. All such adjustments were of a normal recurring nature. Net revenues and net earnings for any interim period are not necessarily indicative of results that may be expected for the entire year.

These statements should be read in conjunction with the consolidated financial statements and related notes, which appear in Altria Group, Inc.'s Annual Report to Shareholders and which are incorporated by reference into Altria Group, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2009.

Balance sheet accounts are segregated by two broad types of businesses. Consumer products assets and liabilities are classified as either current or non-current, whereas financial services assets and liabilities are unclassified, in accordance with respective industry practices.

The 2009 reduction of a Kraft Foods Inc. ( Kraft ) tax-related receivable has been reclassified to conform with the current year's presentation.



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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

**Note 2. UST Acquisition:**

On January 6, 2009, Altria Group, Inc. acquired all of the outstanding common stock of UST. The transaction was valued at approximately \$11.7 billion, which represented a purchase price of \$10.4 billion and approximately \$1.3 billion of UST debt, which together with acquisition-related costs and payments of approximately \$0.6 billion (consisting primarily of financing fees, the funding of UST's non-qualified pension plans, investment banking fees and the early retirement of UST's revolving credit facility), represented a total cash outlay of approximately \$11 billion. Additionally, costs incurred to effect the acquisition, as well as costs to restructure UST, are being recognized as expenses in the periods in which the costs are incurred. For the nine and three months ended September 30, 2010 and 2009, Altria Group, Inc. incurred acquisition-related charges, as well as restructuring and integration costs consisting of the following:

	For the Nine Months Ended		For the Three Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
	(in millions)			
Exit costs	\$ 2	\$ 149	\$ -	\$ 24
Integration costs	15	36	3	6
Inventory adjustments	15	29	5	6
Financing fees		89		1
Transaction costs		60		
<b>Total</b>	<b>\$ 32</b>	<b>\$ 363</b>	<b>\$ 8</b>	<b>\$ 37</b>

Total acquisition-related charges, as well as restructuring and integration costs incurred since the September 8, 2008 announcement of the acquisition, were \$528 million as of September 30, 2010. During the remainder of 2010, Altria Group, Inc. expects to incur additional pre-tax charges and costs of approximately \$15 million related to the acquisition of UST.

UST's financial position and results of operations have been consolidated with Altria Group, Inc. as of January 6, 2009. Pro forma results of Altria Group, Inc., for the nine months ended September 30, 2009 assuming the acquisition had occurred on January 1, 2009, would not have been materially different from the actual results reported for the nine months ended September 30, 2009.

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

**Note 3. Asset Impairment, Exit, Implementation and Integration Costs:**

Pre-tax asset impairment, exit, implementation and integration costs for the nine and three months ended September 30, 2010 and 2009 consisted of the following:

	For the Nine Months Ended September 30, 2010			<u>Total</u>
	and Exit Costs	<u>Costs</u>	<u>Costs</u>	
	(in millions)			
Cigarettes	\$ 28	\$ 70	\$ -	\$ 98
Smokeless products	2		13	15
Cigars			1	1
Wine			2	2
General corporate	1			1
<b>Total</b>	<b>\$ 31</b>	<b>\$ 70</b>	<b>\$ 16</b>	<b>\$ 117</b>

	For the Nine Months Ended September 30, 2009			<u>Total</u>
	<u>Exit Costs</u>	<u>Costs</u>	<u>Costs</u>	
	(in millions)			
Cigarettes	\$ 86	\$ 94	\$ -	\$ 180
Smokeless products	146		33	179
Cigars			7	7
Wine	3		3	6
Financial services	3			3
General corporate	61			61
<b>Total</b>	<b>\$ 299</b>	<b>\$ 94</b>	<b>\$ 43</b>	<b>\$ 436</b>

	For the Three Months Ended September 30, 2010			<u>Total</u>
	<u>Exit Costs</u>	<u>Costs</u>	<u>Costs</u>	
	(in millions)			
Cigarettes	\$ 3	\$ 21	\$ -	\$ 24
Smokeless products			2	2
Wine			1	1

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Total \$ 3 \$ 21 \$ 3 \$ 27

For the Three Months Ended September 30, 2009  
Implementation Integration

	<u>Exit Costs</u>	<u>Costs</u>	<u>Costs</u>	<u>Total</u>
		(in millions)		
Cigarettes	\$ 52	\$ 44	\$ -	\$ 96
Smokeless products	23		5	28
Wine	1		1	2
Financial services	3			3
General corporate	54			54
Total	\$ 133	\$ 44	\$ 6	\$ 183

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

The movement in the severance liability and details of asset impairment and exit costs for Altria Group, Inc. for the nine months ended September 30, 2010 was as follows:

	Severance	Other	Total
	(in millions)		
Severance liability balance, December 31, 2009	\$ 228	\$ -	\$ 228
Charges	2	29	31
Cash spent	(169)	(29)	(198)
 Severance liability balance, September 30, 2010	 \$ 61	 \$ -	 \$ 61

The pre-tax asset impairment, exit, implementation and integration costs shown above are primarily a result of the programs discussed below.

*Integration and Restructuring Program:*

Altria Group, Inc. has largely completed a restructuring program that commenced in December 2008, and was expanded in August 2009. Pursuant to this program, Altria Group, Inc. restructured its corporate, manufacturing, and sales and marketing services functions in connection with the integration of UST into its operations and its focus on optimizing company-wide cost structures in light of ongoing declines in U.S. cigarette volumes.

As a result of this restructuring program, pre-tax exit and integration costs for the nine and three months ended September 30, 2010 and 2009 consisted of the following:

	For the Nine Months Ended September 30, 2010			2009		
	Exit Costs	Integration Costs	Total	Exit Costs	Integration Costs	Total
	(in millions)					
Cigarettes	\$ -	\$ -	\$ -	\$ 17	\$ -	\$ 17
Smokeless products	2	13	15	146	33	179
Wine		2	2	3	3	6
Financial services				3		3
General corporate	1		1	50		50
 Total	 \$ 3	 \$ 15	 \$ 18	 \$ 219	 \$ 36	 \$ 255

For the Three Months Ended September 30, 2010					
Exit Costs	Integration	Total	Exit Costs	Integration	Total
2009					

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	Costs				Integration Costs	
	(in millions)					
Cigarettes	\$ -	\$ -	\$ -	\$ 15	\$ -	\$ 15
Smokeless products		2	2	23	5	28
Wine		1	1	1	1	2
Financial services				3		3
General corporate				44		44
Total	\$ -	\$ 3	\$ 3	\$ 86	\$ 6	\$ 92

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

These charges are primarily related to employee separation costs, lease exit costs, relocation of employees and other costs related to the integration of UST operations. Substantially all of these charges will result in cash expenditures. The pre-tax integration costs were included in marketing, administration and research costs on Altria Group, Inc.'s condensed consolidated statements of earnings for the nine and three months ended September 30, 2010 and 2009. Total pre-tax charges incurred since the inception of the program through September 30, 2010 were \$472 million. Pre-tax charges of approximately \$10 million are expected for the remainder of the program, all of which are expected to be incurred in 2010. Cash payments related to the program of \$98 million and \$24 million were made during the nine and three months ended September 30, 2010, respectively, for total cash payments of \$319 million since inception.

*Manufacturing Optimization Program:*

PM USA ceased production at its Cabarrus, North Carolina manufacturing facility and completed the consolidation of its cigarette manufacturing capacity into its Richmond, Virginia facility on July 29, 2009. PM USA took this action to address ongoing cigarette volume declines including the impact of the federal excise tax ( FET ) increase enacted in early 2009. PM USA expects to complete the de-commissioning of the Cabarrus facility during 2010.

In October 2010, PM USA entered into an agreement for the sale of the Cabarrus facility and land. The sale is contingent on the completion of due diligence by both parties and other customary terms and conditions. Closing of the sale is expected to occur in the fourth quarter of 2010. The sale will not have a material impact on the financial results of Altria Group, Inc.

As a result of this program, which commenced in 2007, PM USA expects to incur total pre-tax charges of approximately \$800 million, which consist of employee separation costs of \$352 million, accelerated depreciation of \$283 million and other charges of \$165 million, primarily related to the relocation of employees and equipment, net of estimated gains on sales of land and buildings. Total pre-tax charges incurred for the program through September 30, 2010 of \$823 million, which are reflected in the cigarettes segment, do not reflect estimated gains on future sales of land and buildings. Approximately \$400 million of the total pre-tax charges have resulted, and in the future are expected to result, in net cash expenditures.

PM USA recorded pre-tax charges for this program as follows:

	For the Nine Months Ended		For the Three Months Ended	
	September 30,		September 30,	
	2010	2009	2010	2009
	(in millions)			
Asset impairment and exit costs	\$ 28	\$ 69	\$ 3	\$ 37
Implementation costs	70	94	21	44
<b>Total</b>	<b>\$ 98</b>	<b>\$ 163</b>	<b>\$ 24</b>	<b>\$ 81</b>

Pre-tax implementation costs related to this program were primarily related to accelerated depreciation and were included in cost of sales in the condensed consolidated statements of earnings for the nine and three months ended September 30, 2010 and 2009, respectively.

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Pre-tax charges of approximately \$10 million are expected during the remainder of 2010 for the program. Cash payments related to the program of \$110 million and \$27 million were made during the nine and

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three months ended September 30, 2010, respectively, for total cash payments of \$416 million since inception, which do not reflect estimated proceeds on future sales of land and buildings.

**Note 4. Benefit Plans:**

Subsidiaries of Altria Group, Inc. sponsor noncontributory defined benefit pension plans covering substantially all employees of Altria Group, Inc. In certain subsidiaries, employees hired on or after a date specific to their employee group instead are eligible to participate in an enhanced defined contribution plan. This transition for new hires occurred from October 1, 2006 to January 1, 2008. In addition, effective January 1, 2010, certain employees of UST and Middleton who were participants in noncontributory defined benefit pension plans ceased to earn additional benefit service under those plans and became eligible to participate in an enhanced defined contribution plan. Altria Group, Inc. and its subsidiaries also provide health care and other benefits to the majority of retired employees.

*Pension Plans***Components of Net Periodic Benefit Cost**

Net periodic pension cost consisted of the following:

	For the Nine Months Ended		For the Three Months Ended	
	September 30, 2010	September 30, 2009	September 30, 2010	September 30, 2009
	(in millions)			
Service cost	\$ 59	\$ 74	\$ 17	\$ 24
Interest cost	266	261	88	88
Expected return on plan assets	(315)	(319)	(107)	(107)
Amortization:				
Net loss	94	87	28	32
Prior service cost	10	9	4	3
Termination and curtailment		3		12
Net periodic pension cost	\$ 114	\$ 115	\$ 30	\$ 52

Termination and curtailment for the nine and three months ended September 30, 2009 shown in the table above primarily reflects termination benefits related to Altria Group, Inc.'s restructuring programs, which for the nine months ended September 30, 2009 were partially offset by curtailment gains related to the restructuring of UST's operations subsequent to the acquisition. For more information on Altria Group, Inc.'s restructuring programs, see Note 3. *Asset Impairment, Exit, Implementation and Integration Costs*.

**Employer Contributions**

Altria Group, Inc. makes contributions, to the extent that they are tax deductible, and to pay benefits that relate to plans for salaried employees that cannot be funded under Internal Revenue Service ( IRS ) regulations. Employer contributions of \$23 million were made to Altria Group, Inc.'s pension plans during the nine months ended September 30, 2010. Currently, Altria Group, Inc. anticipates additional employer contributions during the remainder of 2010 of up to \$27 million to its pension plans, based on current tax law. However, these estimates are subject to change as a result of changes in tax and other benefit laws, as well as asset performance significantly above or below the assumed long-term rate of



return on pension assets, or changes in interest rates.

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*Postretirement Benefit Plans*

Net postretirement health care costs consisted of the following:

	For the Nine Months Ended		For the Three Months Ended	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2010</u>	2009	2010	2009
	(in millions)			
Service cost	\$ 22	\$ 28	\$ 5	\$ 8
Interest cost	102	100	31	27
Amortization:				
Net loss	24	26	8	6
Prior service credit	(16)	(6)	(9)	(2)
Termination and curtailment		40		21
<b>Net postretirement health care costs</b>	<b>\$ 132</b>	<b>\$ 188</b>	<b>\$ 35</b>	<b>\$ 60</b>

Termination and curtailment for the nine and three months ended September 30, 2009 shown in the table above primarily reflects termination benefits and curtailment losses related to Altria Group, Inc.'s restructuring programs, including the restructuring of UST's operations subsequent to the acquisition. For further information on Altria Group, Inc.'s restructuring programs, see Note 3. *Asset Impairment, Exit, Implementation and Integration Costs*.

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**Note 5. Goodwill and Other Intangible Assets, net:**

Goodwill and other intangible assets, net, by segment were as follows:

	Goodwill		Other Intangible Assets, net	
	September 30, 2010	December 31, 2009	September 30, 2010	December 31, 2009
	(in millions)		(in millions)	
Cigarettes	\$ -	\$ -	\$ 264	\$ 272
Smokeless products	5,023	5,023	8,843	8,845
Cigars	77	77	2,745	2,750
Wine	74	74	270	271
<b>Total</b>	<b>\$ 5,174</b>	<b>\$ 5,174</b>	<b>\$ 12,122</b>	<b>\$ 12,138</b>

Intangible assets were as follows:

	September 30, 2010		December 31, 2009	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in millions)		(in millions)	
Indefinite-lived intangible assets	\$ 11,701		\$ 11,701	
Definite-lived intangible assets	464	\$ 43	464	\$ 27
<b>Total intangible assets</b>	<b>\$ 12,165</b>	<b>\$ 43</b>	<b>\$ 12,165</b>	<b>\$ 27</b>

Goodwill relates to the January 2009 acquisition of UST and the December 2007 acquisition of Middleton.

Indefinite-lived intangible assets consist substantially of trademarks from the January 2009 acquisition of UST (\$9.1 billion) and the December 2007 acquisition of Middleton (\$2.6 billion). Definite-lived intangible assets consist primarily of customer relationships and certain cigarette trademarks. Pre-tax amortization expense for definite-lived intangible assets during the nine months ended September 30, 2010 and 2009 was \$16 million for each period. Pre-tax amortization expense for definite-lived intangible assets during the three months ended September 30, 2010 and 2009 was \$6 million and \$7 million, respectively. Annual amortization expense for each of the next five years is estimated to be approximately \$20 million, assuming no additional transactions occur that require the amortization of intangible assets.

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**Note 6. Earnings from Equity Investment in SABMiller:**

Pre-tax earnings from Altria Group, Inc.'s equity investment in SABMiller consisted of the following:

	For the Nine Months Ended September 30, 2010		For the Three Months Ended September 30, 2009	
	(in millions)			
Equity earnings	\$ 396	\$ 259	\$ 181	\$ 111
Gains resulting from issuances of common stock by SABMiller	41	183	5	8
	\$ 437	\$ 442	\$ 186	\$ 119

**Note 7. Debt:**

During the nine months ended September 30, 2010, Altria Group, Inc. issued \$1.0 billion (aggregate principal amount) of 4.125% senior unsecured long-term notes due September 11, 2015, which consisted of \$800 million issued on June 11, 2010 and \$200 million issued on August 5, 2010. Interest on each issuance will be paid semiannually, with interest accruing from June 11, 2010. The net proceeds from the issuance of these senior unsecured notes were added to Altria Group, Inc.'s general funds, which may be used to meet working capital requirements, refinance debt or for general corporate purposes.

The notes are Altria Group, Inc.'s senior unsecured obligations and rank equally in right of payment with all of Altria Group, Inc.'s existing and future senior unsecured indebtedness. Upon the occurrence of both (i) a change of control of Altria Group, Inc. and (ii) the notes ceasing to be rated investment grade by each of Moody's Investor Service, Inc., Standard & Poor's Rating Services (Standard and Poor's) and Fitch Ratings Ltd. within a specified time period, Altria Group, Inc. will be required to make an offer to purchase the notes at a price equal to 101% of the aggregate principal amount of such notes, plus accrued and unpaid interest to the date of repurchase as and to the extent set forth in the terms of the notes.

The obligations of Altria Group, Inc. under the notes are fully and unconditionally guaranteed by PM USA (see Note 13. *Condensed Consolidating Financial Information*).

On June 22, 2010, Altria Group, Inc.'s \$775 million 7.125% notes matured and were repaid.

The aggregate fair value, based substantially on readily available quoted market prices, of Altria Group, Inc.'s total debt at September 30, 2010, was \$15.9 billion, as compared with its carrying value of \$12.2 billion. The aggregate fair value, based substantially on readily available quoted market prices, of Altria Group, Inc.'s total debt at December 31, 2009, was \$14.4 billion, as compared with its carrying value of \$12.0 billion.



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**Note 8. Earnings Per Share:**

Basic and diluted earnings per share ( EPS ) were calculated using the following:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Net earnings attributable to Altria Group, Inc.	\$ 2,986	\$ 2,481	\$ 1,131	\$ 882
Less: Distributed and undistributed earnings attributable to unvested restricted and deferred shares	(12)	(9)	(5)	(3)
Earnings for basic EPS	2,974	2,472	1,126	879
Add: Undistributed earnings attributable to unvested restricted and deferred shares	3	2	2	1
Less: Undistributed earnings reallocated to unvested restricted and deferred shares	(3)	(2)	(2)	(1)
Earnings for diluted EPS	\$ 2,974	\$ 2,472	\$ 1,126	\$ 879
Weighted average shares for basic EPS	2,076	2,064	2,078	2,067
Add: Incremental shares from stock options	2	6	2	5
Weighted average shares for diluted EPS	2,078	2,070	2,080	2,072

For the nine and three months ended September 30, 2010 computations, there were no antidilutive stock options. For the nine and three months ended September 30, 2009 computations, 0.9 million and 0.6 million stock options, respectively, were excluded from the calculation of weighted average shares for diluted EPS because their effects were antidilutive.

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**Note 9. Accumulated Other Comprehensive Losses:**

The following table sets forth the changes in each component of accumulated other comprehensive losses, net of income taxes, attributable to Altria Group, Inc.:

	Currency Translation Adjustments	Changes in Net Loss and Prior Service Cost	Ownership of SABMiller's Other Comprehensive Earnings (Losses) (in millions)	Accumulated Other Comprehensive Losses
Balances, December 31, 2008	\$ -	\$ (2,221)	\$ 40	\$ (2,181)
Period Change	3	375	242	620
Balances, December 31, 2009	3	(1,846)	282	(1,561)
Period Change	1	77	114	192
Balances, September 30, 2010	\$ 4	\$ (1,769)	\$ 396	\$ (1,369)

**Note 10. Segment Reporting:**

The products of Altria Group, Inc.'s consumer products subsidiaries include cigarettes manufactured and sold by PM USA, smokeless products manufactured and sold by or on behalf of USSTC and PM USA, machine-made large cigars and pipe tobacco manufactured and sold by Middleton, and wine produced and distributed by Ste. Michelle. Another subsidiary of Altria Group, Inc., PMCC, maintains a portfolio of leveraged and direct finance leases. The products and services of these subsidiaries constitute Altria Group, Inc.'s reportable segments of cigarettes, smokeless products, cigars, wine and financial services.

Altria Group, Inc.'s chief operating decision maker reviews operating companies income to evaluate segment performance and allocate resources. Operating companies income for the segments excludes general corporate expenses and amortization of intangibles. Interest and other debt expense, net (consumer products), and provision for income taxes are centrally managed at the corporate level and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by Altria Group, Inc.'s chief operating decision maker.

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Segment data were as follows:

	For the Nine Months Ended September 30,		For the Three Months Ended September 30,	
	2010	2009	2010	2009
(in millions)				
<b>Net revenues:</b>				
Cigarettes	\$ 16,441	\$ 15,546	\$ 5,729	\$ 5,626
Smokeless products	1,160	1,023	389	352
Cigars	437	386	147	153
Wine	308	271	107	102
Financial services	90	316	30	67
<b>Net revenues</b>	<b>\$ 18,436</b>	<b>\$ 17,542</b>	<b>\$ 6,402</b>	<b>\$ 6,300</b>
<b>Earnings before income taxes:</b>				
<b>Operating companies income:</b>				
Cigarettes	\$ 4,213	\$ 3,902	\$ 1,533	\$ 1,333
Smokeless products	586	302	210	127
Cigars	146	139	43	49
Wine	31	22	12	12
Financial services	87	260	27	57
Amortization of intangibles	(16)	(16)	(6)	(7)
General corporate expenses	(142)	(138)	(43)	(35)
Reduction of Kraft and PMI tax-related receivables	(169)	(88)		(88)
UST acquisition-related transaction costs		(60)		
Corporate exit costs	(1)	(61)		(54)
<b>Operating income</b>	<b>4,735</b>	<b>4,262</b>	<b>1,776</b>	<b>1,394</b>
Interest and other debt expense, net	(856)	(902)	(279)	(279)
Earnings from equity investment in SABMiller	437	442	186	119
<b>Earnings before income taxes</b>	<b>\$ 4,316</b>	<b>\$ 3,802</b>	<b>\$ 1,683</b>	<b>\$ 1,234</b>

See Note 3. *Asset Impairment, Exit, Implementation and Integration Costs* for a breakdown of these costs by segment, which affect the comparability of operating companies income for the segments.

**Note 11. Income Taxes:**

The income tax rate of 30.8% for the nine months ended September 30, 2010 decreased 3.9 percentage points from 34.7% for the nine months ended September 30, 2009. The decrease for the nine months was due primarily to the higher reversal of tax reserves and associated interest in 2010 following the resolution of various tax matters arising out of the 2000-2003 IRS and various state audits, and the expiration of statutes of



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limitations as discussed below, as well as an increase in the domestic manufacturing deduction, effective January 1, 2010. The income tax rate of 32.8% for the three months ended September 30, 2010 increased 4.3 percentage points from 28.5% for the three months ended September 30, 2009. The increase for the three months was due primarily to the reversal of tax reserves and associated interest in 2009 following the resolution of certain Kraft tax matters arising out of the 2000-2003 IRS audit discussed below, partially offset by an increase in the domestic manufacturing deduction, effective January 1, 2010.

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As discussed in Note 12. *Contingencies*, Altria Group, Inc. and the IRS executed a closing agreement during the second quarter of 2010 in connection with the IRS's examination of Altria Group, Inc.'s consolidated federal income tax returns for the years 2000-2003, which resolved various tax matters for Altria Group, Inc. and its subsidiaries, including its former subsidiaries - Kraft and Philip Morris International Inc. (PMI). As a result of the closing agreement, Altria Group, Inc. paid the IRS approximately \$945 million of tax and associated interest on July 20, 2010 with respect to certain PMCC leveraged lease transactions, referred to by the IRS as lease-in/lease-out (LILO) and sale-in/lease-out (SILO) transactions, entered into during the 1996-2003 years. Altria Group, Inc. intends to file a claim for refund of approximately \$945 million. If the IRS disallows the claim, as anticipated, Altria Group, Inc. intends to commence litigation in federal court. The payment of approximately \$945 million is included in other assets on the condensed consolidated balance sheet of Altria Group, Inc. at September 30, 2010. Also, as a result of this closing agreement, in the second quarter of 2010 Altria Group, Inc. recorded a \$47 million income tax benefit primarily attributable to the reversal of tax reserves and associated interest related to Altria Group, Inc. and its current subsidiaries. In addition, in the second quarter of 2010 Altria Group, Inc. recorded an income tax benefit of \$169 million attributable to the reversal of federal income tax reserves and associated interest related to the resolution of certain Kraft and PMI tax matters.

In the third quarter of 2009, the IRS, Kraft, and Altria Group, Inc. executed a closing agreement that resolved certain Kraft tax matters arising out of the 2000-2003 IRS audit of Altria Group, Inc. As a result of this closing agreement, in the third quarter of 2009 Altria Group, Inc. recorded an income tax benefit of \$88 million attributable to the reversal of federal income tax reserves and associated interest related to the resolution of certain Kraft tax matters.

Under the Tax Sharing agreements entered into in connection with the spin-offs between Altria Group, Inc. and its former subsidiaries, Kraft and PMI are responsible for their respective pre-spin-off tax obligations. Altria Group, Inc., however, remains severally liable for Kraft's and PMI's pre-spin-off federal tax obligations pursuant to regulations governing federal consolidated income tax returns. As a result, Altria Group, Inc. continues to include the pre-spin-off federal income tax reserves of Kraft and PMI in its liability for uncertain tax positions, and also includes corresponding receivables from Kraft and PMI in other assets. The tax benefits of \$169 million for the nine months ended September 30, 2010, and \$88 million for the nine and three months ended September 30, 2009, were offset by a reduction to the corresponding receivables from Kraft and PMI, which were recorded as reductions to operating income on Altria Group, Inc.'s condensed consolidated statements of earnings. As a result, there was no impact on Altria Group, Inc.'s net earnings associated with the resolution of the Kraft and PMI tax matters.

Altria Group, Inc. also recorded \$33 million of income tax benefits during the third quarter of 2010, primarily from the reversal of tax reserves and associated interest following the resolution of several state audits and the expiration of statutes of limitations.

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**Note 12. Contingencies:**

Legal proceedings covering a wide range of matters are pending or threatened in various United States and foreign jurisdictions against Altria Group, Inc. and its subsidiaries, including PM USA and UST and its subsidiaries, as well as their respective indemnitees. Various types of claims are raised in these proceedings, including product liability, consumer protection, antitrust, tax, contraband shipments, patent infringement, employment matters, claims for contribution and claims of distributors.

Litigation is subject to uncertainty and it is possible that there could be adverse developments in pending or future cases. An unfavorable outcome or settlement of pending tobacco-related or other litigation could encourage the commencement of additional litigation. Damages claimed in some tobacco-related and other litigation are or can be significant and, in certain cases, range in the billions of dollars. The variability in pleadings in multiple jurisdictions, together with the actual experience of management in litigating claims, demonstrate that the monetary relief that may be specified in a lawsuit bears little relevance to the ultimate outcome. In certain cases, plaintiffs claim that defendants' liability is joint and several. In such cases, Altria Group, Inc. or its subsidiaries may face the risk that one or more co-defendants decline or otherwise fail to participate in the bonding required for an appeal or to pay their proportionate or jury-allocated share of a judgment. As a result, Altria Group, Inc. or its subsidiaries under certain circumstances may have to pay more than their proportionate share of any bonding- or judgment-related amounts.

Although PM USA has historically been able to obtain required bonds or relief from bonding requirements in order to prevent plaintiffs from seeking to collect judgments while adverse verdicts have been appealed, there remains a risk that such relief may not be obtainable in all cases. This risk has been substantially reduced given that 43 states now limit the dollar amount of bonds or require no bond at all. Tobacco litigation plaintiffs, however, have challenged the constitutionality of Florida's bond cap statute in several cases and plaintiffs may challenge other state bond cap statutes. Although we cannot predict the outcome of such challenges, it is possible that the consolidated results of operations, cash flows or financial position of Altria Group, Inc., or one or more of its subsidiaries, could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome of one or more such challenges.

Altria Group, Inc. and its subsidiaries record provisions in the consolidated financial statements for pending litigation when they determine that an unfavorable outcome is probable and the amount of the loss can be reasonably estimated. At the present time, while it is reasonably possible that an unfavorable outcome in a case may occur, except as discussed elsewhere in this Note 12. *Contingencies*: (i) management has concluded that it is not probable that a loss has been incurred in any of the pending tobacco-related cases; (ii) management is unable to estimate the possible loss or range of loss that could result from an unfavorable outcome in any of the pending tobacco-related cases; and (iii) accordingly, management has not provided any amounts in the consolidated financial statements for unfavorable outcomes, if any. Legal defense costs are expensed as incurred.

Altria Group, Inc. and its subsidiaries have achieved substantial success in managing litigation. Nevertheless, litigation is subject to uncertainty and significant challenges remain. It is possible that the consolidated results of operations, cash flows or financial position of Altria Group, Inc., or one or more of its subsidiaries, could be materially affected in a particular fiscal quarter or fiscal year by an unfavorable outcome or settlement of certain pending litigation. Altria Group, Inc. and each of its subsidiaries named as a defendant believe, and each has been so advised by counsel handling the respective cases, that it has valid defenses to the litigation pending against it, as well as valid bases for appeal of adverse verdicts. Each of the companies has defended, and will continue to defend, vigorously against litigation challenges. However, Altria Group, Inc. and its subsidiaries may enter into settlement discussions in particular cases if they believe it is in the best interests of Altria Group, Inc. to do so.

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**Overview of Altria Group, Inc. and/or PM USA Tobacco-Related Litigation***Types and Number of Cases*

Claims related to tobacco products generally fall within the following categories: (i) smoking and health cases alleging personal injury brought on behalf of individual plaintiffs; (ii) smoking and health cases primarily alleging personal injury or seeking court-supervised programs for ongoing medical monitoring and purporting to be brought on behalf of a class of individual plaintiffs, including cases in which the aggregated claims of a number of individual plaintiffs are to be tried in a single proceeding; (iii) health care cost recovery cases brought by governmental (both domestic and foreign) and non-governmental plaintiffs seeking reimbursement for health care expenditures allegedly caused by cigarette smoking and/or disgorgement of profits; (iv) class action suits alleging that the uses of the terms Lights and Ultra Lights constitute deceptive and unfair trade practices, common law fraud, or violations of the Racketeer Influenced and Corrupt Organizations Act ( RICO ); and (v) other tobacco-related litigation described below. Plaintiffs theories of recovery and the defenses raised in pending smoking and health, health care cost recovery and Lights/Ultra Lights cases are discussed below.

The table below lists the number of certain tobacco-related cases pending in the United States against PM USA and, in some instances, Altria Group, Inc. as of October 25, 2010, October 26, 2009 and November 1, 2008.

Type of Case	Number of Cases Pending as of October 25, 2010	Number of Cases Pending as of October 26, 2009	Number of Cases Pending as of November 1, 2008
Individual Smoking and Health Cases (1)	85	93	98
Smoking and Health Class Actions and Aggregated Claims Litigation (2)	9	8	9
Health Care Cost Recovery Actions	3	3	3
Lights/Ultra Lights Class Actions	29	33	17
Tobacco Price Cases	1	2	2

- (1) Does not include 2,593 cases brought by flight attendants seeking compensatory damages for personal injuries allegedly caused by exposure to environmental tobacco smoke ( ETS ). The flight attendants allege that they are members of an ETS smoking and health class action, which was settled in 1997 (*Broin*). The terms of the court-approved settlement in that case allow class members to file individual lawsuits seeking compensatory damages, but prohibit them from seeking punitive damages. Also, does not include approximately 7,707 individual smoking and health cases (3,286 state court cases and 4,421 federal court cases) brought by or on behalf of approximately 9,400 plaintiffs in Florida (4,980 state court plaintiffs and 4,420 federal court plaintiffs) following the decertification of the *Engle* case discussed below. It is possible that some of these cases are duplicates and additional cases have been filed but not yet recorded on the courts dockets.
- (2) Includes as one case the 649 civil actions (of which 370 are actions against PM USA) that are proposed to be tried in a single proceeding in West Virginia (*In re: Tobacco Litigation*). Middleton and USSTC were named as defendants in this action but they, along with other non-cigarette manufacturers, have been severed from this case. The West Virginia Supreme Court of Appeals has ruled that the United States Constitution does not preclude a trial in two phases in this case. Under the current trial plan, issues related to defendants conduct and plaintiffs entitlement to punitive damages would be determined in the first phase. The second phase would consist of individual trials to determine liability, if any, as well as compensatory and



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punitive damages, if any. The trial court has moved the trial from Kanawha County to Ohio County, West Virginia and has scheduled the case for trial in March 2011.

*International Tobacco-Related Cases*

As of October 25, 2010, PM USA is a named defendant in Israel in one Lights class action and one health care cost recovery action. PM USA is a named defendant in three health care cost recovery actions in Canada, two of which also name Altria Group, Inc. as a defendant. PM USA and Altria Group, Inc. are also named defendants in six smoking and health class actions filed in various Canadian provinces. See Guarantees for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.

*Pending and Upcoming Tobacco-Related Trials*

As of October 25, 2010, three individual smoking and health cases against PM USA are set for trial in 2010, all of which are Engle progeny cases. Cases against other companies in the tobacco industry are also scheduled for trial in 2010. Trial dates are subject to change.

*Trial Results*

Since January 1999, verdicts have been returned in 62 smoking and health, Lights/Ultra Lights and health care cost recovery cases in which PM USA was a defendant. Verdicts in favor of PM USA and other defendants were returned in 36 of the 62 cases. These 36 cases were tried in California (5), Florida (16), Mississippi (1), Missouri (2), New Hampshire (1), New Jersey (1), New York (3), Ohio (2), Pennsylvania (1), Rhode Island (1), Tennessee (2), and West Virginia (1). A motion for a new trial was granted in one of the cases in Florida.

Of the 26 cases in which verdicts were returned in favor of plaintiffs, eleven have reached final resolution and one case (*Williams* see below) has reached partial resolution. A verdict against defendants in one health care cost recovery case (*Blue Cross/Blue Shield*) has been reversed and all claims were dismissed with prejudice. In addition, a verdict against defendants in a purported Lights class action in Illinois (*Price*) was reversed and the case was dismissed with prejudice in December 2006. In December 2008, the plaintiff in *Price* filed a motion with the state trial court to vacate the judgment dismissing this case in light of the United States Supreme Court's decision in *Good* (see below for a discussion of developments in *Good* and *Price*). After exhausting all appeals, PM USA has paid judgments in these cases totaling \$116.4 million and interest totaling \$70.6 million.

The chart below lists the verdicts and post-trial developments in the cases that were pending during 2009 or 2010 that have gone to trial since January 1999 in which verdicts were returned in favor of plaintiffs.

Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
August 2010	Florida/ <i>Piendle</i>	<i>Engle</i> progeny	On August 5, 2010, a Palm Beach County jury returned a verdict in favor of plaintiff and against PM USA and R.J. Reynolds. The jury awarded \$4 million in compensatory damages and allocated 27.5% of the fault	PM USA filed post-trial motions on August 16 and August 30, 2010. Plaintiff filed a motion for a new trial on punitive damages on August 27, 2010. On September 8, 2010, the trial court entered final



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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
			to PM USA (an amount of approximately \$1.1 million). The jury also awarded \$90,000 in punitive damages against PM USA.	judgment. The post-trial motions are still pending.
July 2010	Florida/ <i>Tate</i>	<i>Engle</i> progeny	On July 8, 2010, a Broward County jury in the <i>Tate</i> trial returned a verdict in favor of the plaintiff and against PM USA. The jury awarded \$8 million in compensatory damages and allocated 64% of the fault to PM USA (an amount of approximately \$5.1 million). The jury also awarded approximately \$16.3 million in punitive damages against PM USA.	On July 15, 2010, PM USA filed several post-verdict motions, including a motion for a new trial, which motions were denied on July 22, 2010. On August 6, 2010, the trial court entered final judgment. On August 25, 2010, PM USA filed its notice of appeal. On August 31, 2010, PM USA posted a \$5 million appeal bond.
April 2010	Florida/ <i>Putney</i>	<i>Engle</i> progeny	In April 2010, a Broward County jury in the <i>Putney</i> trial returned a verdict in favor of the plaintiff and against PM USA, R.J. Reynolds and Liggett Group. The jury awarded approximately \$15.1 million in compensatory damages and allocated 15% of the fault to PM USA (an amount of approximately \$2.3 million). The jury also awarded \$2.5 million in punitive damages against PM USA.	In May 2010, PM USA and R.J. Reynolds filed several post-trial motions. In May 2010, the trial court denied the defendants motion to set aside the verdict and to enter judgment in accordance with their motion for directed verdict. On August 24, 2010, the trial court denied the parties remaining motions and entered final judgment. On August 20, 2010, PM USA filed its notice of appeal. PM USA has posted a \$1.6 million appeal bond.
March 2010	Florida/ <i>R. Cohen</i>	<i>Engle</i> progeny	In March 2010, a Broward County jury in the <i>R. Cohen</i> trial returned a verdict in favor of the plaintiff and against PM USA and R.J. Reynolds. The jury	In April 2010, PM USA and R.J. Reynolds filed a motion to set aside the verdict and a motion to order a new trial or, in the alternative, for <i>remitter</i>



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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
			awarded \$10 million in compensatory damages and allocated 33 1/3% of the fault to PM USA (an amount of approximately \$3.3 million). The jury also awarded a total of \$20 million in punitive damages, assessing separate \$10 million awards against both defendants.	of the jury's award of compensatory and punitive damages, all of which motions were denied except the defendants' motion seeking a new trial or <i>remittitur</i> based on errors in the second phase of the case. On July 21, 2010, the trial court denied PM USA's remaining motion and entered final judgment. On August 23, 2010, PM USA filed its notice of appeal and, on October 7, 2010, PM USA posted a \$2.5 million appeal bond.
March 2010	Florida/ <i>Douglas</i>	<i>Engle</i> progeny	In March 2010, the jury in the <i>Douglas</i> trial (conducted in Hillsborough County) returned a verdict in favor of the plaintiff and against PM USA, R.J. Reynolds and Liggett Group. The jury awarded \$5 million in compensatory damages. Punitive damages were dismissed prior to trial. The jury allocated 18% of the fault to PM USA, resulting in an award of \$900,000.	In March 2010, PM USA and R.J. Reynolds filed a motion to set aside the verdict and a motion to order a new trial or, in the alternative, for <i>remittitur</i> of the jury's award of compensatory damages. In June 2010, these motions were denied, PM USA filed its notice of appeal and posted a \$900,000 appeal bond. On September 27, 2010, the plaintiff filed with the trial court a challenge to the constitutionality of the Florida bond cap statute.
November 2009	Florida/ <i>Naugle</i>	<i>Engle</i> progeny	In November 2009, a Broward County jury in the <i>Naugle</i> trial returned a verdict in favor of the plaintiff and against PM USA. The jury awarded approximately \$56.6 million in compensatory damages and \$244 million in punitive	In March 2010, the trial court entered final judgment reflecting a reduced award of approximately \$13 million in compensatory damages and \$26 million in punitive damages. In April 2010, PM USA filed

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
August 2009	Florida/ <i>F. Campbell</i>	<i>Engle</i> progeny	damages. The jury allocated 90% of the fault to PM USA.  In August 2009, the jury in the <i>F. Campbell</i> trial (conducted in Escambia County) returned a verdict in favor of the plaintiff and against R.J. Reynolds, PM USA and Liggett Group. The jury awarded \$7.8 million in compensatory damages. There was no punitive damages award. In September 2009, the trial court entered final judgment and awarded the plaintiff \$156,000 in damages against PM USA due to the jury allocating only 2% of the fault to PM USA.	its notice of appeal and posted a \$5 million appeal bond. On August 18, 2010, upon the motion of PM USA, the trial court entered an amended final judgment of approximately \$12.3 million in compensatory damages and approximately \$24.5 million in punitive damages to correct a clerical error. The case remains on appeal.  In January 2010, defendants filed their notice of appeal, and PM USA posted a \$156,000 appeal bond.
August 2009	Florida/ <i>Barbanell</i>	<i>Engle</i> progeny	In August 2009, a Broward County jury in the <i>Barbanell</i> trial returned a verdict in favor of the plaintiff, awarding \$5.3 million in compensatory damages. The judge had previously dismissed the punitive damages claim. In September 2009, the trial court entered final judgment and awarded plaintiff \$1.95 million in actual damages. The judgment reduced the	A notice of appeal was filed by PM USA in September 2009, and PM USA posted a \$1.95 million appeal bond.

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
February 2009	Florida/ <i>Hess</i>	<i>Engle</i> progeny	<p>jury s \$5.3 million award of compensatory damages due to the jury allocating 36.5% of the fault to PM USA.</p> <p>In February 2009, a Broward County jury in the <i>Hess</i> trial found in favor of plaintiffs and against PM USA. The jury awarded \$3 million in compensatory damages and \$5 million in punitive damages. In June 2009, the trial court entered final judgment and awarded plaintiffs \$1,260,000 in actual damages and \$5 million in punitive damages. The judgment reduced the jury s \$3 million award of compensatory damages due to the jury allocating 42% of the fault to PM USA.</p>	PM USA noticed an appeal to the Fourth District Court of Appeal in July 2009 and posted a \$7.3 million appeal bond. Although the case remains on appeal, in April 2010, the trial court signed an order releasing the appeal bond pursuant to an agreement between the parties.
May 2007	California/ <i>Whiteley</i>	Individual Smoking and Health	Approximately \$2.5 million in compensatory damages against PM USA and the other defendant in the case, as well as \$250,000 in punitive damages against the other defendant in the case.	In October 2007, in a limited retrial on the issue of punitive damages, the jury found that plaintiffs are not entitled to punitive damages against PM USA. In November 2007, the trial court entered final judgment and PM USA filed a motion for a new trial and for judgment notwithstanding the verdict. The trial court rejected these motions in January 2008. In March 2008, PM USA noticed an appeal to the California Court of Appeal, First Appellate District and, in May 2008, posted a \$2.2 million appeal bond. The court affirmed the judgment in October 2009. In November 2009,

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
August 2006	District of Columbia/ <i>United States of America</i>	Health Care Cost Recovery	Finding that defendants, including Altria Group, Inc. and PM USA, violated the civil provisions of RICO. No monetary damages were assessed, but the court made specific findings and issued injunctions. See <i>Federal Government's Lawsuit</i> below.	PM USA and the other defendant in the case filed a petition for review with the California Supreme Court. In January 2010, the California Supreme Court denied defendants' petition for review. PM USA recorded a provision for compensatory damages of \$1.26 million plus costs and interest in the first quarter of 2010, and paid its share of the judgment in February 2010, concluding this litigation. See <i>Federal Government's Lawsuit</i> below.
March 2005	New York/ <i>Rose</i> (now known as <i>Adamo</i> )	Individual Smoking and Health	\$3.42 million in compensatory damages against two defendants, including PM USA, and \$17.1 million in punitive damages against PM USA.	In April 2008, an intermediate New York appellate court reversed the verdict and vacated the compensatory and punitive damages awards against PM USA. In December 2008, the New York Court of Appeals affirmed the appellate court decision. In January 2009, plaintiffs filed a petition with the New York Court of Appeals requesting that the court either vacate its earlier decision and reinstate the jury verdict or remand the case to the trial court for a

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
May 2004	Louisiana/ <i>Scott</i>	Smoking and Health Class Action	Approximately \$590 million against all defendants, including PM USA, jointly and severally, to fund a 10-year smoking cessation program.	new trial. The New York Court of Appeals denied plaintiffs' motion in March 2009. Plaintiffs filed a petition for a <i>writ of certiorari</i> with the United States Supreme Court, which was denied in October 2009, concluding this litigation. See <i>Scott</i> Class Action below.
October 2002	California/ <i>Bullock</i>	Individual Smoking and Health	\$850,000 in compensatory damages and \$28 billion in punitive damages against PM USA.	See discussion (1) below.
June 2002	Florida/ <i>Lukacs</i>	<i>Engle</i> progeny	\$37.5 million in compensatory damages against all defendants, including PM USA.	In March 2003, the trial court reduced the damages award to \$24.8 million. PM USA's share of the damages award is approximately \$6 million. In January 2007, defendants petitioned the trial court to set aside the jury's verdict and dismiss plaintiffs' punitive damages claim. In August 2008, the trial court granted plaintiffs' motion for entry of judgment and ordered compensatory damages of \$24.8 million plus interest from the date of the verdict. In August 2008, PM USA filed a motion for reconsideration, which was denied. Final judgment was entered in November 2008, awarding

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
March 2002	Oregon/ <i>Schwarz</i>	Individual Smoking and Health	\$168,500 in compensatory damages and \$150 million in punitive damages against PM USA.	<p>plaintiffs actual damages of \$24.8 million, plus interest from the date of the verdict. Defendants filed a notice of appeal in December 2008 and collectively posted an appeal bond of \$30.3 million (\$15.1 million of which was posted by PM USA). In March 2010, the Florida Third District Court of Appeal affirmed <i>per curiam</i> the trial court decision without issuing an opinion. Subsequent review by the Florida Supreme Court of a <i>per curiam</i> affirmance without opinion is generally prohibited. In April 2010, defendants filed their petition for rehearing with the court of appeal. In May 2010, the court of appeal denied the defendants' petition. In June 2010, PM USA paid its share of the judgment which, with interest, amounted to approximately \$15.1 million.</p> <p>In May 2002, the trial court reduced the punitive damages award to \$100 million. In October 2002, PM USA posted an appeal bond of approximately \$58.3 million. In May 2006, the Oregon Court of Appeals affirmed the compensatory damages verdict, reversed the award of punitive damages and remanded the case to the trial court</p>

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Date	Location of Court/Name of Plaintiff	Type of Case	Verdict	Post-Trial Developments
July 2000	Florida/ <i>Engle</i>	Smoking and Health Class Action	\$145 billion in punitive damages against all defendants, including \$74 billion against PM USA.	for a second trial to determine the amount of punitive damages, if any. In June 2006, plaintiff petitioned the Oregon Supreme Court to review the portion of the court of appeals decision reversing and remanding the case for a new trial on punitive damages. In June 2010, the Oregon Supreme Court affirmed the court of appeals decision and remanded the case to the trial court for a new trial limited to the question of punitive damages. On July 9, 2010, plaintiff filed a petition for rehearing with the Oregon Supreme Court.  See <i>Engle</i> Class Action below.
March 1999	Oregon/ <i>Williams</i>	Individual Smoking and Health	\$800,000 in compensatory damages (capped statutorily at \$500,000), \$21,500 in medical expenses and \$79.5 million in punitive damages against PM USA.	See discussion (2) below.

- (1) *Bullock*: In December 2002, the trial court reduced the punitive damages award to \$28 million. In April 2006, the California Court of Appeal affirmed the \$28 million punitive damages award. In August 2006, the California Supreme Court denied plaintiffs' petition to overturn the trial court's reduction of the punitive damages award and granted PM USA's petition for review challenging the punitive damages award. The court granted review of the case on a grant and hold basis under which further action by the court was deferred pending the United States Supreme Court's 2007 decision on punitive damages in the *Williams* case described below. In February 2007, the United States Supreme Court vacated the punitive damages judgment in *Williams* and remanded the case to the Oregon Supreme Court for proceedings consistent with its decision. In May 2007, the California Supreme Court transferred the case to the Second District of the California Court of Appeal with directions that

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the court vacate its 2006 decision and reconsider the case in light of the United States Supreme Court's decision in *Williams*. In January 2008, the California Court of Appeal reversed the judgment with respect to the \$28 million punitive damages award, affirmed the judgment in all other respects, and remanded the case to the trial court to conduct a new trial on the amount of punitive damages. In March 2008, plaintiffs and PM USA appealed to the California Supreme Court. In April 2008, the California Supreme Court denied both petitions for review. In July 2008, \$43.3 million of escrow funds were returned to PM USA. The case was remanded to the superior court for a new trial on the amount of punitive damages, if any. In August 2009, the jury returned a verdict, and in December 2009, the superior court entered a judgment, awarding plaintiff \$13.8 million in punitive damages, plus costs. In December 2009, PM USA filed a motion for judgment notwithstanding the verdict that seeks a reduction of the punitive damages award, which motion was denied in January 2010. PM USA noticed an appeal in February 2010 and posted an appeal bond of approximately \$14.7 million. As of September 30, 2010, PM USA has recorded a provision of approximately \$1.7 million for compensatory damages, costs and interest.

- (2) *Williams*: The trial court reduced the punitive damages award to approximately \$32 million, and PM USA and plaintiff appealed. In June 2002, the Oregon Court of Appeals reinstated the \$79.5 million punitive damages award. Following the Oregon Supreme Court's refusal to hear PM USA's appeal, PM USA recorded a provision of \$32 million and petitioned the United States Supreme Court for further review (PM USA later recorded additional provisions of approximately \$29 million related primarily to accrued interest). In October 2003, the United States Supreme Court set aside the Oregon appellate court's ruling and directed the Oregon court to reconsider the case in light of the 2003 *State Farm* decision by the United States Supreme Court, which limited punitive damages. In June 2004, the Oregon Court of Appeals reinstated the \$79.5 million punitive damages award. In February 2006, the Oregon Supreme Court affirmed the Court of Appeals decision. The United States Supreme Court granted PM USA's petition for *writ of certiorari* in May 2006. In February 2007, the United States Supreme Court vacated the \$79.5 million punitive damages award, holding that the United States Constitution prohibits basing punitive damages awards on harm to non-parties. The Court also found that states must assure that appropriate procedures are in place so that juries are provided with proper legal guidance as to the constitutional limitations on awards of punitive damages. Accordingly, the Court remanded the case to the Oregon Supreme Court for further proceedings consistent with this decision. In January 2008, the Oregon Supreme Court affirmed the Oregon Court of Appeals' June 2004 decision, which in turn, upheld the jury's compensatory damages award and reinstated the jury's award of \$79.5 million in punitive damages. In March 2008, PM USA filed a petition for *writ of certiorari* with the United States Supreme Court, which was granted in June 2008. In March 2009, the United States Supreme Court dismissed the *writ of certiorari* as being improvidently granted. Subsequent to the United States Supreme Court's dismissal, PM USA paid \$61.1 million to the plaintiffs, representing the compensatory damages award, forty percent of the punitive damages award and accrued interest. Oregon state law requires that sixty percent of any punitive damages award be paid to the state. However, PM USA believes that, as a result of the Master Settlement Agreement (MSA), it is not liable for the sixty percent that would be paid to the state. Oregon and PM USA are parties to a proceeding in Oregon state court that seeks a determination of PM USA's liability for that sixty percent. If PM USA prevails, its obligation to pay punitive damages will be limited to the forty percent previously paid to the plaintiff. The court has consolidated that MSA proceeding with *Williams*, where plaintiff seeks to challenge the constitutionality of the Oregon statute apportioning the punitive damages award and claims that any punitive damages award released by the state reverts to plaintiff. In February 2010, the trial court ruled that the state is not entitled to collect its sixty percent share of the punitive damages award. In June 2010, after hearing argument, the trial court held that, under the Oregon statute, PM USA is not required to pay the sixty percent share to plaintiff. On October 15, 2010 the trial court rejected plaintiff's argument that



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the Oregon statute regarding allocation of punitive damages is unconstitutional. The combined effect of these rulings is that PM USA would not be required to pay the state's sixty percent share of the punitive damages award. Both the plaintiff in *Williams* and the state are expected to appeal these rulings.

*Security for Judgments*

To obtain stays of judgments pending current appeals, as of September 30, 2010, PM USA has posted various forms of security totaling approximately \$103 million, the majority of which has been collateralized with cash deposits that are included in other assets on the condensed consolidated balance sheets.

*Engle Class Action*

In July 2000, in the second phase of the *Engle* smoking and health class action in Florida, a jury returned a verdict assessing punitive damages totaling approximately \$145 billion against various defendants, including \$74 billion against PM USA. Following entry of judgment, PM USA posted a bond in the amount of \$100 million and appealed.

In May 2001, the trial court approved a stipulation providing that execution of the punitive damages component of the *Engle* judgment will remain stayed against PM USA and the other participating defendants through the completion of all judicial review. As a result of the stipulation, PM USA placed \$500 million into a separate interest-bearing escrow account that, regardless of the outcome of the judicial review, will be paid to the court and the court will determine how to allocate or distribute it consistent with Florida Rules of Civil Procedure. In July 2001, PM USA also placed \$1.2 billion into an interest-bearing escrow account, which was returned to PM USA in December 2007. In addition, the \$100 million bond related to the case has been discharged. In connection with the stipulation, PM USA recorded a \$500 million pre-tax charge in its consolidated statement of earnings for the quarter ended March 31, 2001. In May 2003, the Florida Third District Court of Appeal reversed the judgment entered by the trial court and instructed the trial court to order the decertification of the class. Plaintiffs petitioned the Florida Supreme Court for further review.

In July 2006, the Florida Supreme Court ordered that the punitive damages award be vacated, that the class approved by the trial court be decertified, and that members of the decertified class could file individual actions against defendants within one year of issuance of the mandate. The court further declared the following Phase I findings are entitled to *res judicata* effect in such individual actions brought within one year of the issuance of the mandate: (i) that smoking causes various diseases; (ii) that nicotine in cigarettes is addictive; (iii) that defendants' cigarettes were defective and unreasonably dangerous; (iv) that defendants concealed or omitted material information not otherwise known or available knowing that the material was false or misleading or failed to disclose a material fact concerning the health effects or addictive nature of smoking; (v) that defendants agreed to misrepresent information regarding the health effects or addictive nature of cigarettes with the intention of causing the public to rely on this information to their detriment; (vi) that defendants agreed to conceal or omit information regarding the health effects of cigarettes or their addictive nature with the intention that smokers would rely on the information to their detriment; (vii) that all defendants sold or supplied cigarettes that were defective; and (viii) that defendants were negligent. The court also reinstated compensatory damages awards totaling approximately \$6.9 million to two individual plaintiffs and found that a third plaintiff's claim was barred by the statute of limitations. In February 2008, PM USA paid a total of \$2,964,685, which represents its share of compensatory damages and interest to the two individual plaintiffs identified in the Florida Supreme Court's order.

In August 2006, PM USA sought rehearing from the Florida Supreme Court on parts of its July 2006 opinion, including the ruling (described above) that certain jury findings have *res judicata* effect in subsequent individual trials timely brought by *Engle* class members. The rehearing motion also asked, among other things,

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that legal errors that were raised but not expressly ruled upon in the Third District Court of Appeal or in the Florida Supreme Court now be addressed. Plaintiffs also filed a motion for rehearing in August 2006 seeking clarification of the applicability of the statute of limitations to non-members of the decertified class. In December 2006, the Florida Supreme Court refused to revise its July 2006 ruling, except that it revised the set of Phase I findings entitled to *res judicata* effect by excluding finding (v) listed above (relating to agreement to misrepresent information), and added the finding that defendants sold or supplied cigarettes that, at the time of sale or supply, did not conform to the representations of fact made by defendants. In January 2007, the Florida Supreme Court issued the mandate from its revised opinion. Defendants then filed a motion with the Florida Third District Court of Appeal requesting that the court address legal errors that were previously raised by defendants but have not yet been addressed either by the Third District Court of Appeal or by the Florida Supreme Court. In February 2007, the Third District Court of Appeal denied defendants' motion. In May 2007, defendants' motion for a partial stay of the mandate pending the completion of appellate review was denied by the Third District Court of Appeal. In May 2007, defendants filed a petition for *writ of certiorari* with the United States Supreme Court. In October 2007, the United States Supreme Court denied defendants' petition. In November 2007, the United States Supreme Court denied defendants' petition for rehearing from the denial of their petition for *writ of certiorari*.

The deadline for filing *Engle* progeny cases, as required by the Florida Supreme Court's decision, expired in January 2008. As of October 25, 2010, approximately 7,707 cases (3,286 state court cases and 4,421 federal court cases) were pending against PM USA or Altria Group, Inc. asserting individual claims by or on behalf of approximately 9,400 plaintiffs (4,980 state court plaintiffs and 4,420 federal court plaintiffs). It is possible that some of these cases are duplicates. Some of these cases have been removed from various Florida state courts to the federal district courts in Florida, while others were filed in federal court. In July 2007, PM USA and other defendants requested that the multi-district litigation panel order the transfer of all such cases pending in the federal courts, as well as any other *Engle* progeny cases that may be filed, to the Middle District of Florida for pretrial coordination. The panel denied this request in December 2007. In October 2007, attorneys for plaintiffs filed a motion to consolidate all pending and future cases filed in the state trial court in Hillsborough County. The court denied this motion in November 2007. In February 2008, the trial court decertified the class except for purposes of the May 2001 bond stipulation, and formally vacated the punitive damages award pursuant to the Florida Supreme Court's mandate. In April 2008, the trial court ruled that certain defendants, including PM USA, lacked standing with respect to allocation of the funds escrowed under the May 2001 bond stipulation and will receive no credit at this time from the \$500 million paid by PM USA against any future punitive damages awards in cases brought by former *Engle* class members.

In May 2008, the trial court, among other things, decertified the limited class maintained for purposes of the May 2001 bond stipulation and, in July 2008, severed the remaining plaintiffs' claims except for those of Howard Engle. The only remaining plaintiff in the *Engle* case, Howard Engle, voluntarily dismissed his claims with prejudice. In July 2008, attorneys for a putative former *Engle* class member petitioned the Florida Supreme Court to permit members of the *Engle* class additional time to file individual lawsuits. The Florida Supreme Court denied this petition in January 2009.

Three federal district courts (in the *Merlob*, *Brown* and *Burr* cases) ruled that the findings in the first phase of the *Engle* proceedings cannot be used to satisfy elements of plaintiffs' claims, and two of those rulings (*Brown* and *Burr*) were certified by the trial court for interlocutory review. The certification in both cases was granted by the United States Court of Appeals for the Eleventh Circuit and the appeals were consolidated. In February 2009, the appeal in *Burr* was dismissed for lack of prosecution. On July 22, 2010, the Eleventh Circuit ruled that plaintiffs do not have an unlimited right to use the findings from the original *Engle* trial to meet their burden of establishing the elements of their claims at trial. Rather, plaintiffs may only use the findings to establish those specific facts, if any, that they demonstrate with a reasonable degree of certainty were actually decided by the original *Engle* jury. The Eleventh Circuit remanded the case to the district court to determine what specific factual findings the *Engle* jury actually made. *Engle* progeny cases pending in the federal district

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courts in the Middle District of Florida asserting individual claims by or on behalf of approximately 4,420 plaintiffs had been stayed pending the Eleventh Circuit's review. These cases were returned to the federal trial courts in which they were filed for further proceedings.

In June 2009, Florida amended its existing bond cap statute by adding a \$200 million bond cap that applies to all *Engle* progeny lawsuits in the aggregate and establishes individual bond caps for individual *Engle* progeny cases in amounts that vary depending on the number of judgments in effect at a given time. The legislation, which became effective in June 2009, applies to judgments entered after the effective date and remains in effect until December 31, 2012. Plaintiffs in three *Engle* progeny cases against R.J. Reynolds in Alachua County, Florida (*Alexander, Townsend and Hall*) have challenged the constitutionality of the bond cap statute. The Florida Attorney General has intervened in these cases in defense of the constitutionality of the statute. Argument in these cases was heard on September 10, 2010. Plaintiffs in one *Engle* progeny case against PM USA and R.J. Reynolds in Hillsborough County (*Douglas*) have also challenged the constitutionality of the bond cap statute.

*Engle Progeny Trial Results*

As of October 25, 2010, sixteen *Engle* progeny cases involving PM USA have resulted in verdicts since the Florida Supreme Court *Engle* decision. Nine verdicts (see *Hess, Barbanell, Campbell, Naugle, Douglas, R. Cohen, Putney, Tate and Piendle* descriptions in the table above) were returned in favor of plaintiffs and seven verdicts were returned in favor of PM USA (*Gelep, Kalyvas, Gil de Rubio, Warrick, Willis, Frazier and C. Campbell*). *Engle* progeny trial results are included in the totals provided in *Trial Results* above. In addition, there have been a number of mistrials, only some of which have resulted in new trials as of October 25, 2010.

In *Lukacs*, a case that was tried to verdict before the Florida Supreme Court *Engle* decision and is described in *Trial Results* above, the Florida Third District Court of Appeal in March 2010 affirmed *per curiam* the trial court decision without issuing an opinion. Under Florida procedure, further review of a *per curiam* affirmance without opinion by the Florida Supreme Court is generally prohibited. In April 2010, defendants filed their petition for rehearing with the Court of Appeal. In May 2010, the Court of Appeal denied the defendants' petition. The defendants paid the judgment in June 2010.

In May 2010, the jury returned a verdict in favor of PM USA in the *Gil de Rubio* case. In June 2010, plaintiff filed a motion for a new trial.

On October 4, 2010 (*Warrick*), October 6, 2010 (*Willis*), and October 15, 2010 (*Frazier and C. Campbell*), juries in four *Engle* progeny cases returned verdicts in favor of PM USA. The plaintiffs in the *Warrick, Willis* and *Frazier* cases have filed motions for a new trial.

*Scott Class Action*

In July 2003, following the first phase of the trial in the *Scott* class action, in which plaintiffs sought creation of a fund to pay for medical monitoring and smoking cessation programs, a Louisiana jury returned a verdict in favor of defendants, including PM USA, in connection with plaintiffs' medical monitoring claims, but also found that plaintiffs could benefit from smoking cessation assistance. The jury also found that cigarettes as designed are not defective but that the defendants failed to disclose all they knew about smoking and diseases and marketed their products to minors. In May 2004, in the second phase of the trial, the jury awarded plaintiffs approximately \$590 million against all defendants jointly and severally, to fund a 10-year smoking cessation program.

In June 2004, the court entered judgment, which awarded plaintiffs the approximately \$590 million jury award plus prejudgment interest accruing from the date the suit commenced. PM USA's share of the jury award and prejudgment interest has not been allocated. Defendants, including PM USA, appealed. Pursuant to a stipulation

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of the parties, the trial court entered an order setting the amount of the bond at \$50 million for all defendants in accordance with an article of the Louisiana Code of Civil Procedure, and a Louisiana statute (the bond cap law), fixing the amount of security in civil cases involving a signatory to the MSA. Under the terms of the stipulation, plaintiffs reserve the right to contest, at a later date, the sufficiency or amount of the bond on any grounds including the applicability or constitutionality of the bond cap law. In September 2004, defendants collectively posted a bond in the amount of \$50 million (\$12.5 million of which was posted by PM USA).

In February 2007, the Louisiana Fourth Circuit Court of Appeal issued a ruling on defendants' appeal that, among other things: affirmed class certification but limited the scope of the class; struck certain of the categories of damages included in the judgment, reducing the amount of the award by approximately \$312 million; vacated the award of prejudgment interest, which totaled approximately \$444 million as of February 15, 2007; and ruled that the only class members who are eligible to participate in the smoking cessation program are those who began smoking before, and whose claims accrued by, September 1, 1988. As a result, the Louisiana Court of Appeal remanded the case for proceedings consistent with its opinion, including further reduction of the amount of the award based on the size of the new class. In March 2007, the Louisiana Court of Appeal rejected defendants' motion for rehearing and clarification. In January 2008, the Louisiana Supreme Court denied plaintiffs' and defendants' petitions for *writ of certiorari*. In March 2008, plaintiffs filed a motion to execute the approximately \$279 million judgment plus post-judgment interest or, in the alternative, for an order to the parties to submit revised damages figures. Defendants filed a motion to have judgment entered in favor of defendants based on accrual of all class member claims after September 1, 1988 or, in the alternative, for the entry of a case management order. In April 2008, the Louisiana Supreme Court denied defendants' motion to stay proceedings and the defendants filed a petition for *writ of certiorari* with the United States Supreme Court. In June 2008, the United States Supreme Court denied the defendant's petition. Plaintiffs filed a motion to enter judgment in the amount of approximately \$280 million (subsequently changed to approximately \$264 million) and defendants filed a motion to enter judgment in their favor dismissing the case entirely or, alternatively, to enter a case management order for a new trial. In July 2008, the trial court entered an Amended Judgment and Reasons for Judgment denying both motions, but ordering defendants to deposit into the registry of the court the sum of \$263,532,762 plus post-judgment interest.

In September 2008, defendants filed an application for *writ of mandamus* or *supervisory writ* to secure the right to appeal with the Louisiana Fourth Circuit Court of Appeals, and in December 2008, the trial court entered an order permitting the appeal and approving a \$50 million bond for all defendants in accordance with the Louisiana bond cap law discussed above. In April 2009, plaintiffs filed a cross-appeal seeking to reinstate the June 2004 judgment and to award the medical monitoring rejected by the jury.

In April 2010, the Louisiana Fourth Circuit Court of Appeal issued a decision that affirmed in part prior decisions ordering the defendants to fund a statewide 10-year smoking cessation program. In its decision, the Court of Appeal amended and, as amended, affirmed the amended 2008 trial court judgment and ruled that, although the trial court erred, the defendants have no right to a trial to determine, among other things, those class members with valid claims not barred by Louisiana law. After conducting its own independent review of the record, the Court of Appeal made its own factual findings with respect to liability and the amount owed, lowering the amount of the judgment to approximately \$241 million, plus interest commencing July 21, 2008, the date of entry of the amended judgment (which as of October 25, 2010 is approximately \$30 million). In its decision, the Court of Appeal disallowed approximately \$80 million in post-judgment interest. In addition, the Court of Appeal declined plaintiffs' cross appeal requests for a medical monitoring program and reinstatement of other components of the smoking cessation program. The Court of Appeal specifically reserved to the defendants the right to assert claims to any unspent or unused surplus funds at the termination of the smoking cessation program. In June 2010, defendants and plaintiffs filed separate *writ of certiorari* applications with the Louisiana Supreme Court. On September 3, 2010, the Louisiana Supreme Court denied both sides' applications. On September 13, 2010, defendants filed a single-justice application with the United States Supreme Court seeking a stay of the judgment pending the defendants' filing and the Court's disposition of the

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defendants' petition for a *writ of certiorari*. On September 24, 2010, Justice Antonin Scalia, as the Justice responsible for the U.S. Fifth Circuit, granted the stay. The defendants' petition for a *writ of certiorari* is due on December 2, 2010. As of September 30, 2010, PM USA has recorded a provision of \$26 million in connection with the case and has recorded additional provisions of approximately \$3.2 million related to accrued interest.

**Smoking and Health Litigation**

*Overview*

Plaintiffs' allegations of liability in smoking and health cases are based on various theories of recovery, including negligence, gross negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, nuisance, breach of express and implied warranties, breach of special duty, conspiracy, concert of action, violations of deceptive trade practice laws and consumer protection statutes, and claims under the federal and state anti-racketeering statutes. Plaintiffs in the smoking and health actions seek various forms of relief, including compensatory and punitive damages, treble/multiple damages and other statutory damages and penalties, creation of medical monitoring and smoking cessation funds, disgorgement of profits, and injunctive and equitable relief. Defenses raised in these cases include lack of proximate cause, assumption of the risk, comparative fault and/or contributory negligence, statutes of limitations and preemption by the Federal Cigarette Labeling and Advertising Act.

In July 2008, the New York Supreme Court, Appellate Division, First Department in *Fabiano*, an individual personal injury case, held that plaintiffs' punitive damages claim was barred by the MSA based on principles of *res judicata* because the New York Attorney General had already litigated the punitive damages claim on behalf of all New York residents. In May 2010, the New York Supreme Court, Appellate Division, Second Department, adopted the reasoning of the First Department in *Fabiano* and issued a *per curiam* opinion affirming separate trial court rulings dismissing plaintiffs' punitive damages claims in *Shea* and *Tomasino*, two individual personal injury cases. In June 2010, the plaintiffs filed a motion seeking to reargue this decision before the appellate court, which motion was denied on September 17, 2010.

*Smoking and Health Class Actions*

Since the dismissal in May 1996 of a purported nationwide class action brought on behalf of allegedly addicted smokers, plaintiffs have filed numerous putative smoking and health class action suits in various state and federal courts. In general, these cases purport to be brought on behalf of residents of a particular state or states (although a few cases purport to be nationwide in scope) and raise addiction claims and, in many cases, claims of physical injury as well.

Class certification has been denied or reversed by courts in 58 smoking and health class actions involving PM USA in Arkansas (1), the District of Columbia (2), Florida (2), Illinois (3), Iowa (1), Kansas (1), Louisiana (1), Maryland (1), Michigan (1), Minnesota (1), Nevada (29), New Jersey (6), New York (2), Ohio (1), Oklahoma (1), Pennsylvania (1), Puerto Rico (1), South Carolina (1), Texas (1) and Wisconsin (1).

PM USA and Altria Group, Inc. are named as defendants, along with other cigarette manufacturers, in six actions filed in the Canadian provinces of Alberta, Manitoba, Nova Scotia, Saskatchewan and British Columbia. In Saskatchewan and British Columbia, plaintiffs seek class certification on behalf of individuals who suffer or have suffered from various diseases including chronic obstructive pulmonary disease, emphysema, heart disease or cancer after smoking defendants' cigarettes. In the actions filed in Alberta, Manitoba and Nova Scotia, plaintiffs seek certification of classes of all individuals who smoked defendants' cigarettes. See *Guarantees* for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.

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*Medical Monitoring Class Actions*

A class remains certified in the *Scott* class action discussed above. Four other purported class actions are pending. Three of the purported class actions pending against PM USA have been brought in New York (*Caronia*, filed in January 2006 in the United States District Court for the Eastern District of New York), Massachusetts (*Donovan*, filed in December 2006 in the United States District Court for the District of Massachusetts) and California (*Xavier*, filed on May 14, 2010 in the United States District Court for the Northern District of California) on behalf of each state's respective residents who: are age 50 or older; have smoked the *Marlboro* brand for 20 pack-years or more; and have neither been diagnosed with lung cancer nor are under investigation by a physician for suspected lung cancer. Plaintiffs in these cases seek to impose liability under various product-based causes of action and the creation of a court-supervised program providing members of the purported class Low Dose CT Scanning in order to identify and diagnose lung cancer. Neither claim seeks punitive damages.

In *Caronia*, in February 2010, the trial court granted in part PM USA's summary judgment motion, dismissing plaintiffs' strict liability and negligence claims and certain other claims, granted plaintiffs leave to amend their complaint to allege a medical monitoring cause of action and requested further briefing on PM USA's summary judgment motion as to plaintiffs' implied warranty claim and, if plaintiffs amend their complaint, their medical monitoring claim. In March 2010, plaintiffs filed their amended complaint and PM USA moved to dismiss the implied warranty and medical monitoring claims. Argument was heard in June 2010.

In *Donovan*, the Supreme Judicial Court of Massachusetts, in answering questions certified to it by the district court, held in October 2009 that under certain circumstances state law recognizes a claim by individual smokers for medical monitoring despite the absence of an actual injury. The court also ruled that whether or not the case is barred by the applicable statute of limitations is a factual issue to be determined by the trial court. The case was remanded to federal court for further proceedings. In June 2010, the district court granted in part the plaintiffs' motion for class certification, certifying the class as to plaintiffs' claims for breach of implied warranty and violation of the Massachusetts Consumer Protection Act, but denying certification as to plaintiffs' negligence claim. On July 8, 2010, PM USA petitioned the United States Court of Appeals for the First Circuit for appellate review of the class certification decision. The petition was denied on September 1, 2010.

In *Xavier*, on October 4, 2010, the trial court granted PM USA's motion to dismiss plaintiffs' unfair competition claim and independent medical monitoring cause of action. Trial has been set for November 14, 2011.

The fourth purported class action (*Calistro*) was filed on July 7, 2010, and is pending in the U.S. District Court for the District of the Virgin Islands, Division of St. Thomas & St. John. Altria Group, Inc. was voluntarily dismissed from the case by the plaintiffs on August 23, 2010. On September 13 and 14, 2010, plaintiffs voluntarily dismissed without prejudice their claims against all defendants except PM USA. Plaintiffs seek certification of a class of residents of the U.S. Virgin Islands who do not suffer from personal injury but who have been unable to successfully complete at least one effort to quit because of addiction. In addition to requesting medical monitoring, plaintiffs seek the funding of a smoking cessation program, compensatory and punitive damages and attorneys' fees. Plaintiffs have filed a motion to stay and transfer the case to the Lights multidistrict litigation proceeding discussed below. PM USA has filed an opposition to this motion.

**Health Care Cost Recovery Litigation**

*Overview*

In health care cost recovery litigation, governmental entities and non-governmental plaintiffs seek reimbursement of health care cost expenditures allegedly caused by tobacco products and, in some cases, of



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future expenditures and damages as well. Relief sought by some but not all plaintiffs includes punitive damages, multiple damages and other statutory damages and penalties, injunctions prohibiting alleged marketing and sales to minors, disclosure of research, disgorgement of profits, funding of anti-smoking programs, additional disclosure of nicotine yields, and payment of attorney and expert witness fees.

The claims asserted include the claim that cigarette manufacturers were unjustly enriched by plaintiffs' payment of health care costs allegedly attributable to smoking, as well as claims of indemnity, negligence, strict liability, breach of express and implied warranty, violation of a voluntary undertaking or special duty, fraud, negligent misrepresentation, conspiracy, public nuisance, claims under federal and state statutes governing consumer fraud, antitrust, deceptive trade practices and false advertising, and claims under federal and state anti-racketeering statutes.

Defenses raised include lack of proximate cause, remoteness of injury, failure to state a valid claim, lack of benefit, adequate remedy at law, unclean hands (namely, that plaintiffs cannot obtain equitable relief because they participated in, and benefited from, the sale of cigarettes), lack of antitrust standing and injury, federal preemption, lack of statutory authority to bring suit, and statutes of limitations. In addition, defendants argue that they should be entitled to set off any alleged damages to the extent the plaintiffs benefit economically from the sale of cigarettes through the receipt of excise taxes or otherwise. Defendants also argue that these cases are improper because plaintiffs must proceed under principles of subrogation and assignment. Under traditional theories of recovery, a payor of medical costs (such as an insurer) can seek recovery of health care costs from a third party solely by standing in the shoes of the injured party. Defendants argue that plaintiffs should be required to bring any actions as subrogees of individual health care recipients and should be subject to all defenses available against the injured party.

Although there have been some decisions to the contrary, most judicial decisions have dismissed all or most health care cost recovery claims against cigarette manufacturers. Nine federal circuit courts of appeals and six state appellate courts, relying primarily on grounds that plaintiffs' claims were too remote, have ordered or affirmed dismissals of health care cost recovery actions. The United States Supreme Court has refused to consider plaintiffs' appeals from the cases decided by five circuit courts of appeals.

In March 1999, in the first health care cost recovery case to go to trial, an Ohio jury returned a verdict in favor of defendants on all counts. In addition, a \$17.8 million verdict against defendants (including \$6.8 million against PM USA) was reversed in a health care cost recovery case in New York, and all claims were dismissed with prejudice in February 2005 (*Blue Cross/Blue Shield*). In the health care cost recovery case brought by the City of St. Louis, Missouri and approximately 40 Missouri hospitals, in which PM USA, USSTC and Altria Group, Inc. are defendants (*City of St. Louis*), the trial court on July 2, 2010, granted defendants' motion for summary judgment with respect to certain of plaintiffs' claims on the grounds that they were preempted. The court had earlier denied a number of other summary judgment motions by defendants and denied plaintiffs' motion for summary judgment claiming collateral estoppel from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described below). The court also had previously granted defendants' motion for partial summary judgment on plaintiffs' claim for future damages (although plaintiffs will be allowed to amend their claims to seek damages that have accrued as of trial). On September 2, 2010, the trial court denied several of defendants' summary judgment motions, but granted defendants' motion seeking to prevent plaintiffs from recovering the present value of their damages, which are alleged to amount to approximately \$300 million. On October 8, 2010, the trial court granted defendants' summary judgment with respect to plaintiffs' fraud and negligent misrepresentation claims. Trial is currently scheduled to begin in January 2011.

Individuals and associations have also sued in purported class actions or as private attorneys general under the Medicare as Secondary Payer (MSP) provisions of the Social Security Act to recover from defendants' Medicare expenditures allegedly incurred for the treatment of smoking-related diseases. Cases brought in



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New York (*Mason*), Florida (*Glover*) and Massachusetts (*United Seniors Association*) have been dismissed by federal courts. In April 2008, an action, *National Committee to Preserve Social Security and Medicare, et al. v. Philip Morris USA, et al.* ( *National Committee I* ), was brought under the MSP statute in the Circuit Court of the Eleventh Judicial Circuit of and for Miami County, Florida, but was dismissed voluntarily in May 2008. The action purported to be brought on behalf of Medicare to recover an unspecified amount of damages equal to double the amount paid by Medicare for smoking-related health care services provided from April 19, 2002 to the present.

In May 2008, an action, *National Committee to Preserve Social Security, et al. v. Philip Morris USA, et al.*, was brought under the MSP statute in United States District Court for the Eastern District of New York. This action was brought by the same plaintiffs as *National Committee I* and similarly purports to be brought on behalf of Medicare to recover an unspecified amount of damages equal to double the amount paid by Medicare for smoking-related health care services provided from May 21, 2002 to the present. In July 2008, defendants filed a motion to dismiss plaintiffs' claims and plaintiffs filed a motion for partial summary judgment. In March 2009, the court granted defendants' motion to dismiss. Plaintiffs noticed an appeal in May 2009. In February 2010, defendants moved to dismiss the individual plaintiff's appeal. On October 4, 2010, the United States Court of Appeals for the Second Circuit dismissed plaintiffs' complaint for lack of subject matter jurisdiction.

In addition to the cases brought in the United States, health care cost recovery actions have also been brought against tobacco industry participants, including PM USA and Altria Group, Inc., in Israel (1), the Marshall Islands (1 dismissed), and Canada (3), and other entities have stated that they are considering filing such actions. In the case in Israel, the defendants' appeal of the district court's denial of their motion to dismiss was heard by the Israel Supreme Court in March 2005, and the parties are awaiting the court's decision. In September 2005, in the first of the three health care cost recovery cases filed in Canada, the Canadian Supreme Court ruled that legislation passed in British Columbia permitting the lawsuit is constitutional, and, as a result, the case, which had previously been dismissed by the trial court, was permitted to proceed. PM USA's and other defendants' challenge to the British Columbia court's exercise of jurisdiction was rejected by the Court of Appeals of British Columbia and, in April 2007, the Supreme Court of Canada denied review of that decision. In December 2009, the Court of Appeals of British Columbia ruled that certain defendants can proceed against the Federal Government of Canada as third parties on the theory that the Federal Government of Canada negligently misrepresented to defendants the efficacy of a low tar tobacco variety that the Federal Government of Canada developed and licensed to defendants. On May 20, 2010, the Supreme Court of Canada granted leave to the Federal Government of Canada to appeal this decision and leave to defendants to cross-appeal the Court of Appeals' decision to dismiss claims against the Federal Government of Canada based on other theories of liability. The Supreme Court of Canada is scheduled to hear the appeal in February 2011. During 2008, the Province of New Brunswick, Canada, proclaimed into law previously adopted legislation allowing reimbursement claims to be brought against cigarette manufacturers, and it filed suit shortly thereafter. In September 2009, the Province of Ontario, Canada, filed suit against a number of cigarette manufacturers based on previously adopted legislation nearly identical in substance to the New Brunswick health care cost recovery legislation. PM USA is named as a defendant in the British Columbia case, while Altria Group, Inc. and PM USA are named as defendants in the New Brunswick and Ontario cases. Several other provinces and territories in Canada have enacted similar legislation or are in the process of enacting similar legislation. See *Guarantees* for a discussion of the Distribution Agreement between Altria Group, Inc. and PMI that provides for indemnities for certain liabilities concerning tobacco products.

*Settlements of Health Care Cost Recovery Litigation*

In November 1998, PM USA and certain other United States tobacco product manufacturers entered into the MSA with 46 states, the District of Columbia, Puerto Rico, Guam, the United States Virgin Islands, American Samoa and the Northern Marianas to settle asserted and unasserted health care cost recovery and other claims. PM USA and certain other United States tobacco product manufacturers had previously settled similar claims

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brought by Mississippi, Florida, Texas and Minnesota (together with the MSA, the State Settlement Agreements). The State Settlement Agreements require that the original participating manufacturers make substantial annual payments of approximately \$9.4 billion each year (excluding future annual payments, if any, under the National Tobacco Grower Settlement Trust), subject to adjustments for several factors, including inflation, market share and industry volume. In addition, the original participating manufacturers are required to pay settling plaintiffs attorneys' fees, subject to an annual cap of \$500 million. For the three and nine months ended September 30, 2010, the aggregate amount recorded in cost of sales with respect to the State Settlement Agreements and the Fair and Equitable Tobacco Reform Act of 2004 (FETRA) was approximately \$1.3 billion and \$3.7 billion, respectively.

The State Settlement Agreements also include provisions relating to advertising and marketing restrictions, public disclosure of certain industry documents, limitations on challenges to certain tobacco control and underage use laws, restrictions on lobbying activities and other provisions.

*Possible Adjustments in MSA Payments for 2003 to 2009*

Pursuant to the provisions of the MSA, domestic tobacco product manufacturers, including PM USA, who are original signatories to the MSA (the Original Participating Manufacturers or OPMs) are participating in proceedings that may result in downward adjustments to the amounts paid by the OPMs and the other MSA-participating manufacturers to the states and territories that are parties to the MSA for each of the years 2003 to 2009. The proceedings relate to an MSA payment adjustment (the NPM Adjustment) based on the collective loss of market share for the relevant year by all participating manufacturers who are subject to the payment obligations and marketing restrictions of the MSA to non-participating manufacturers (NPMs) who are not subject to such obligations and restrictions.

As part of these proceedings, an independent economic consulting firm jointly selected by the MSA parties or otherwise selected pursuant to the MSA's provisions is required to determine whether the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the year in question. If the firm determines that the disadvantages of the MSA were such a significant factor, each state may avoid a downward adjustment to its share of the participating manufacturers' annual payments for that year by establishing that it diligently enforced a qualifying escrow statute during the entirety of that year. Any potential downward adjustment would then be reallocated to any states that do not establish such diligent enforcement. PM USA believes that the MSA's arbitration clause requires a state to submit its claim to have diligently enforced a qualifying escrow statute to binding arbitration before a panel of three former federal judges in the manner provided for in the MSA. A number of states have taken the position that this claim should be decided in state court on a state-by-state basis.

In March 2006, an independent economic consulting firm determined that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the year 2003. In February 2007, this same firm determined that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the year 2004. In February 2008, the same economic consulting firm determined that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the year 2005. A different economic consulting firm was selected to make the significant factor determination regarding the participating manufacturers' collective loss of market share for the year 2006. In March 2009, this firm determined that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the year 2006. Following the firm's determination for 2006, the OPMs and the states agreed that the states would not contest that the disadvantages of the MSA were a significant factor contributing to the participating manufacturers' collective loss of market share for the years 2007, 2008 and 2009. Accordingly, the OPMs and the states have agreed that no significant factor determination by the firm will be necessary with respect to the participating manufacturers' collective loss of

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market share for the years 2007, 2008 and 2009. This agreement became effective for 2007 on February 1, 2010 and will become effective for 2008 and 2009 on February 1, 2011 and February 1, 2012, respectively.

Following the economic consulting firm's determination with respect to 2003, thirty-eight states filed declaratory judgment actions in state courts seeking a declaration that the state diligently enforced its escrow statute during 2003. The OPMs and other MSA-participating manufacturers responded to these actions by filing motions to compel arbitration in accordance with the terms of the MSA, including filing motions to compel arbitration in eleven MSA states and territories that did not file declaratory judgment actions. Courts in all but one of the forty-six MSA states and the District of Columbia and Puerto Rico have ruled that the question of whether a state diligently enforced its escrow statute during 2003 is subject to arbitration. One state court (in *State of Montana*) has ruled that the diligent enforcement claims of that state may be litigated in state court, rather than in arbitration. Several of these rulings may be subject to further review. In January 2010, the OPMs filed a petition for a *writ of certiorari* in the United States Supreme Court seeking further review of the one decision holding that a state's diligent enforcement claims may be litigated in state court, rather than in arbitration. The petition was denied in June 2010. Following the denial of this petition, Montana renewed an action in its state court seeking a declaratory judgment that it diligently enforced its escrow statute during 2003 and other relief. The OPMs have moved to stay that action. Argument on the motion occurred on October 22, 2010.

PM USA, the other OPMs and approximately twenty-five other MSA-participating manufacturers have entered into an agreement regarding arbitration with forty-five MSA states concerning the 2003 NPM Adjustment, including the states' claims of diligent enforcement for 2003. The agreement further provides for a partial liability reduction for the 2003 NPM Adjustment for states that entered into the agreement by January 30, 2009 and are determined in the arbitration not to have diligently enforced a qualifying escrow statute during 2003. Based on the number of states that entered into the agreement by January 30, 2009 (forty-five), the partial liability reduction for those states is 20%. The partial liability reduction would reduce the amount of PM USA's 2003 NPM Adjustment by up to a corresponding percentage. The selection of the arbitration panel for the 2003 NPM Adjustment was completed on July 1, 2010, and the arbitration is currently ongoing. Proceedings to determine state diligent enforcement claims for the years 2004 through 2009 have not yet been scheduled.

Once a significant factor determination in favor of the participating manufacturers for a particular year has been made by the economic consulting firm, or the states' agreement not to contest significant factor for a particular year has become effective, PM USA has the right under the MSA to pay the disputed amount of the NPM Adjustment for that year into a disputed payments account or withhold it altogether. To date, PM USA has made its full MSA payment each year to the states (subject to a right to recoup the NPM Adjustment amount in the form of a credit against future MSA payments), even though it had the right to deduct the disputed amounts of the 2003-2007 NPM Adjustments, as described above, from its MSA payments due in the years 2006-2010, respectively. The approximate maximum principal amounts of PM USA's share of the disputed NPM Adjustment for the years 2003 through 2009, as currently calculated by the MSA's Independent Auditor, are as follows (these amounts do not include interest, which PM USA believes accrues at the prime rate from the payment date for the year for which the NPM Adjustment is calculated):

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Year for which NPM Adjustment calculated	2003	2004	2005	2006	2007	2008	2009
Year in which deduction for NPM Adjustment may be taken	2006	2007	2008	2009	2010	2011	2012
PM USA's Approximate Share of Disputed NPM Adjustment (in millions)	\$337	\$388	\$181	\$156	\$209	\$266	\$202

The foregoing amounts may be recalculated by the Independent Auditor if it receives information that is different from or in addition to the information on which it based these calculations, including, among other things, if it receives revised sales volumes from any participating manufacturer. Disputes among the manufacturers could also reduce the foregoing amounts. The availability and the precise amount of any NPM Adjustment for 2003, 2004, 2005, 2006, 2007, 2008 and 2009 will not be finally determined until 2011 or thereafter. There is no certainty that the OPMs and other MSA-participating manufacturers will ultimately receive any adjustment as a result of these proceedings, and the amount of any adjustment received for a year could be less than the amount for that year listed above. If the OPMs do receive such an adjustment through these proceedings, the adjustment would be allocated among the OPMs pursuant to the MSA's provisions, and PM USA would receive its share of any adjustments in the form of a credit against future MSA payments.

*Other MSA-Related Litigation*

PM USA was named as a defendant in an action (*Vibo*) brought in October 2008 in federal court in Kentucky by an MSA participating manufacturer that is not an OPM. Other defendants include various other participating manufacturers and the Attorneys General of all 52 states and territories that are parties to the MSA. The plaintiff alleged that certain of the MSA's payment provisions discriminate against it in favor of certain other participating manufacturers in violation of the federal antitrust laws and the United States Constitution. The plaintiff also sought injunctive relief, alteration of certain MSA payment provisions as applied to it, treble damages under the federal antitrust laws, and/or rescission of its joinder in the MSA. The plaintiff also filed a motion for a preliminary injunction enjoining the states from enforcing the allegedly discriminatory payment provisions against it during the pendency of the action. In January 2009, the district court dismissed the complaint and denied plaintiff's request for preliminary injunctive relief. In January 2010, the court entered final judgment dismissing the case. Plaintiff has appealed this decision to the United States Court of Appeals for the Sixth Circuit.

Without naming PM USA or any other private party as a defendant, NPMs and/or their distributors or customers have filed several legal challenges to the MSA and related legislation. New York state officials are defendants in a lawsuit (*Freedom Holdings*) filed in the United States District Court for the Southern District of New York in which cigarette importers allege that the MSA and/or related legislation violates federal antitrust laws and the Commerce Clause of the United States Constitution. In a separate proceeding pending in the same court (*Pryor*), plaintiffs assert the same theories against not only New York officials but also the Attorneys General for thirty other states. The United States Court of Appeals for the Second Circuit has held that the allegations in both actions, if proven, establish a basis for relief on antitrust and Commerce Clause grounds and that the trial courts in New York have personal jurisdiction sufficient to enjoin other states' officials from enforcing their MSA-related legislation. On remand in *Freedom Holdings*, the trial court granted summary judgment for the New York officials and lifted a preliminary injunction against New York officials' enforcement against plaintiffs of the state's allocable share amendment to the MSA's Model Escrow Statute. The United States Court of Appeals for the Second Circuit affirmed that decision on October 18, 2010. On remand in *Pryor*, the trial court held that plaintiffs are unlikely to succeed on the merits and refused to enjoin

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the enforcement of New York's allocable share amendment to the MSA's Model Escrow Statute. That decision was affirmed by the United States Court of Appeals for the Second Circuit. The parties in that case have filed cross-motions for summary judgment, and the trial court heard oral argument on those motions in April 2010.

In another action (*Xcaliber*), the United States Court of Appeals for the Fifth Circuit reversed a trial court's dismissal of challenges to MSA-related legislation in Louisiana under the First and Fourteenth Amendments to the United States Constitution. On remand in that case, and in another case filed against the Louisiana Attorney General (*S&M Brands*), trial courts have granted summary judgment for the Louisiana Attorney General. The United States Court of Appeals for the Fifth Circuit affirmed those judgments in decisions issued on July 15, 2010 and August 10, 2010.

In addition, the United States Courts of Appeals for the Sixth, Eighth, Ninth and Tenth Circuits have affirmed dismissals or grants of summary judgment in favor of state officials in four other cases asserting antitrust and constitutional challenges to the allocable share amendment legislation in those states.

Another proceeding (*Grand River*) has been initiated before an international arbitration tribunal under the provisions of the North American Free Trade Agreement. A hearing on the merits concluded in February 2010. A decision is pending.

*Federal Government's Lawsuit*

In 1999, the United States government filed a lawsuit in the United States District Court for the District of Columbia against various cigarette manufacturers, including PM USA, and others, including Altria Group, Inc. asserting claims under three federal statutes, namely the Medical Care Recovery Act (MCRA), the MSP provisions of the Social Security Act and the civil provisions of RICO. Trial of the case ended in June 2005. The lawsuit sought to recover an unspecified amount of health care costs for tobacco-related illnesses allegedly caused by defendants' fraudulent and tortious conduct and paid for by the government under various federal health care programs, including Medicare, military and veterans' health benefits programs, and the Federal Employees Health Benefits Program. The complaint alleged that such costs total more than \$20 billion annually. It also sought what it alleged to be equitable and declaratory relief, including disgorgement of profits which arose from defendants' allegedly tortious conduct, an injunction prohibiting certain actions by the defendants, and a declaration that the defendants are liable for the federal government's future costs of providing health care resulting from defendants' alleged past tortious and wrongful conduct. In September 2000, the trial court dismissed the government's MCRA and MSP claims, but permitted discovery to proceed on the government's claims for relief under the civil provisions of RICO.

The government alleged that disgorgement by defendants of approximately \$280 billion is an appropriate remedy. In May 2004, the trial court issued an order denying defendants' motion for partial summary judgment limiting the disgorgement remedy. In February 2005, a panel of the United States Court of Appeals for the District of Columbia Circuit held that disgorgement is not a remedy available to the government under the civil provisions of RICO and entered summary judgment in favor of defendants with respect to the disgorgement claim. In April 2005, the Court of Appeals denied the government's motion for rehearing. In July 2005, the government petitioned the United States Supreme Court for further review of the Court of Appeals' ruling that disgorgement is not an available remedy, and in October 2005, the Supreme Court denied the petition.

In June 2005, the government filed with the trial court its proposed final judgment seeking remedies of approximately \$14 billion, including \$10 billion over a five-year period to fund a national smoking cessation program and \$4 billion over a ten-year period to fund a public education and counter-marketing campaign. Further, the government's proposed remedy would have required defendants to pay additional monies to these programs if targeted reductions in the smoking rate of those under 21 are not achieved according to a prescribed timetable. The government's proposed remedies also included a series of measures and restrictions applicable to

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cigarette business operations including, but not limited to, restrictions on advertising and marketing, potential measures with respect to certain price promotional activities and research and development, disclosure requirements for certain confidential data and implementation of a monitoring system with potential broad powers over cigarette operations.

In August 2006, the federal trial court entered judgment in favor of the government. The court held that certain defendants, including Altria Group, Inc. and PM USA, violated RICO and engaged in 7 of the 8 sub-schemes to defraud that the government had alleged. Specifically, the court found that:

defendants falsely denied, distorted and minimized the significant adverse health consequences of smoking;

defendants hid from the public that cigarette smoking and nicotine are addictive;

defendants falsely denied that they control the level of nicotine delivered to create and sustain addiction;

defendants falsely marketed and promoted low tar/light cigarettes as less harmful than full-flavor cigarettes;

defendants falsely denied that they intentionally marketed to youth;

defendants publicly and falsely denied that ETS is hazardous to non-smokers; and

defendants suppressed scientific research.

The court did not impose monetary penalties on the defendants, but ordered the following relief: (i) an injunction against committing any act of racketeering relating to the manufacturing, marketing, promotion, health consequences or sale of cigarettes in the United States; (ii) an injunction against participating directly or indirectly in the management or control of the Council for Tobacco Research, the Tobacco Institute, or the Center for Indoor Air Research, or any successor or affiliated entities of each; (iii) an injunction against making, or causing to be made in any way, any material false, misleading, or deceptive statement or representation or engaging in any public relations or marketing endeavor that is disseminated to the United States public and that misrepresents or suppresses information concerning cigarettes; (iv) an injunction against conveying any express or implied health message through use of descriptors on cigarette packaging or in cigarette advertising or promotional material, including lights, ultra lights and low tar, which the court found could cause consumers to believe one cigarette brand is less hazardous than another brand; (v) the issuance of corrective statements in various media regarding the adverse health effects of smoking, the addictiveness of smoking and nicotine, the lack of any significant health benefit from smoking low tar or light cigarettes, defendants manipulation of cigarette design to ensure optimum nicotine delivery and the adverse health effects of exposure to environmental tobacco smoke; (vi) the disclosure on defendants public document websites and in the Minnesota document repository of all documents produced to the government in the lawsuit or produced in any future court or administrative action concerning smoking and health until 2021, with certain additional requirements as to documents withheld from production under a claim of privilege or confidentiality; (vii) the disclosure of disaggregated marketing data to the government in the same form and on the same schedule as defendants now follow in disclosing such data to the Federal Trade Commission (FTC) for a period of ten years; (viii) certain restrictions on the sale or transfer by defendants of any cigarette brands, brand names, formulas or cigarette businesses within the United States; and (ix) payment of the government's costs in bringing the action.



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In September 2006, defendants filed notices of appeal to the United States Court of Appeals for the District of Columbia Circuit and in October 2006, a three judge panel of the Court of Appeals stayed the trial court's judgment pending its review of the decision. Certain defendants, including PM USA and Altria Group, Inc., filed a motion to clarify the trial court's August 2006 Final Judgment and Remedial Order. In March 2007, the trial court denied in part and granted in part defendants' post-trial motion for clarification of portions of the court's remedial order.

In May 2009 a three judge panel of the Court of Appeals for the District of Columbia Circuit issued a *per curiam* decision largely affirming the trial court's judgment against defendants and in favor of the government. Although the panel largely affirmed the remedial order that was issued by the trial court, it vacated the following aspects of the order:

its application to defendants' subsidiaries;

the prohibition on the use of express or implied health messages or health descriptors, but only to the extent of extraterritorial application;

its point-of-sale display provisions; and

its application to Brown & Williamson Holdings.

The Court of Appeals panel remanded the case for the trial court to reconsider these four aspects of the injunction and to reformulate its remedial order accordingly.

Furthermore, the Court of Appeals panel rejected all of the government's and intervenors' cross appeal arguments and refused to broaden the remedial order entered by the trial court. The Court of Appeals panel also left undisturbed its prior holding that the government cannot obtain disgorgement as a permissible remedy under RICO.

In July 2009, defendants filed petitions for a rehearing before the panel and for a rehearing by the entire Court of Appeals. Defendants also filed a motion to vacate portions of the trial court's judgment on the grounds of mootness because of the passage of legislation granting FDA broad authority over the regulation of tobacco products. In September 2009, the Court of Appeals entered three *per curiam* rulings. Two of them denied defendants' petitions for panel rehearing or for rehearing *en banc*. In the third *per curiam* decision, the Court of Appeals denied defendants' suggestion of mootness and motion for partial *vacatur*. In September 2009, defendants petitioned the Court of Appeals to issue a stay of its mandate pending the filing and disposition of petitions for *writs of certiorari* to the United States Supreme Court. In October 2009, the Court of Appeals granted the motion in part, staying the issuance of the mandate until December 2009. In December 2009, the Court of Appeals extended the stay of the mandate through the Supreme Court's final disposition of defendants' *certiorari* petitions. In February 2010, PM USA and Altria Group, Inc. filed their *certiorari* petitions with the United States Supreme Court. In addition, the federal government and the intervenors filed their own *certiorari* petitions, asking the court to reverse an earlier Court of Appeals decision and hold that civil RICO allows the trial court to order disgorgement as well as other equitable relief, such as smoking cessation remedies, designed to redress continuing consequences of prior RICO violations. In June 2010, the United States Supreme Court denied all of the parties' petitions. On July 7, 2010, the Court of Appeals issued its mandate lifting the stay of the trial court's judgment and remanding the case to the trial court.



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As a result of the mandate, except for those matters remanded to the trial court for further proceedings, defendants are now subject to the injunction discussed above and the other elements of the trial court's judgment. On September 15, 2010, the trial court held a status conference to hear the parties' preliminary views regarding the remaining issues to be addressed on remand. After the conference, the trial court issued an order

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requesting that the parties submit a detailed status report by November 24, 2010. A subsequent status conference is scheduled for December 20, 2010.

**Lights/Ultra Lights Cases**

*Overview*

Plaintiffs in certain pending matters seek certification of their cases as class actions and allege, among other things, that the uses of the terms Lights and/or Ultra Lights constitute deceptive and unfair trade practices, common law fraud, or RICO violations, and seek injunctive and equitable relief, including restitution and, in certain cases, punitive damages. These class actions have been brought against PM USA and, in certain instances, Altria Group, Inc. or its subsidiaries, on behalf of individuals who purchased and consumed various brands of cigarettes, including *Marlboro Lights*, *Marlboro Ultra Lights*, *Virginia Slims Lights* and *Superslims*, *Merit Lights* and *Cambridge Lights*. Defenses raised in these cases include lack of misrepresentation, lack of causation, injury, and damages, the statute of limitations, express preemption by the Federal Cigarette Labeling and Advertising Act ( FCLAA ) and implied preemption by the policies and directives of the FTC, non-liability under state statutory provisions exempting conduct that complies with federal regulatory directives, and the First Amendment. As of October 25, 2010, a total of twenty-nine such cases were pending in the United States. Fifteen of these cases were pending in a multidistrict litigation proceeding in a single U.S. federal court as discussed below. These cases were pending in various U.S. state courts. In addition, a purported Lights class action is pending against PM USA in Israel. Other entities have stated that they are considering filing such actions against Altria Group, Inc. and PM USA.

In the one Lights case pending in Israel, hearings on plaintiffs motion for class certification were held in November and December 2008.

*The Good Case*

In May 2006, a federal trial court in Maine granted PM USA s motion for summary judgment in *Good*, a purported Lights class action, on the grounds that plaintiffs claims are preempted by the FCLAA and dismissed the case. In August 2007, the United States Court of Appeals for the First Circuit vacated the district court s grant of PM USA s motion for summary judgment on federal preemption grounds and remanded the case to district court. The district court stayed the case pending the United States Supreme Court s ruling on defendants petition for *writ of certiorari* with the United States Supreme Court, which was granted in January 2008. The case was stayed pending the United States Supreme Court s decision. In December 2008, the United States Supreme Court ruled that plaintiffs claims are not barred by federal preemption. Although the Court rejected the argument that the FTC s actions were so extensive with respect to the descriptors that the state law claims were barred as a matter of federal law, the Court s decision was limited: it did not address the ultimate merits of plaintiffs claim, the viability of the action as a class action, or other state law issues. The case has been returned to the federal court in Maine for further proceedings and has been consolidated with other federal cases in the multidistrict litigation proceeding discussed below.

*Certain Developments Since December 2008 Good Decision*

Since the December 2008 U.S. Supreme Court decision in *Good*, and through October 25, 2010, twenty-three Lights class actions were served upon PM USA and Altria Group, Inc. These twenty-three cases were filed in 15 states and the District of Columbia. All of these cases either were filed in federal court or were removed to federal court by PM USA.

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A number of Lights class actions have been transferred and consolidated by the Judicial Panel on Multidistrict Litigation ( JPMDL ) before the U.S. District Court for the District of Maine for pretrial proceedings ( MDL proceeding ). As of October 25, 2010, fifteen cases against Altria Group, Inc. and/or PM USA were pending in or awaiting transfer to the MDL proceeding. These cases, and the states in which each originated, are: *Biundo* (Illinois), *Corse* (Tennessee), *Domaingue* (New York), *Good* (Maine), *Haubrich* (Pennsylvania), *Mirick* (Mississippi), *Mulford* (New Mexico), *Parsons* (District of Columbia), *Phillips* (Ohio), *Slater* (District of Columbia), *Tang* (New York), *Tyrer* (California), *Watson* (Arkansas), *Williams* (Arkansas) and *Wyatt* (formerly *Nikolic*) (Wisconsin).

In November 2009, plaintiffs in the MDL proceeding filed a motion seeking collateral estoppel effect from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described above), which motion was denied in March 2010. In January 2010, PM USA filed a motion for summary judgment regarding plaintiffs' claims for purchases made after December 1, 2002. In March 2010, PM USA filed additional summary judgment motions, and plaintiffs filed a motion for class certification. In May 2010, and on July 26, 2010 and September 16, 2010, the district court denied all of PM USA's summary judgment motions. The court has not yet ruled on plaintiff's motion for class certification. Argument was held on July 21, 2010.

*Lights Cases Dismissed, Not Certified or Ordered De-Certified*

To date, 15 courts in 16 Lights cases have refused to certify class actions, dismissed class action allegations, reversed prior class certification decisions or have entered judgment in favor of PM USA.

Trial courts in Arizona, Illinois, Kansas, New Jersey, New Mexico, Oregon, Tennessee and Washington have refused to grant class certification or have dismissed plaintiffs' class action allegations. Plaintiffs voluntarily dismissed a case in Michigan after a trial court dismissed the claims plaintiffs asserted under the Michigan Unfair Trade and Consumer Protection Act.

Several appellate courts have issued rulings that either affirmed rulings in favor of Altria Group, Inc. and/or PM USA or reversed rulings entered in favor of plaintiffs. In Florida, an intermediate appellate court overturned an order by a trial court that granted class certification in *Hines*. The Florida Supreme Court denied review in January 2008. The Supreme Court of Illinois has overturned a judgment that awarded damages to a certified class in the *Price* case. See *The Price Case* below for further discussion. In Louisiana, the United States Court of Appeals for the Fifth Circuit dismissed a purported Lights class action brought in Louisiana federal court (*Sullivan*) on the grounds that plaintiffs' claims were preempted by the FCLAA. In New York, the United States Court of Appeals for the Second Circuit overturned a decision by a New York trial court in *Schwab* that denied defendants' summary judgment motions and granted plaintiffs' motion for certification of a nationwide class of all United States residents that purchased cigarettes in the United States that were labeled Light or Lights. On July 13, 2010, plaintiffs in *Schwab* voluntarily dismissed the case with prejudice. In Ohio, the Ohio Supreme Court overturned class certifications in the *Marrone* and *Phillips* cases. Plaintiffs voluntarily dismissed both cases in August 2009. The Supreme Court of Washington denied a motion for interlocutory review filed by the plaintiffs in the *Davies* case that sought review of an order by the trial court that refused to certify a class. Plaintiffs subsequently voluntarily dismissed the *Davies* case with prejudice. Plaintiffs in the New Mexico case (*Mulford*) renewed their motion for class certification, which motion was denied by the federal district court in March 2009, with leave to file a new motion for class certification.

In Oregon (*Pearson*), a state court denied plaintiff's motion for interlocutory review of the trial court's refusal to certify a class. In February 2007, PM USA filed a motion for summary judgment based on federal preemption and the Oregon statutory exemption. In September 2007, the district court granted PM USA's motion based on express preemption under the FCLAA, and plaintiffs appealed this dismissal and the class certification denial to the Oregon Court of Appeals. Argument was held in April 2010.

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In *Cleary*, which was pending in an Illinois federal court, the district court dismissed plaintiffs' Lights claims against one defendant and denied plaintiffs' request to remand the case to state court. In September 2009, the court issued its ruling on PM USA's and the remaining defendants' motion for summary judgment as to all Lights claims. The court granted the motion as to all defendants except PM USA. As to PM USA, the court granted the motion as to all Lights and other low tar brands other than *Marlboro Lights*. As to *Marlboro Lights*, the court ordered briefing on why the 2002 state court order dismissing the *Marlboro Lights* claims should not be vacated based upon *Good*. In January 2010, the court vacated the previous dismissal. In February 2010, the court granted summary judgment in favor of defendants as to all claims except for the *Marlboro Lights* claims, based on the statute of limitations and deficiencies relating to the named plaintiffs. In June 2010, the court granted summary judgment in favor of all defendants on all remaining claims, dismissing the case. On July 20, 2010, plaintiffs filed a motion for reconsideration with the district court, which was denied on July 23, 2010. On August 20, 2010, plaintiffs filed an appeal with the United States Court of Appeals for the Seventh Circuit.

*Other Developments*

In December 2009, the state trial court in the *Holmes* case (pending in Delaware), denied PM USA's motion for summary judgment based on an exemption provision in the Delaware Consumer Fraud Act.

In June 2007, the United States Supreme Court reversed the lower court rulings in the *Watson* case that denied plaintiffs' motion to have the case heard in a state, as opposed to federal, trial court. The Supreme Court rejected defendant's contention that the case must be tried in federal court under the federal officer statute. The case was removed to federal court in Arkansas and the case was transferred to the MDL proceeding discussed above. On October 18, 2010, the JPMDL denied plaintiffs' motion to remand the case to state court and to vacate the transfer order.

In New Hampshire (*Lawrence*), plaintiffs have petitioned the state trial court to certify a class. Argument was held on September 14, 2010.

*The Price Case*

Trial in the *Price* case commenced in state court in Illinois in January 2003, and in March 2003, the judge found in favor of the plaintiff class and awarded \$7.1 billion in compensatory damages and \$3 billion in punitive damages against PM USA. In connection with the judgment, PM USA deposited into escrow various forms of collateral, including cash and negotiable instruments. In December 2005, the Illinois Supreme Court issued its judgment, reversing the trial court's judgment in favor of the plaintiffs and directing the trial court to dismiss the case. In May 2006, the Illinois Supreme Court denied plaintiffs' motion for re-hearing, in November 2006, the United States Supreme Court denied plaintiffs' petition for writ of certiorari and, in December 2006, the Circuit Court of Madison County enforced the Illinois Supreme Court's mandate and dismissed the case with prejudice. In January 2007, plaintiffs filed a motion to vacate or withhold judgment based upon the United States Supreme Court's grant of the petition for writ of certiorari in *Watson* (described below). In May 2007, PM USA filed applications for a writ of mandamus or a supervisory order with the Illinois Supreme Court seeking an order compelling the lower courts to deny plaintiffs' motion to vacate and/or withhold judgment. In August 2007, the Illinois Supreme Court granted PM USA's motion for supervisory order and the trial court dismissed plaintiff's motion to vacate or withhold judgment. The collateral that PM USA deposited into escrow after the initial 2003 judgment was released and returned to PM USA.

In December 2008, plaintiffs filed with the trial court a petition for relief from the final judgment that was entered in favor of PM USA. Specifically, plaintiffs sought to vacate the 2005 Illinois Supreme Court judgment, contending that the United States Supreme Court's December 2008 decision in *Good* demonstrated that the Illinois Supreme Court's decision was inaccurate. PM USA filed a motion to dismiss plaintiffs' petition and,



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in February 2009, the trial court granted PM USA's motion. In March 2009, the *Price* plaintiffs filed a notice of appeal with the Fifth Judicial District of the Appellate Court of Illinois. Argument was held in February 2010.

In June 2009, the plaintiff in an individual smoker lawsuit (*Kelly*) brought on behalf of an alleged smoker of Lights cigarettes in Madison County, Illinois state court filed a motion seeking a declaration that (1) his claims under the Illinois Consumer Fraud Act are not barred by the exemption in that statute based on his assertion that the Illinois Supreme Court's decision in *Price* is no longer good law in light of the decisions by the U.S. Supreme Court in *Good* and *Watson*, and (2) their claims are not preempted in light of the U.S. Supreme Court's decision in *Good*. In September 2009, the court granted plaintiff's motion as to federal preemption, but denied it with respect to the state statutory exemption.

*State Trial Court Class Certifications*

State trial courts have certified classes against PM USA in Massachusetts (*Aspinall*), Minnesota (*Curtis*), and Missouri (*Larsen*, formerly *Craft*). Significant developments in these cases include:

*Aspinall*: In August 2004, the Massachusetts Supreme Judicial Court affirmed the class certification order. In August 2006, the trial court denied PM USA's motion for summary judgment and granted plaintiffs' motion for summary judgment on the defenses of federal preemption and a state law exemption to Massachusetts' consumer protection statute. On motion of the parties, the trial court subsequently reported its decision to deny summary judgment to the appeals court for review and stayed further proceedings pending completion of the appellate review. In December 2008, subsequent to the United States Supreme Court's decision in *Good*, the Massachusetts Supreme Judicial Court issued an order requesting that the parties advise the court within 30 days whether the *Good* decision is dispositive of federal preemption issues pending on appeal. In January 2009, PM USA notified the Massachusetts Supreme Judicial Court that *Good* is dispositive of the federal preemption issues on appeal, but requested further briefing on the state law statutory exemption issue. In March 2009, the Massachusetts Supreme Judicial Court affirmed the order denying summary judgment to PM USA and granting the plaintiffs' cross-motion. In January 2010, plaintiffs moved for partial summary judgment as to liability claiming collateral estoppel from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described above).

*Curtis*: In April 2005, the Minnesota Supreme Court denied PM USA's petition for interlocutory review of the trial court's class certification order. In October 2009, the trial court denied plaintiffs' motion for partial summary judgment, filed in February 2009, claiming collateral estoppel from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described above). In October 2009, the trial court granted PM USA's motion for partial summary judgment, filed in August 2009, as to all consumer protection counts and, in December 2009, dismissed the case in its entirety. Both sides have appealed to the Minnesota Court of Appeals. Argument was heard on October 7, 2010.

*Larsen*: In August 2005, a Missouri Court of Appeals affirmed the class certification order. In December 2009, the trial court denied plaintiff's motion for reconsideration of the period during which potential class members can qualify to become part of the class. The class period remains 1995–2003. In January 2010, PM USA filed a motion for partial summary judgment regarding plaintiffs' request for punitive damages, which motion was denied on June 28, 2010. In April 2010, plaintiffs moved for partial summary judgment as to an element of liability in the case, claiming collateral estoppel from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described above). Argument was held on July 27, 2010. Also on July 27, 2010, the parties stipulated to the dismissal of Altria Group, Inc. as a defendant in the case. PM USA remains a defendant. The case is tentatively set for trial in September 2011.



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*Certain Other Tobacco-Related Litigation*

*Tobacco Price Cases:* As of October 25, 2010, one case remains pending in Kansas (*Smith*) in which plaintiffs allege that defendants, including PM USA and Altria Group, Inc., conspired to fix cigarette prices in violation of antitrust laws. Plaintiffs' motion for class certification has been granted. No trial date has been set. In June 2006, defendants' motion for summary judgment was granted in a similar case filed in New Mexico (*Romero*). In November 2008, the New Mexico Court of Appeals reversed the trial court decision granting summary judgment as to certain defendants, including PM USA. In February 2009, the New Mexico Supreme Court granted the petition for *writ of certiorari* filed by PM USA and other defendants. In June 2010, the New Mexico Supreme Court reversed the decision of the New Mexico Court of Appeals and affirmed the district court's grant of summary judgment to the defendants. The litigation in *Romero* has now concluded.

*Cases Under the California Business and Professions Code:* In June 1997, a lawsuit (*Brown*) was filed in California state court alleging that domestic cigarette manufacturers, including PM USA and others, have violated California Business and Professions Code Sections 17200 and 17500 regarding unfair, unlawful and fraudulent business practices. Class certification was granted as to plaintiffs' claims that class members are entitled to reimbursement of the costs of cigarettes purchased during the class periods and injunctive relief. In September 2004, the trial court granted defendants' motion for summary judgment as to plaintiffs' claims attacking defendants' cigarette advertising and promotion and denied defendants' motion for summary judgment on plaintiffs' claims based on allegedly false affirmative statements. Plaintiffs' motion for rehearing was denied. In March 2005, the court granted defendants' motion to decertify the class based on a California law, which *inter alia* limits the ability to bring a lawsuit to only those plaintiffs who have suffered injury in fact and lost money or property as a result of defendant's alleged statutory violations ( Proposition 64 ). In two July 2006 opinions, the California Supreme Court held Proposition 64 applicable to pending cases. Plaintiffs' motion for reconsideration of the order that decertified the class was denied, and plaintiffs appealed. In September 2006, an intermediate appellate court affirmed the trial court's order decertifying the class. In May 2009, the California Supreme Court reversed the trial court decision that was affirmed by the appellate court and remanded the case to the trial court. Defendants filed a rehearing petition in June 2009. In August 2009, the California Supreme Court denied defendants' rehearing petition and issued its mandate. In March 2010, the trial court granted reconsideration of its September 2004 order granting partial summary judgment to defendants with respect to plaintiffs' Lights claims on the basis of judicial decisions issued since its order was issued, including the United States Supreme Court's ruling in *Good*, thereby reinstating plaintiffs' Lights claims. Since the trial court's prior ruling decertifying the class was reversed on appeal by the California Supreme Court, the parties and the court are treating all claims currently being asserted by the plaintiffs as certified, subject, however, to defendants' challenge to the class representatives' standing to assert their claims. On July 14, 2010, plaintiffs filed a motion seeking collateral estoppel effect from the findings in the case brought by the Department of Justice (see *Federal Government's Lawsuit* described above). On September 8, 2010, plaintiffs filed a motion for preliminary resolution of legal issues regarding restitutionary relief. Argument on both motions is scheduled for November 3, 2010. The case is scheduled for trial in May 2011.

*Ignition Propensity Cases:* PM USA is currently a defendant in two wrongful death actions in which plaintiffs contend that fires caused by cigarettes led to other individuals' deaths. In one case pending in federal court in Massachusetts (*Sarro*), the district court in August 2009 granted in part PM USA's motion to dismiss, but ruled that two claims unrelated to product design could go forward. In January 2010, plaintiff filed a motion for reconsideration or to certify questions to the Massachusetts Supreme Judicial Court, which motion was denied in May 2010. In a Kentucky federal court case (*Walker*), the court dismissed plaintiffs' claims in February 2009 and plaintiffs subsequently filed a notice of appeal. The appeal is pending before the United States Court of Appeals for the Sixth Circuit. Argument was held on October 13, 2010.



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**UST Litigation**

*Types of Cases*

Claims related to smokeless tobacco products generally fall within the following categories:

First, UST and/or its tobacco subsidiaries has been named in certain health care cost reimbursement/third-party recoupment/class action litigation against the major domestic cigarette companies and others seeking damages and other relief. The complaints in these cases on their face predominantly relate to the usage of cigarettes; within that context, certain complaints contain a few allegations relating specifically to smokeless tobacco products. These actions are in varying stages of pretrial activities.

Second, UST and/or its tobacco subsidiaries has been named in certain actions in West Virginia brought on behalf of individual plaintiffs against cigarette manufacturers, smokeless tobacco manufacturers, and other organizations seeking damages and other relief in connection with injuries allegedly sustained as a result of tobacco usage, including smokeless tobacco products. Included among the plaintiffs are five individuals alleging use of USSTC's smokeless tobacco products and alleging the types of injuries claimed to be associated with the use of smokeless tobacco products. While certain of these actions had not been consolidated for pretrial and trial proceedings, USSTC, along with other non-cigarette manufacturers, has remained severed from such proceedings since December 2001.

Third, UST and/or its tobacco subsidiaries has been named in a number of other individual tobacco and health suits. Plaintiffs' allegations of liability in these cases are based on various theories of recovery, such as negligence, strict liability, fraud, misrepresentation, design defect, failure to warn, breach of implied warranty, addiction, and breach of consumer protection statutes. Plaintiffs seek various forms of relief, including compensatory and punitive damages, and certain equitable relief, including but not limited to disgorgement. Defenses raised in these cases include lack of causation, assumption of the risk, comparative fault and/or contributory negligence, and statutes of limitations. USSTC is currently named in an action in Florida (*Vassallo*) and in an action in Connecticut (*Hill*). USSTC has agreed to honor a \$5 million settlement offer it made to the plaintiff in the *Hill* case before the January 2009 acquisition of UST by Altria Group, Inc. The settlement is subject to the approval of the trial court.

**Certain Other Actions**

*IRS Challenges to PMCC Leases:* The IRS concluded its examination of Altria Group, Inc.'s consolidated tax returns for the years 1996 through 1999, and issued a final Revenue Agent's Report (RAR) in March 2006. The RAR disallowed tax benefits pertaining to certain PMCC LILO and SILO transactions, for the years 1996 through 1999. Altria Group, Inc. agreed with all conclusions of the RAR, with the exception of the disallowance of tax benefits pertaining to the LILO and SILO transactions. Altria Group, Inc. contests approximately \$150 million of tax and net interest assessed and paid with regard to them.

In October 2006, Altria Group, Inc. filed a complaint in the United States District Court for the Southern District of New York to claim refunds on a portion of these tax payments and associated interest for the years 1996 and 1997. In July 2009, the jury returned a unanimous verdict in favor of the IRS and subsequently Altria Group, Inc. filed motions for judgment as a matter of law or, in the alternative, for a new trial. In March 2010, the court denied Altria Group, Inc.'s post-trial motions and, in April 2010, entered final judgment in favor of the IRS. Altria Group, Inc. filed an appeal with the United States Court of Appeals for the Second Circuit in June 2010.

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In March 2008, Altria Group, Inc. filed a second complaint in the United States District Court for the Southern District of New York seeking a refund of the tax payments and associated interest for the years 1998 and 1999 attributable to the disallowance of tax benefits claimed in those years with respect to the leases subject to the jury verdict and with respect to certain other leases entered into in 1998 and 1999. In May 2009, the district court granted a stay pending the decision by the United States Court of Appeals for the Second Circuit in the case involving the 1996 and 1997 years.

In May 2010, Altria Group, Inc. executed a closing agreement with the IRS for the 2000-2003 years, which resolved various tax matters of Altria Group, Inc. and its former subsidiaries, with the exception of the LILO and SILO transactions. Altria Group, Inc. disputes the IRS' disallowance of tax benefits related to the LILO and SILO transactions in the 2000-2003 years. Altria Group, Inc. intends to file a claim for refund of approximately \$945 million of tax and associated interest paid on July 20, 2010 in connection with the closing agreement, with respect to the LILO and SILO transactions that PMCC entered into during the 1996-2003 years. If the IRS disallows the claim, as anticipated, Altria Group, Inc. intends to commence litigation in federal court. Altria Group, Inc. and the IRS agreed that, with the exception of the LILO and SILO transactions, the tax treatment reported by Altria Group, Inc. on its consolidated tax returns for the 2000-2003 years, as amended by the agreed-upon adjustments in the closing agreement, is appropriate and final. The IRS may not assess against Altria Group, Inc. any further taxes or additions to tax (including penalties) with respect to these years.

Altria Group, Inc. further expects the IRS to challenge and disallow tax benefits claimed in subsequent years related to the LILO and SILO transactions that PMCC entered into from 1996 through 2003. For the period January 1, 2004 through December 31, 2010, the disallowance of federal income tax and associated interest related to the LILO and SILO transactions would be approximately \$1.0 billion, taking into account federal income tax paid or payable on gains associated with sales of leased assets during that period and excluding potential penalties. The payment, if any, of this amount would depend upon the timing and outcome of future IRS audits and any related administrative challenges or litigation. The IRS is currently auditing the 2004 - 2006 years.

As of September 30, 2010, the LILO and SILO transactions represented approximately 41% of the Net Finance Assets of PMCC's lease portfolio. PMCC has not entered into any LILO or SILO transactions since 2003.

Should Altria Group, Inc. not prevail in these matters, Altria Group, Inc. may have to accelerate the payment of significant additional amounts of federal income tax, pay associated interest costs and penalties, if imposed, and significantly lower its earnings to reflect the recalculation of the income from the affected leveraged leases, which could have a material effect on the earnings and cash flows of Altria Group, Inc. in a particular fiscal quarter or fiscal year.

*Kraft Thrift Plan Case:* Four participants in the Kraft Foods Global, Inc. Thrift Plan ( *Kraft Thrift Plan* ), a defined contribution plan, filed a class action complaint on behalf of all participants and beneficiaries of the Kraft Thrift Plan in July 2008 in the United States District Court for the Northern District of Illinois alleging breach of fiduciary duty under the Employee Retirement Income Security Act ( *ERISA* ). Named defendants in this action include Altria Corporate Services, Inc. (now Altria Client Services Inc.) and certain company committees that allegedly had a relationship to the Kraft Thrift Plan. Plaintiffs request, among other remedies, that defendants restore to the Kraft Thrift Plan all losses improperly incurred. The Altria Group, Inc. defendants deny any violation of ERISA or other unlawful conduct and are defending the case vigorously.

In December 2009, the court granted in part and denied in part defendants' motion to dismiss plaintiffs' complaint. In addition to dismissing certain claims made by plaintiffs for equitable relief under ERISA as to all defendants, the court dismissed claims alleging excessive administrative fees and mismanagement of company stock funds as to one of the Altria Group, Inc. defendants. In February 2010, the court granted a joint



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stipulation dismissing the fee and stock fund claims without prejudice as to the remaining defendants, including Altria Corporate Services, Inc. Accordingly, the only claim remaining at this time relates to the alleged negligence of plan fiduciaries for including the Growth Equity Fund and Balanced Fund as Kraft Thrift Plan investment options. Plaintiffs filed a motion for class certification in March 2010, which the court granted on August 26, 2010.

Under the terms of a Distribution Agreement between Altria Group, Inc. and Kraft, the Altria Group, Inc. defendants may be entitled to indemnity against any liabilities incurred in connection with this case.

**Environmental Regulation**

Altria Group, Inc. and its subsidiaries (and former subsidiaries) are subject to various federal, state and local laws and regulations concerning the discharge of materials into the environment, or otherwise related to environmental protection, including, in the United States: The Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act (commonly known as Superfund ), which can impose joint and several liability on each responsible party. Subsidiaries (and former subsidiaries) of Altria Group, Inc. are involved in several matters subjecting them to potential costs of remediation and natural resource damages under Superfund or other laws and regulations. Altria Group, Inc. s subsidiaries expect to continue to make capital and other expenditures in connection with environmental laws and regulations. Although it is not possible to predict precise levels of environmental-related expenditures, compliance with such laws and regulations, including the payment of any remediation costs or damages and the making of such expenditures, has not had, and is not expected to have, a material adverse effect on Altria Group, Inc. s consolidated results of operations, capital expenditures, financial position, earnings or competitive position.

**Guarantees**

In the ordinary course of business, certain subsidiaries of Altria Group, Inc. have agreed to indemnify a limited number of third parties in the event of future litigation. At September 30, 2010, subsidiaries of Altria Group, Inc. were also contingently liable for \$23 million of guarantees related to their own performance, consisting primarily of surety bonds. These items have not had, and are not expected to have, a significant impact on Altria Group, Inc. s liquidity.

Under the terms of a distribution agreement between Altria Group, Inc. and PMI, entered into as a result of the PMI spin-off, liabilities concerning tobacco products will be allocated based in substantial part on the manufacturer. PMI will indemnify Altria Group, Inc. and PM USA for liabilities related to tobacco products manufactured by PMI or contract manufactured for PMI by PM USA, and PM USA will indemnify PMI for liabilities related to tobacco products manufactured by PM USA, excluding tobacco products contract manufactured for PMI. Altria Group, Inc. does not have a related liability recorded on its condensed consolidated balance sheet at September 30, 2010 as the fair value of this indemnification is insignificant.

As more fully discussed in Note 13. *Condensed Consolidating Financial Information*, PM USA has issued guarantees relating to Altria Group, Inc. s obligations under its outstanding debt securities and borrowings under its revolving credit agreements and commercial paper program.

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**Redeemable Noncontrolling Interest**

In September 2007, UST completed the acquisition of *Stag's Leap Wine Cellars* through one of its consolidated subsidiaries, Michelle-Antinori, LLC ( Michelle-Antinori ), in which UST holds an 85% ownership interest with a 15% noncontrolling interest held by Antinori California ( Antinori ). In connection with the acquisition of *Stag's Leap Wine Cellars*, UST entered into a put arrangement with Antinori. The put arrangement, as later amended, provides Antinori with the right to require UST to purchase its 15% ownership interest in Michelle-Antinori at a price equal to Antinori's initial investment of \$27 million. The put arrangement became exercisable on September 11, 2010 and has no expiration date. As of September 30, 2010, the redemption value of the put arrangement did not exceed the noncontrolling interest balance. Therefore, no adjustment to the value of the redeemable noncontrolling interest was recognized in the condensed consolidated balance sheet for the put arrangement.

The noncontrolling interest put arrangement is accounted for as mandatorily redeemable securities because redemption is outside of the control of UST. As such, the redeemable noncontrolling interest is reported in the mezzanine equity section in the condensed consolidated balance sheet at September 30, 2010.

**Note 13. Condensed Consolidating Financial Information:**

PM USA has issued guarantees relating to Altria Group, Inc.'s obligations under its outstanding debt securities, borrowings under its revolving credit agreements and amounts outstanding under its commercial paper program (the Guarantees ). Pursuant to the Guarantees, PM USA fully and unconditionally guarantees, as primary obligor, the payment and performance of Altria Group, Inc.'s obligations under the guaranteed debt instruments (the Obligations ).

The Guarantees provide that PM USA fully and unconditionally guarantees the punctual payment when due, whether at stated maturity, by acceleration or otherwise, of the Obligations. The liability of PM USA under the Guarantees is absolute and unconditional irrespective of: any lack of validity, enforceability or genuineness of any provision of any agreement or instrument relating thereto; any change in the time, manner or place of payment of, or in any other term of, all or any of the Obligations, or any other amendment or waiver of or any consent to departure from any agreement or instrument relating thereto; any exchange, release or non-perfection of any collateral, or any release or amendment or waiver of or consent to departure from any other guarantee, for all or any of the Obligations; or any other circumstance that might otherwise constitute a defense available to, or a discharge of, Altria Group, Inc. or PM USA.

The obligations of PM USA under the Guarantees are limited to the maximum amount as will, after giving effect to such maximum amount and all other contingent and fixed liabilities of PM USA that are relevant under Bankruptcy Law, the Uniform Fraudulent Conveyance Act, the Uniform Fraudulent Transfer Act or any similar federal or state law to the extent applicable to the Guarantees, result in PM USA's obligations under the Guarantees not constituting a fraudulent transfer or conveyance. For this purpose, Bankruptcy Law means Title 11, U.S. Code, or any similar federal or state law for the relief of debtors.

PM USA will be unconditionally released and discharged from its obligations under each of the Guarantees upon the earliest to occur of:

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Altria Group, Inc. and Subsidiaries  
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the date, if any, on which PM USA consolidates with or merges into Altria Group, Inc. or any successor;

the date, if any, on which Altria Group, Inc. or any successor consolidates with or merges into PM USA;

the payment in full of the Obligations pertaining to such Guarantees; or

the rating of Altria Group, Inc.'s long-term senior unsecured debt by Standard & Poor's of A or higher.

At September 30, 2010, the respective principal wholly-owned subsidiaries of Altria Group, Inc. and PM USA were not limited by long-term debt or other agreements in their ability to pay cash dividends or make other distributions with respect to their common stock.

The following sets forth the condensed consolidating balance sheets as of September 30, 2010 and December 31, 2009, condensed consolidating statements of earnings for the nine and three months ended September 30, 2010 and 2009, and condensed consolidating statements of cash flows for the nine months ended September 30, 2010 and 2009 for Altria Group, Inc., PM USA and Altria Group, Inc.'s other subsidiaries that are not guarantors of Altria Group, Inc.'s debt instruments (the Non-Guarantor Subsidiaries). The financial information is based on Altria Group, Inc.'s understanding of the SEC interpretation and application of Rule 3-10 of SEC Regulation S-X.

The financial information may not necessarily be indicative of results of operations or financial position had PM USA and the Non-Guarantor Subsidiaries operated as independent entities. Altria Group, Inc. and PM USA account for investments in their subsidiaries under the equity method of accounting.

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheets

September 30, 2010

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Consumer products</b>					
Cash and cash equivalents	\$ 1,677	\$ -	\$ 23	\$ -	\$ 1,700
Receivables, net	11	9	62		82
Inventories:					
Leaf tobacco		505	329		834
Other raw materials		135	34		169
Work in process		7	218		225
Finished product		125	265		390
		772	846		1,618
Due from Altria Group, Inc. and subsidiaries	626	2,393	1,348	(4,367)	
Deferred income taxes	27	1,256		(19)	1,264
Other current assets	32	650	160		842
Total current assets	2,373	5,080	2,439	(4,386)	5,506
Property, plant and equipment, at cost	2	3,765	1,410		5,177
Less accumulated depreciation	2	2,331	422		2,755
		1,434	988		2,422
Goodwill			5,174		5,174
Other intangible assets, net		2	12,120		12,122
Investment in SABMiller	5,374				5,374
Investment in consolidated subsidiaries	5,979	321		(6,300)	
Due from Altria Group, Inc. and subsidiaries	8,000			(8,000)	
Other assets	1,515	625	95	(398)	1,837
Total consumer products assets	23,241	7,462	20,816	(19,084)	32,435
<b>Financial services</b>					
Finance assets, net			4,647		4,647
Due from Altria Group, Inc. and subsidiaries			650	(650)	
Other assets			28		28

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Total financial services assets			5,325	(650)	4,675
TOTAL ASSETS	\$ 23,241	\$ 7,462	\$ 26,141	\$ (19,734)	\$ 37,110

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## Altria Group, Inc. and Subsidiaries

## Notes to Condensed Consolidated Financial Statements

(Unaudited)

## Condensed Consolidating Balance Sheets (Continued)

September 30, 2010

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>LIABILITIES</b>					
<b>Consumer products</b>					
Accounts payable	\$ 13	\$ 159	\$ 148	\$ -	\$ 320
Accrued liabilities:					
Marketing		454	30		484
Taxes, except income taxes		115	17		132
Employment costs	27	7	146		180
Settlement charges		3,221	5		3,226
Other	328	569	333	(19)	1,211
Dividends payable	796				796
Due to Altria Group, Inc. and subsidiaries	3,136	249	1,632	(5,017)	
Total current liabilities	4,300	4,774	2,311	(5,036)	6,349
Long-term debt	11,295		899		12,194
Deferred income taxes	1,885		3,292	(398)	4,779
Accrued pension costs	193		950		1,143
Accrued postretirement health care costs		1,525	848		2,373
Due to Altria Group, Inc. and subsidiaries			8,000	(8,000)	
Other liabilities	418	365	177		960
Total consumer products liabilities	18,091	6,664	16,477	(13,434)	27,798
<b>Financial services</b>					
Deferred income taxes			3,992		3,992
Other liabilities			135		135
Total financial services liabilities			4,127		4,127
Total liabilities	18,091	6,664	20,604	(13,434)	31,925
<b>Contingencies</b>					
Redeemable noncontrolling interest			33		33
<b>STOCKHOLDERS EQUITY</b>					
Common stock	935		9	(9)	935
Additional paid-in capital	5,760	408	6,660	(7,068)	5,760
Earnings reinvested in the business	23,334	672	235	(907)	23,334

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Accumulated other comprehensive losses	(1,369)	(282)	(1,402)	1,684	(1,369)
Cost of repurchased stock	(23,510)				(23,510)
Total stockholders' equity attributable to Altria Group, Inc.	5,150	798	5,502	(6,300)	5,150
Noncontrolling interests			2		2
Total stockholders' equity	5,150	798	5,504	(6,300)	5,152
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 23,241</b>	<b>\$ 7,462</b>	<b>\$ 26,141</b>	<b>\$ (19,734)</b>	<b>\$ 37,110</b>

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Balance Sheets

December 31, 2009

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>ASSETS</b>					
<b>Consumer products</b>					
Cash and cash equivalents	\$ 1,862	\$ -	\$ 9	\$ -	\$ 1,871
Receivables, net	3	13	80		96
Inventories:					
Leaf tobacco		632	361		993
Other raw materials		120	37		157
Work in process		4	289		293
Finished product		136	231		367
		892	918		1,810
Due from Altria Group, Inc. and subsidiaries	1,436	3,633	1,138	(6,207)	
Deferred income taxes	27	1,250	59		1,336
Other current assets	188	349	123		660
 Total current assets	 3,516	 6,137	 2,327	 (6,207)	 5,773
Property, plant and equipment, at cost	2	4,811	1,331		6,144
Less accumulated depreciation	2	3,054	404		3,460
		1,757	927		2,684
Goodwill			5,174		5,174
Other intangible assets, net		272	11,866		12,138
Investment in SABMiller	4,980				4,980
Investment in consolidated subsidiaries	5,589			(5,589)	
Due from Altria Group, Inc. and subsidiaries	8,000			(8,000)	
Other assets	774	122	201		1,097
 Total consumer products assets	 22,859	 8,288	 20,495	 (19,796)	 31,846
<b>Financial services</b>					

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Finance assets, net			4,803		4,803
Due from Altria Group, Inc. and subsidiaries			603	(603)	
Other assets			28		28
<b>Total financial services assets</b>			<b>5,434</b>	<b>(603)</b>	<b>4,831</b>
<b>TOTAL ASSETS</b>	<b>\$ 22,859</b>	<b>\$ 8,288</b>	<b>\$ 25,929</b>	<b>\$ (20,399)</b>	<b>\$ 36,677</b>

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Balance Sheets (Continued)

December 31, 2009

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>LIABILITIES</b>					
<b>Consumer products</b>					
Current portion of long-term debt	\$ 775	\$ -	\$ -	\$ -	\$ 775
Accounts payable	1	202	291		494
Accrued liabilities:					
Marketing		415	52		467
Taxes, except income taxes		298	20		318
Employment costs	29	19	191		239
Settlement charges		3,632	3		3,635
Other	270	728	356		1,354
Dividends payable	710				710
Due to Altria Group, Inc. and subsidiaries	4,341	241	2,228	(6,810)	
<b>Total current liabilities</b>	<b>6,126</b>	<b>5,535</b>	<b>3,141</b>	<b>(6,810)</b>	<b>7,992</b>
Long-term debt	10,287		898		11,185
Deferred income taxes	1,579	111	2,693		4,383
Accrued pension costs	194		963		1,157
Accrued postretirement health care costs		1,519	807		2,326
Due to Altria Group, Inc. and subsidiaries			8,000	(8,000)	
Other liabilities	604	453	191		1,248
<b>Total consumer products liabilities</b>	<b>18,790</b>	<b>7,618</b>	<b>16,693</b>	<b>(14,810)</b>	<b>28,291</b>
<b>Financial services</b>					
Deferred income taxes			4,180		4,180
Other liabilities			102		102
<b>Total financial services liabilities</b>			<b>4,282</b>		<b>4,282</b>
<b>Total liabilities</b>	<b>18,790</b>	<b>7,618</b>	<b>20,975</b>	<b>(14,810)</b>	<b>32,573</b>
Contingencies					
Redeemable noncontrolling interest			32		32

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STOCKHOLDERS EQUITY

Common stock	935		9	(9)	935
Additional paid-in capital	5,997	408	6,349	(6,757)	5,997
Earnings reinvested in the business	22,599	553	26	(579)	22,599
Accumulated other comprehensive losses	(1,561)	(291)	(1,465)	1,756	(1,561)
Cost of repurchased stock	(23,901)				(23,901)
Total stockholders equity attributable to Altria Group, Inc.	4,069	670	4,919	(5,589)	4,069
Noncontrolling interests			3		3
Total stockholders equity	4,069	670	4,922	(5,589)	4,072
<b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>	<b>\$ 22,859</b>	<b>\$ 8,288</b>	<b>\$ 25,929</b>	<b>\$ (20,399)</b>	<b>\$ 36,677</b>

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statements of Earnings

For the Nine Months Ended September 30, 2010

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ -	\$ 16,405	\$ 2,051	\$ (20)	\$ 18,436
Cost of sales		5,308	531	(20)	5,819
Excise taxes on products		5,431	252		5,683
Gross profit		5,666	1,268		6,934
Marketing, administration and research costs	90	1,635	258		1,983
Reduction of Kraft and PMI tax-related receivables	169				169
Asset impairment and exit costs		28	3		31
Amortization of intangibles			16		16
Operating (expense) income	(259)	4,003	991		4,735
Interest and other debt expense, net	411	4	441		856
Earnings from equity investment in SABMiller	(437)				(437)
(Loss) earnings before income taxes and equity earnings of subsidiaries	(233)	3,999	550		4,316
(Benefit) provision for income taxes	(285)	1,411	203		1,329
Equity earnings of subsidiaries	2,934	31		(2,965)	
Net earnings	2,986	2,619	347	(2,965)	2,987
Net earnings attributable to noncontrolling interests			(1)		(1)
Net earnings attributable to Altria Group, Inc.	\$ 2,986	\$ 2,619	\$ 346	\$ (2,965)	\$ 2,986

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## Altria Group, Inc. and Subsidiaries

## Notes to Condensed Consolidated Financial Statements

(Unaudited)

## Condensed Consolidating Statements of Earnings

For the Nine Months Ended September 30, 2009

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ -	\$ 15,549	\$ 1,993	\$ -	\$ 17,542
Cost of sales		5,465	476		5,941
Excise taxes on products		4,631	187		4,818
Gross profit		5,453	1,330		6,783
Marketing, administration and research costs	155	1,608	355		2,118
Reduction of Kraft tax-related receivable	88				88
Exit costs		86	213		299
Amortization of intangibles		8	8		16
Operating (expense) income	(243)	3,751	754		4,262
Interest and other debt expense (income), net	445	(3)	460		902
Earnings from equity investment in SABMiller	(442)				(442)
(Loss) earnings before income taxes and equity earnings of subsidiaries	(246)	3,754	294		3,802
(Benefit) provision for income taxes	(256)	1,497	79		1,320
Equity earnings of subsidiaries	2,471			(2,471)	
Net earnings	2,481	2,257	215	(2,471)	2,482
Net earnings attributable to noncontrolling interests			(1)		(1)
Net earnings attributable to Altria Group, Inc.	\$ 2,481	\$ 2,257	\$ 214	\$ (2,471)	\$ 2,481



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## Altria Group, Inc. and Subsidiaries

## Notes to Condensed Consolidated Financial Statements

(Unaudited)

## Condensed Consolidating Statements of Earnings

For the Three Months Ended September 30, 2010

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ -	\$ 5,716	\$ 693	\$ (7)	\$ 6,402
Cost of sales		1,813	179	(7)	1,985
Excise taxes on products		1,853	88		1,941
Gross profit		2,050	426		2,476
Marketing, administration and research costs	30	589	72		691
Exit costs		3			3
Amortization of intangibles			6		6
Operating (expense) income	(30)	1,458	348		1,776
Interest and other debt expense (income), net	134	(3)	148		279
Earnings from equity investment in SABMiller	(186)				(186)
Earnings before income taxes and equity earnings of subsidiaries	22	1,461	200		1,683
(Benefit) provision for income taxes	(30)	509	73		552
Equity earnings of subsidiaries	1,079	10		(1,089)	
Net earnings attributable to Altria Group, Inc.	\$ 1,131	\$ 962	\$ 127	\$ (1,089)	\$ 1,131

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Statements of Earnings

For the Three Months Ended September 30, 2009

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
Net revenues	\$ -	\$ 5,626	\$ 674	\$ -	\$ 6,300
Cost of sales		1,862	171		2,033
Excise taxes on products		1,899	83		1,982
Gross profit		1,865	420		2,285
Marketing, administration and research costs	34	578	51		663
Reduction of Kraft tax-related receivable	88				88
Exit costs		52	81		133
Amortization of intangibles		3	4		7
Operating (expense) income	(122)	1,232	284		1,394
Interest and other debt expense, net	128		151		279
Earnings from equity investment in SABMiller	(119)				(119)
(Loss) earnings before income taxes and equity earnings of subsidiaries	(131)	1,232	133		1,234
(Benefit) provision for income taxes	(188)	540			352
Equity earnings of subsidiaries	825			(825)	
Net earnings attributable to Altria Group, Inc.	\$ 882	\$ 692	\$ 133	\$ (825)	\$ 882

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Altria Group, Inc. and Subsidiaries  
Notes to Condensed Consolidated Financial Statements  
(Unaudited)

Condensed Consolidating Statements of Cash Flows

For the Nine Months Ended September 30, 2010

(in millions of dollars)

	Altria Group, Inc.	PM USA	Non- Guarantor Subsidiaries	Total Consolidating Adjustments	Consolidated
<b>CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>					
Net cash (used in) provided by operating activities	\$ (606)	\$ 1,933	\$ 395	\$ -	\$ 1,722
<b>CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES</b>					
<b>Consumer products</b>					
Capital expenditures		(30)	(86)		(116)
Other		2	78		80
<b>Financial services</b>					
Proceeds from finance assets			119		119
Net cash (used in) provided by investing activities		(28)	111		83
<b>CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>					
<b>Consumer products</b>					
Long-term debt issued	1,007				1,007
Long-term debt repaid	(775)				(775)
Dividends paid on common stock	(2,165)				(2,165)
Issuance of common stock	89				89
Changes in amounts due to/from Altria Group, Inc. and subsidiaries	(400)	636	(236)		
Financing fees and debt issuance costs	(6)				(6)
Cash dividends received from/(paid by) subsidiaries	2,616	(2,470)	(146)		
Other	55	(71)	(110)		(126)
Net cash provided by (used in) financing activities	421	(1,905)	(492)		(1,976)
<b>Cash and cash equivalents:</b>					