

APPENDIX K

Amending the Baseline Amount

The Parties established the Baseline Amount as a reasonable estimate of the annual quantity of seizures of Contraband Philip Morris Cigarettes they might expect in the Territory of the Member States as of January 1, 2004. The Parties recognize, however, that as New Member States join the European Union, as Non-Participating Member States wish to become Participating Member States, and as circumstances change with respect to the movement and pricing of Cigarettes in the Member States, the Baseline Amount may require adjustment so that it continues to comport with the reasonable expectations of the Parties. In determining whether to adjust the Baseline Amount, and if so, by what amount, the following shall be considered:

- 1) The size of the Philip Morris Cigarette market(s) in the New Member States whose seizures of Contraband Philip Morris Cigarettes are likely to result in Supplemental Payments in the following calendar year but whose incidence of Contraband Philip Morris Cigarettes is not already factored into the Baseline Amount, as well as the incidence of Contraband Philip Morris Cigarettes in such New Member States. In determining the size of the market for Philip Morris Cigarettes and the incidence of Contraband Philip Morris Cigarettes in the New Member States, the Parties shall take account of and rely on:
 - a) Historical seizure data;
 - b) Available studies and reports of the industry;
 - c) Philip Morris International data and reports;
 - d) Reliable published information;
 - e) Joint studies, if any, conducted by the European Community and Philip Morris International concerning contraband and counterfeit volumes, contraband and counterfeit flows, cigarette sales, cigarette seizures, or other matters reasonably relevant to this Agreement;
 - f) Reports generated by independent third-party companies retained by Philip Morris International, in accordance with methodology agreed to by the Parties, whose business involves in whole or in part the monitoring of Cigarette sales and distribution; and
 - g) Available data published by the European Community and the Member States;
- 2) The incidence of Contraband Cigarettes and Counterfeit Cigarettes in the New Member State(s) and the incidence of Contraband and Counterfeit Cigarettes manufactured by entities other than Philip Morris International, as measured by one or more independent companies retained by Philip Morris International; and
- 3) The situation concerning the maintenance and protection of the European Community's Customs border as published in official reports and other reliable sources.

Amending Supplemental Payment Obligations

The Supplemental Payment regime set forth in Article 4 of the Agreement reinforces Philip Morris International's commitment to take commercially reasonable steps as a manufacturer of Cigarettes to promote the Parties' joint objective that Philip Morris Cigarettes be sold, distributed, stored, and shipped in accordance with all applicable fiscal and legal requirements, and, in particular, sold at retail in accordance with all applicable tax and duty laws in the intended retail market, and in quantities consistent with legitimate Retail Demand in such intended market. The Parties recognize that there are factors within the control and factors outside the control of Philip Morris International and that the Supplemental Payment regime was designed with reference to a reasonable estimate of the annual quantity of seizures of Contraband Philip Morris Cigarettes they might expect in the Territory of the Member States as of January 1, 2004, in light of the substantial efforts of the Parties in their ongoing fight against the illegal trade in Cigarettes.

The Parties also recognize, however, that as New Member States join the European Union, as Non-Participating Member States wish to become Participating Member States, and as circumstances change with respect to the movement and pricing of Cigarettes in the Member States, problems could arise that might bring about serious imbalances in the application of the obligations of Philip Morris International under Article 4 of the Agreement, requiring their possible amendment so that they continue to comport with the reasonable expectations of the Parties that the provisions of Article 4 will serve as an incentive for Philip Morris International to address factors within its control and to comply with its obligations under this Agreement, but not as a mechanism to increase Philip Morris International's obligations by virtue of factors outside the control of Philip Morris International.

In determining whether to amend the provisions of, and the obligations of Philip Morris International under, Article 4, the Parties shall consider whether there has been a significant increase in the incidence of Contraband Philip Morris Cigarettes in any Member State whose seizures of Contraband Philip Morris Cigarettes are likely to result in Supplemental Payments in the following calendar year. If there has been a significant increase in such incidence substantially caused by external factors, as evidenced by the fact that a substantial portion of the seizures of Philip Morris Contraband Cigarettes are Cigarettes for which applicable taxes on the retail price have been paid in a non-Member State, the Parties shall either amend, or provide Philip Morris International with appropriate relief from the obligations under Article 4. However, amendment of, or relief from, Supplemental Payment obligations is only appropriate where (i) the significant increase in the incidence of Contraband Philip Morris Cigarettes in that Member State is not substantially attributable to a failure on the part of Philip Morris International to adhere to the terms of this Agreement, and (ii) Philip Morris International can reasonably demonstrate that its sales to a pertinent Intended Market of Retail Sale are consistent with reasonable estimates of legitimate Retail Demand in such Intended Market of Retail Sale, and such market seems to account for a meaningful proportion of the increase in such incidence as described above.