

We have provided this brief outline of the main system and business environment surrounding tobacco industry and JT.



▲ Cigarette vending machines with adult identification functions
(See P47 for more details)

Business Environment Surrounding JT

International Business Environment Pertaining to the Tobacco Business

WHO: Framework convention on tobacco control

During the May 1999 World Health Assembly of the WHO, a resolution was adopted to commence work that would lead toward adoption of the Framework Convention on Tobacco Control (FCTC). Following six rounds of intergovernmental negotiation, the FCTC was adopted in May 2003 and entered into force on February 27, 2005, the 90th day after its ratification by 40 of its signatories. Moreover, as a result of the convention's entry into force, in February 2006, the first conference of the parties to the FCTC was held with the participation of 110 signatory nations including Japan, a further 49 non-signatory nations, and UN agencies, etc. At this conference, discussions were held concerning such items as the procedural rules for subsequent conferences of the signatory nations, reports to be presented at the next confer-

ence, and the production of draft guidelines and draft protocols, etc. As of June 13, 2006, a total of 131 countries including EC had signed the FCTC. Japan signed the FCTC on March 9, 2004 and accepted it on June 8, 2004. The FCTC contains a number of provisions, some of which are legally binding on the signatory nations while others allow for discretion by each signatory nation in respect of interpretation and implementation. Key provisions of the FCTC include:

- **Establishing price and tax measures and restrictions of duty-free sales, as appropriate, without prejudice to the nations' sovereign taxation policies.**
- **Packaging and labeling measures:**
 - Adoption of measures to ensure that tobacco product packaging and labeling do not promote tobacco products by any means that could create an erroneous impression that a particular tobacco product is less harmful than another.
 - Health warnings on tobacco packaging that cover not less

than 30% of the principal display area.

- **A comprehensive ban on tobacco advertising, promotion and sponsorship or suitable restrictions if a country cannot implement a comprehensive ban because of its constitution or constitutional principles.**
- **Adoption/Implementation of effective measures to ban sales of tobacco products to minors.**
- **Support for economically viable alternative activities for tobacco workers, growers and sellers as appropriate.**

JT has long been committed to some of the FCTC's provisions, including prevention of underage smoking and curbing illicit trade. JT believes, however, that it is better for tobacco to be regulated by individual countries who can best determine the most appropriate legislative and regulatory framework in the light of their own actual conditions and taking into account their own unique legal systems, cultures and social circumstance. JT intends to continue working with the governments of signatory nations on appropriate and reasonable measures through which the FCTC's provisions can be implemented.

International tobacco product marketing standards

In September 2001, JT and several other tobacco companies reached an agreement on the International Tobacco Product Marketing Standards. These standards set a baseline for responsible tobacco product marketing worldwide. The cornerstones of the standards are ensuring that brand marketing has no particular appeal to youth; restricting youth exposure to tobacco marketing; and ensuring that adult smokers are appropriately informed about the risks of smoking. Accordingly, marketing activities in Japan are also subject to the standards.

Other key features of the standards include:

- **Uniform definitions of “advertisement,” “promotional event,” and “sponsorship.”**
- **Tough guidelines applicable to advertising tobacco products:**
 - Print advertising is limited to publications with at least 75 percent adult readership.
 - Billboard advertising must not exceed 35 square meters in size.
 - Advertising on television, radio and the Internet are prohibited unless a 100% adult audience is verified.
 - Advertisements cannot run in cinemas unless there is a reasonable basis to believe that at least 75% of the audience is adult.
 - Advertisements cannot feature celebrities, show individuals that appear younger than 25, or suggest that smoking enhances athletic, professional, personal or sexual success.

— **Display of health warnings on advertisements, etc:**

- Except for in a very small number of cases such as point-of-sale materials that are smaller than 250 sq. cm, health warnings must appear on virtually all advertising, promotional and merchandising materials.

— **Restriction on sponsorship:**

- For events or activities that bear a tobacco product brand name, all participants who compete or otherwise actively participate must be adults.
- From December 1, 2006, attendance at an event or activity sponsored for the purpose of tobacco product brand promotion must be comprised of at least 75% adults, and these events can only generate incidental coverage in electronic media.

— **All promotional activity limited to verified adult smokers.**

Prevention of youth smoking

The problem of youth smoking has to be addressed by all members of society. JT has been taking various steps toward dealing with this problem over and above proper performance of its global business operations in the countries in which it operates, based on its own standards, relevant local laws and regulations, and the International Marketing Standards (IMS).

To learn more about JT's efforts to prevent smoking by youths, please refer to our website.

<http://www.jti.co.jp/sstyle/think/underage/index.html>

(for efforts in Japan)

http://www.jti.com/english/corp_responsibility/youth_smoking_prevent.aspx (for efforts overseas)

Domestic Business Environment Pertaining to the Tobacco Business

The Japan Tobacco, Inc. law

JT was established under the Japan Tobacco, Inc. Law (JT Law) for the purpose of developing businesses related to the manufacture, sale, and import of tobacco products. The JT Law provides that the Japanese government must continue to hold at least one-half of all of the shares that the government acquired by voluntary conveyance upon JT's establishment (the number of such shares following the share split carried out on April 1, 2006 is 5 million shares), and that even if JT issues new shares in the future, the government must continue to hold more than one-third of all of the issued shares. The JT Law also states that the flotation of subscribers for new shares, for options to subscribe for new shares or, in case of share-for-share exchange, issuance of new shares or

issuance of options for new shares or issuance of bonds with options or warrants to subscribe for new shares requires the approval of the Minister of Finance. The JT Law grants JT the freedom to enter other non-tobacco-related business areas in line with its overall objectives as a corporation, dependent upon ministerial permission, in addition to the manufacture, distribution, and import of tobacco products and tobacco-related businesses. JT must also obtain authorization from the Minister of Finance for certain matters, including the appointment or dismissal of directors, executive officers, and auditors, amendments to JT's Articles of Incorporation, appropriations of surplus (except disposal of losses), and any merger, corporate split, or dissolution of JT. Within three months after the close of each business year, JT must issue its balance sheets, statements of income or loss, and business report to the Minister of Finance.

Tobacco business law

The Tobacco Business Law was enacted in August 1984 for the purpose of achieving sound growth for Japan's tobacco industry, securing stable government revenues, and contributing to the healthy expansion of the Japanese economy. The Tobacco Business Law governs the cultivation and purchase of leaf tobacco and the manufacture and distribution of tobacco products. JT is obliged to negotiate contracts with domestic leaf tobacco growers to determine the total area used for tobacco cultivation and tobacco leaf prices based on type and quality. JT is required to purchase the entire usable domestic tobacco crop. Contracts stipulate the area to be cultivated and the prices of leaf tobacco for the subsequent year, and in this regard JT respects the opinion of the Leaf Tobacco Deliberative Council.* As the sole manufacturer of tobacco products in Japan as established by law, JT must obtain the approval of the Minister of Finance on the maximum price of each class of tobacco released from storage to the market. Tobacco product importers and wholesalers must register with the Minister of Finance, and retailers of tobacco products are required to obtain approval from the Minister of Finance. In addition, list prices for JT's tobacco products and imported tobacco products must be approved by the Minister of Finance, although in general, manufacturers' list prices are approved unless the Minister of Finance deems them unfair to consumers. Tobacco retailers are only permitted to sell tobacco products at list prices that have been approved by the Minister of Finance.

* The Leaf Tobacco Deliberative Council is a council for conferring on important matters concerning the cultivation and purchase of domestically grown leaf tobacco in response to inquiries by JT representatives. The council consists of no more than 11 members, appointed by JT with the approval of the Minister of Finance from among representatives of domestic leaf tobacco growers and academic appointees.

Revision of cautionary statements

In Japan, based on Article 39 of the Tobacco Business Law, the packaging of tobacco products must, as stipulated in Article 36 of the Tobacco Business Law Enforcement Regulations, include "statements to promote caution regarding the connection between the consumption of tobacco products and health (cautionary statements)." In November 2003, the Tobacco Business Law Enforcement Regulations were revised and the cautionary statements were updated. The revised regulations specified eight types of warning labels: four regarding direct effects of smoking (lung cancer, heart attack, stroke, and emphysema), one about smoking by pregnant women, one about passive smoking, one about smoking dependence, and one about underage smoking. Each tobacco product package must contain, on its main surfaces, at least one of the first four types (direct) and at least one of the other four types. The regulations specify that the various types must be visible equally throughout the year on every category of product and packaging, and that these warnings must take up at least 30% of the main surface of the package. JT had completed the package redesign for all its tobacco products by June 30, 2005, the date when the provisional measures ended as stipulated in the supplement to the regulations. With effect from July 1, 2005, all tobacco products shipped by JT bear the statements in accordance with these regulations. In addition, the same revised regulations specify that if the words "mild," "light," or similar words are used, they must be accompanied by specific notation to consumers so as to avoid misleading consumers about the relationship between the consumption of tobacco and health. The specific notation has been introduced for all JT tobacco product shipments with effect from July 1, 2005, as required by the revised regulations. The JT Group intends to continue using the words "mild," "light," and similar words in the domestic market, in accordance with the specified conditions.

Revision of the guideline on tobacco advertising

In Japan, a guideline has been published concerning advertising of tobacco products, based on Article 40 of the Tobacco Business Law. The TIOJ* has drawn up self-regulatory standards in line with this guideline and all member companies including JT are abiding by these standards. In March 2004, the Minister of Finance revised the Guideline Concerning Advertising of Tobacco Products. With the revision, the guideline stipulates that outdoor advertising of tobacco products (posters, billboards, etc.) must not be displayed except where tobacco products are sold, or in designated smoking areas. It also stipulates that consideration must be given to the methods of advertising in daily newspapers (with the

exception of tabloids) and the phrasing and content of cautionary statements allowed for all tobacco advertising is also specified. In consideration of these facts, in March of the same year the TIOJ revised its voluntary codes and its member companies including JT are continuing to implement new measures as required, such as banning outdoor billboard advertising or brand-specific advertising in public transportation vehicles, limiting the volume of advertising in newspapers, and specifying which sections of newspapers may contain such ads.

* Tobacco Institute of Japan: The TIOJ is a public service corporation established for the purpose of contributing to the promotion of a fair and objective social understanding of tobacco through the collection and propagation of information regarding tobacco, enhancing the sound development of the tobacco industry in Japan, and thereby contributing to the sound progress of the national economy by responding appropriately to the social environment surrounding tobacco and carrying out various activities.

The TIOJ was established as a voluntary organization in 1987 as an offshoot of the Association of Tobacco Manufacturers, which was established in 1985, and was reorganized as an incorporated body in 1990.

Cigarette vending machines with adult identification functions

In November 2001, the Tobacco Institute of Japan (TIOJ), the Japan Tobacconist Federation, and the Japan Vending Machine Manufacturers Association reached an agreement to cooperate in the development and implementation of cigarette vending machines with adult identification functions and have been working together toward equipping all vending machines throughout Japan with such functions by 2008. Vending machines with these functions are designed to prevent minors from purchasing cigarettes from vending machines and will dispense cigarettes only after scanning and verifying special IC cards that indicate the purchaser's age. A one-year trial use of these new machines was conducted from April 2002 to March 2003 in Yokaichiba, Chiba Prefecture, with the full support of local authorities. Basic technical and operational knowledge was attained and market receptivity was ascertained. We are now at the stage of making necessary preparations building on the results of these tests and those of a further trial in Tanegashima, Kagoshima Prefecture toward the construction of a system for nationwide introduction of these machines in 2008. JT fully respects the intentions of these cooperative efforts and intends to actively participate in the smooth development and implementation of cigarette vending machines with adult identification functions.

Tobacco Related Litigation

Lawsuits related to smoking and health in which JT and its subsidiaries are involved outside Japan include damages claims filed by individuals, medical expense recovery lawsuits filed by governments and insurers, and class actions for damages and injunctive relief. As of the end of May 2006, a total of 13 such lawsuits were pending in which JT or its subsidiaries are named as a defendant or for which RJ Reynolds Tobacco Company has sought indemnification following JT's acquisition of RJR Nabisco Inc.'s overseas (non-US) tobacco operations.

At present, JT and its subsidiaries have never lost a smoking and health case or paid any money in order to settle a case out of court.

In addition to smoking and health cases, various kinds of smuggling and counterfeiting of tobacco products have created major problems for the entire tobacco industry. JT and its subsidiaries are involved in lawsuits brought by the European Community and legal claims asserted by several Canadian governments seeking compensation for damages allegedly resulting from alleged cigarette smuggling. Also, a Canadian subsidiary of JT received a tax assessment from the Quebec Ministry of Revenue requiring immediate payment of the alleged loss of tobacco taxes. That subsidiary has challenged the tax assessment in court.

In addition, there are lawsuits in which Russian subsidiaries of JT are contesting various tax assessments issued by tax authorities.

JT and its subsidiaries are confident of the correctness of their defenses and claims and believe that they are well supported.