
Disposition of Long-Term Liabilities of Former Japanese National Railways (JNR)

When JNR was restructured in April 1987, responsibility for its long-term liabilities was clearly divided between the national government and the JR Companies. The process leading to this division included debate in the Diet. At the time of the restructuring, JNR's liabilities totaled ¥37.1 trillion, including costs that will be incurred in the future. The JR Companies were allocated ¥14.5 trillion of this amount, and Japanese National Railways Settlement Corporation (JNRSC) assumed responsibility for the remaining ¥22.7 trillion. It was decided at this time that JNRSC would repay as much of this amount as possible using funds generated by the sale of land left by JNR and JR Company stock held by JNRSC. Any remaining liabilities were to be assumed and disposed of by the national government.

However, sales of land by JNRSC were temporarily halted by the October 1987 Guidelines for Urgent Measures to Deal with Land that were determined by the Cabinet. Japan's economy subsequently fell into a recession in the early 1990s, further preventing JNRSC from selling land. Furthermore, a delay in the sale of stock in JR companies and other factors meant that liabilities could not be decreased; on the contrary, interest payments caused them to increase.

As of April 1987, liabilities held by JNRSC were ¥25.5 trillion, the combination of the above-mentioned ¥22.7 trillion and ¥2.9 trillion. The ¥2.9 trillion was one portion of the Shinkansen usage fees paid by the three Honshu-based JR passenger railway companies, and was to be used to repay JNRSC's debt. Due to the above factors, these liabilities had grown to ¥28.3 trillion by the dissolution of JNRSC in October 1998.

In October 1998, the Law for Disposal of Debts and Liabilities of the Japanese National Railways Settlement Corporation was passed and enforced. It included the following provisions concerning the disposal of JNRSC's liabilities:

- JNRSC's interest-bearing liabilities would be assumed by the national government's general account and JNRSC would be absolved of its non-interest bearing liabilities to the government.
- The land, JR Company stock and other assets held by JNRSC would be transferred to JRCC, which would pay for pension and other obligations.
- With regard to the amount to be transferred from the Japan Railways Group Mutual Aid Association to the Welfare Pension, a portion of the liabilities legally assigned to JNRSC would become additional obligations of the JR Companies.

Discussing the possibility of imposing further additional liabilities on the JR Companies, the Prime Minister stated during the debate in the Diet prior to passage of this law: "Regarding those debts and pension liabilities of JNRSC that have not been designated for assumption by JR Companies, the Government is of the view that such obligations must not be imposed on JR Companies in the future."

Construction and Operation of Seibi Shinkansen Lines

The Seibi Shinkansen is a network of proposed Shinkansen lines pursuant to the Nationwide Shinkansen Railway Development Law. The basic plan for these new lines was decided in 1973. Currently, work is under way on five sectors of three lines. Within JR East's service area, JRCC is now involved in building full-scale Shinkansen lines on the Hokuriku Shinkansen line's one sector (Nagano-Joetsu) and on the Tohoku Shinkansen line's one sector (Hachinohe-Shin-Aomori). Service on the Hokuriku Shinkansen line's sector from Takasaki to Nagano already commenced in October 1997 (operationally named Nagano Shinkansen). The operation of the Tohoku Shinkansen line's sector from Morioka to Hachinohe will start on December 1, 2002.

JR East has reached the following agreement with the government.

(1) JR East will pay only usage fees after the Company has started operations on the new lines. The usage fees will not exceed the corresponding benefits of the applicable line. JR East will incur no financial burden other than these usage fees.

(2) JR East will separate itself from conventional lines running parallel to the new Shinkansen lines.

JR East agreed to the construction of the two lines mentioned above in its service area based on its judgment that these new lines would not adversely affect the Company's results.

In December 1996, the Japanese government and ruling parties agreed that all future decisions regarding the order for starting construction on Seibi Shinkansen lines should be based on the assent of the local governments and relevant JR company in respect of the profitability of each sector of the lines and management separation of the parallel conventional lines, etc., and that the financial burden of each JR company should be limited to usage fees and advance payments that do not exceed the corresponding benefits of the applicable line in each company's service area.

In May 1997, an amendment to the Nationwide Shinkansen Railway Development Law was passed. This amendment clarifies the division of responsibilities for funding new Shinkansen lines between the national and prefectural governments. Under this system, the national government funds two-thirds of construction costs and prefectures fund the remainder. JR East confirmed the basic principles of the Seibi Shinkansen lines in respect of the sectors between Hachinohe and Shin-Aomori of the Tohoku Shinkansen line and between Nagano and Joetsu of the Hokuriku Shinkansen line within the JR East's service area and has agreed to construct them. The construction of these two sectors commenced in March 1998. The construction of these two sectors is estimated to complete 12 years later and a little more than 12 years later, respectively, from the date of amended license of construction dated April 2001.

JR East's Yamagata and Akita hybrid Shinkansen are not covered by the Nationwide Shinkansen Railway Development Law. JR East has constructed these two lines independently, with the cooperation of the national and local governments in the form of interest-free loans and other support.

Deregulation

In December 1996, the Ministry of Transport (predecessor of the Ministry of Land, Infrastructure and Transport) decided on a policy of abolishing most of its restrictions, originally imposed to maintain the supply-demand balance, on the entry of companies in the public transportation sector. After much internal and public debate at the Council for Transport Policy and other organizations, an Amendment Bill to the Railway Business Law was passed in May 1999 and enforced in March 2000.

It includes the following provisions:

- Review of regulations on entry and withdrawal

Previously, railway companies needed a license from the Minister of Transport (predecessor of the Minister of Land, Infrastructure and Transport) to operate. The amended law requires only the Minister's permission. Operators wishing to cease providing a service now need to submit notification one year in advance, without having to seek permission as was previously required.

- Revisions of regulations on fares and charges

The amended law clearly states that approval is required for upper limits on ordinary fares and Shinkansen

Changes in Accounting Standards

In Japan, the accounting standards are presently being revised significantly in line with the trend of adoption of the international accounting standards, which enable more accurate understanding and analysis of the operating results and the financial position of the whole corporate group.

Following are the revised matters already applicable from the year ended March 31, 2000.

- Shift in emphasis from nonconsolidated to consolidated financial statements
- Scope of consolidation to be decided on the basis of the effective control and influencing standards
- Presentation of statements of cash flows
- Adoption of tax effect accounting

Following are the revised matters applicable from the year ended March 31, 2001.

- Presentation of interim consolidated financial statements (applicable from the interim period ended September 30, 2000).
- Adoption of Accounting Standards for Retirement Benefits (recognition of obligations for severance and retirement benefits, etc.)*
- Adoption of Accounting Standards for Financial Instruments (market values of financial instruments, etc.)*

In April 2002, Japan's Business Accounting Council issued draft accounting standards calling for the adoption of asset impairment accounting. Under the proposed accounting standard for long-lived assets, companies would be required to recognize an impairment loss in their income statements if certain indicators of asset impairment exist and the book value of an asset exceeds the undiscounted sum of future cash flows of the asset. The impairment loss would be measured as the excess of the book value over the higher of (I) the fair market value of the asset net of disposition cost and (II) the present value of future cash flows arising from ongoing utilization of the asset and from disposal after asset use. The standards cover land, factories, buildings and other forms of property, plant and equipment. Assets would be grouped at the lowest level for which there are identifiable cash flows that are independent of the cash flows of other groups of assets. Restoration of previously recognized impairment losses would be prohibited. The draft calls for a two-year phase-in period beginning with the year ending March 31, 2004 during which companies may voluntarily adopt the new standards and mandatory adoption of the standards by the year ending March 31, 2006. The Business Accounting Council plans to issue a final set of standards in the summer of 2002 at the earliest, after evaluating comments received on the draft standards. Until the final set of standards is announced and its application to railway companies is determined, JR East cannot predict the future effect of the new accounting standards on its results of operations.

*For further details, see Notes to consolidated financial statements.