



British American Tobacco

REPORT ON COMPLIANCE WITH
THE COMBINED CODE ON
CORPORATE GOVERNANCE

26 March 2007



**BRITISH AMERICAN TOBACCO P.L.C. (the “Company”)
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Introduction

The principal governance rules applying to UK companies listed on the London Stock Exchange are contained in the Combined Code on Corporate Governance adopted by the Financial Reporting Council in July 2003 (the “Code”). The Corporate Governance Statement, at pages 72 to 78 of the Company’s 2006 Report and Accounts (the “Corporate Governance Statement”), explains how the Principles of the Code have been applied by the Company and confirms that the Company has either complied with the Provisions of the Code throughout 2006 or else provided a full explanation where it has not.

In the interests of further transparency, the Company has also voluntarily prepared this Report which summarises its approach by reference to each Principle and Provision of the Code.

A. Directors

Code Principle or Provision	Company’s approach
A.1	<p>The Board is responsible to the Company’s shareholders for the success of the Group and for its overall strategic direction, its values and its governance. It provides the leadership necessary to enable the Group’s business objectives to be met within the framework of the internal controls described in the Corporate Governance Statement, while ensuring that the Company’s obligations to its shareholders and others are met.</p> <p>See the Corporate Governance Statement for a further explanation of how the Supporting Principals are applied.</p>
A.1.1	<p>The Board meets at least seven times annually. Among the key matters on which the Board alone may make decisions are the Group’s business strategy, its annual budget, dividends, and major corporate activities. It is also responsible for reviewing the Company’s internal controls and governance system and for approving the Company’s Standards of Business Conduct. Additional matters addressed annually by the Board are specified in the Corporate Governance Statement.</p> <p>The Board delegates to the Management Board responsibility for overseeing the implementation by the Group’s operating subsidiaries of the policies and strategy which it sets, and for creating the conditions for their successful day-to-day operation.</p>

	The Corporate Governance Statement includes a high level description of how the Board operates.
A.1.2	The Corporate Governance Statement identifies (by reference to the Directors' Report at page 53) the Chairman (Jan du Plessis), the Non-Executive Deputy Chairman and Senior Independent Director (Kenneth Clarke), the Chief Executive (Paul Adams) and the Chairmen and members of the Nominations, Audit, Remuneration and Corporate Social Responsibility Committees. It also includes a table setting out the number of meetings of the Board and those Committees and the individual attendance by Directors.
A.1.3	The Non-Executive Directors, led by the Chairman, meet, if required, prior to meetings of the Board without the Executive Directors present and also meet annually, led by the Deputy Chairman, without the Chairman present (see also A.6.1 below).
A.1.4	If any Director has concerns about the running of the Company or a proposed action which cannot be resolved, such concerns will be recorded in the Board minutes. No such concerns arose in 2006.
A.1.5	The Company has arranged appropriate insurance to provide cover in the event of legal action against its Directors.
A.2	<p>The roles of Chairman and Chief Executive are separate, with each having distinct and clearly defined responsibilities.</p> <p>The Chairman is responsible for leadership of the Board, ensuring its effectiveness and setting its agenda, and for ensuring that a clear business and financial strategy for the Group is formulated for recommendation to the Board. An important aspect of his function is to ensure effective communication with the Company's shareholders and facilitate the productive contribution of the Non-Executive Directors in particular.</p> <p>Once agreed by the Board as a whole, it is the Chief Executive's responsibility to ensure delivery of the strategic and financial objectives. He is also responsible for stewardship of the Group's assets and, jointly with the Chairman, for representation of the Group externally.</p>
A.2.1	See A.2 above.
A.2.2	The Chairman was appointed prior to the period under review in the Corporate Governance Statement.
A.3	The Company has a Board of twelve Directors, of whom eight are Non-Executive Directors.

A.3.1	<p>The Board considers that six of the eight Non-Executive Directors are independent. Thys Visser and Pieter Beyers are presumed not to be independent, because of the shareholdings that they represent.</p> <p>Rupert Pennant-Rea has served on the Board for just under nine years but, including his tenure on the board of B.A.T Industries p.l.c., he has served on the board of the Group's ultimate holding company for slightly in excess of eleven years. It had originally been envisaged that he would retire in 2006. However, in order to provide ongoing continuity and stability in 2006, following a two year period in which there had been a number of changes to the Board's membership, it was agreed that he would remain a Non-Executive Director during the year. The extension of his tenure was approved at the Annual General Meeting in April 2006. The Board recognises that length of service can impact on the independence of a Non-Executive Director and has therefore kept his position under careful review. It is satisfied, in light of his continuing valuable contributions to the Board and its Committees, that he has remained independent throughout the period under review. Rupert Pennant-Rea will retire from the Board at the conclusion of the Company's Annual General Meeting on 26 April 2007.</p>
A.3.2	<p>Throughout the period covered, at least half of the Board, excluding the Chairman, has comprised Non-Executive Directors determined by the Board to be independent.</p>
A.3.3	<p>The Non-Executive Deputy Chairman, Kenneth Clarke, is the Senior Independent Director. He is available, should occasion arise, where there is a need to convey concerns to the Main Board other than through the Chairman or Chief Executive.</p>
A.4	<p>The Nominations Committee is responsible for ensuring that the procedure for appointing new Directors is rigorous and transparent and that appointments are made on merit and against objective criteria for the purpose.</p>
A.4.1	<p>The Nominations Committee's role is to make recommendations on suitable candidates for appointment to the Board and for promotion to the Management Board, ensuring that both Boards have the appropriate balance of expertise and ability. It is chaired by the Chairman and its remaining membership comprises all the Non-Executive Directors. Its terms of reference are available from the Company Secretary (and through the Company's website bat.com).</p>
A.4.2	<p>The Committee reviews forthcoming retirements at least once a year and considers the need to identify candidates to fill vacancies for non-executive positions on the Board. This process includes an evaluation of the skills and experience to be looked for in those candidates to ensure continuing Board balance. In light of Rupert Pennant-Rea's forthcoming retirement, this process is in hand.</p> <p>See also above and the Nomination Committee's terms of reference.</p>
A.4.3	<p>The Chairman was appointed prior to the period under review in the Corporate Governance Statement.</p>

A.4.4	Copies of the Executive Directors' service contracts and the details of the terms of appointment of each Non-Executive Director and the Chairman are available for inspection during normal business hours at the Company's registered office
A.4.5	No Executive Director has more than one non-executive directorship in a FTSE 100 company or the chairmanship of such a company.
A.4.6	The Corporate Governance Statement describes the work of the Nominations Committee.
A.5	The Board and its Committees receive high quality, up-to-date information for review in good time ahead of each meeting and the Company Secretary, under the direction of the Chairman, ensures good information flows within the Board and its Committees and between the Non-Executive Directors and senior management. She is also responsible for advising the Board through the Chairman on all governance matters.
A.5.1	Directors receive induction on joining the Board, which consists of at least two days' briefings on all areas of the Company's business. After a period on the Board, they are given an opportunity to review the induction programme and raise questions on any areas in respect of which they would like further information. In addition, they have the opportunity to update their skills and knowledge on a regular basis, for example by further briefings on the business and by visits to Company production sites. They also make use of the opportunity to attend meetings of the Group's regional audit committees.
A.5.2	A procedure is in place for the Directors to take independent professional advice at the Company's expense should this be required.
A.5.3	All Directors have access to the advice and services of the Company Secretary. The appointment and removal of the Company Secretary is a matter for the Board.
A.6	The Board conducts a critical evaluation of its activities on an annual basis.
A.6.1	The Corporate Governance Statement describes how performance evaluation of the Board, its Committees and its individual Directors has been conducted. The Chairman's performance is appraised annually at a meeting of the Non-Executive Directors, led by the Senior Independent Director, without the Chairman present.
A.7	Directors are submitted for reappointment at regular intervals by application of the Company's articles of association.
A.7.1	All Directors are subject to election by the shareholders at the first Annual General Meeting after their appointment.

	<p>At each Annual General Meeting: (1) not less than one-third of the Directors who are subject to retirement by rotation must retire, and (2) any Director has to retire who was not appointed at either of the two previous Annual General Meetings and who has served as a director for more than two years since appointment or last reappointment.</p> <p>Biographical details and other relevant information for Directors submitted for election or re-election are supplied with the Notice of Meeting.</p>
A.7.2	<p>Non-Executive Directors are appointed for a specified term, being an initial period to the next Annual General Meeting after appointment and, subject to reappointment at that meeting, for a further period ending with the Annual General Meeting three years thereafter. Subsequent appointment will be subject to endorsement by the Board and the approval of shareholders.</p> <p>The Notice of the Company's Annual General Meeting on 26 April 2007 confirms that the performance of the Directors being proposed for reappointment continues to be effective and that they continue to show commitment to their role.</p> <p>The performance and commitment of any non-executive director being proposed for a third term of three years should be subject to a particularly rigorous review. This was done in the case of Thys Visser, who will be proposed for reappointment at the Annual General Meeting on 26 April 2007.</p> <p>There is a general assumption on the part of the Board that Non-Executive Directors will not normally be invited to stand for reappointment after serving nine years.</p>

B. Remuneration

Code Principle or Provision	Company's approach
B.1	<p>The Company's Remuneration Report is at pages 57 to 71 of its 2006 Report and Accounts.</p> <p>The overriding objective of the British American Tobacco remuneration policy is to reward the achievement of corporate and individual goals by linking success in those areas to the Group strategy: a balanced approach to achieving growth, improving productivity, managing the business in a responsible manner and developing a winning organisation. The delivery of strategy is measured by the Key Performance Indicators (KPIs) and business measures. The continued focus by the Executive Directors of British American Tobacco and the members of its Management Board on driving all four elements of the strategy will continue to build a sustainable business. This methodology is supported by a competitively positioned and integrated pay and benefits structure which reflects the nature of the Group's worldwide operations and the need to attract, motivate and retain high-quality executives. In order to strengthen the alignment of executive remuneration</p>

	<p>to the generation of shareholder value, a balance is maintained between the short and long term elements of the structure. This policy will continue to be applied during 2007.</p>
<p>B.1.1</p>	<p>See B.1 above.</p> <p>The Committee has a guideline that approximately 50 per cent of the remuneration (assuming 'on target' performance) should be of a performance related or variable nature. The remuneration package comprises both performance based variable rewards (cash and share incentive annual bonus plan and Long Term Incentive Plan ('LTIP')) and core fixed elements (base salary, pension and other benefits).</p> <p>Schedule A: Provisions on the design of performance related remuneration:</p> <ol style="list-style-type: none"> 1. The Executive Directors continue to participate in an annual performance bonus plan, now called the International Executive Incentive Scheme (IEIS), comprising both cash and deferred shares elements. The deferred shares element is delivered through the Deferred Share Bonus Scheme - the 'Deferred Scheme'. <p>Bonus entitlements and awards to the Executive Directors and members of the Management Board under the IEIS depend upon the performance of the business. Demanding targets are set by the Remuneration Committee at the beginning of each year and are measured in terms of both financial and business performance. Awards made under the Deferred Scheme are in the form of free ordinary shares in the Company, which are normally held in trust for three years and no further performance conditions apply in that period.</p> <ol style="list-style-type: none"> 2. The Company operates a Long Term Incentive Plan ('LTIP'), which provides for awards of free ordinary shares to the Executive Directors and senior employees, provided certain demanding performance conditions are met. Two performance conditions attach to an award of ordinary shares made under the LTIP. These relate to an apportionment between measures relating to Total Shareholder Return ('TSR') and earnings per share based criteria with reference to a three year performance period. <p>It is the policy of the Remuneration Committee not normally to grant options in any year to individuals who receive an award under the LTIP. No options were granted to Executive Directors under the Company's Share Option Scheme in the year ended 31 December 2006 and no options have been granted to Executive Directors since September 1999. Further, in line with current policy, no options have been granted to any Share Option Scheme participants since March 2004. The Share Option Scheme will expire in April 2008 and there is no intention to renew it.</p> <ol style="list-style-type: none"> 3. Following a review of the current incentive arrangements for the senior executives, shareholder approval is being sought for a new Long Term Incentive Plan (the "New LTIP") to replace the current LTIP which expires in April 2008. The proposed new plan, in which all Executive Directors and members of the Management Board will participate, is, in many respects, very similar to the existing arrangements although there are some differences which are identified and described in the Notice for the 2007 Annual General Meeting and accompanying letter from the Chairman of the

	<p>Remuneration Committee. Awards under the New LTIP would continue to deliver shares subject to stretching performance conditions over three years. Participants would continue to receive the LTIP Dividend Equivalent.</p> <p>The remuneration strategy for the British American Tobacco Group is to pay competitively.</p> <ol style="list-style-type: none"> 4. Payouts or grants under incentive schemes are subject to challenging performance criteria which reflect the Company's objectives. Please see references to the annual performance bonus plans and the LTIP in paragraphs 1 and 2 above. 5. Awards of shares made under the LTIP are normally made annually. This policy will continue in respect of the New LTIP. Grants of options are no longer made under the Share Option Scheme; these were normally made on an annual basis. 6. Only basic salary is pensionable. 7. Basic salaries are reviewed annually or on a significant change of responsibilities, which will take account of the individuals' retirement profiles.
B.1.2	<p>Share options granted under the Company's Share Option Scheme have not been made at a discount. See paragraph 2 under Schedule A above.</p>
B.1.3	<p>The fees paid to the Non-Executive Directors are determined in the light of market best practice and with reference to the time commitment and responsibilities associated with the roles. Non-Executive Directors do not receive grants of share options and receive no other material pay or benefits (with the exception of reimbursement of expenses incurred in respect of their duties as Directors of the Company).</p>
B.1.4	<p>Executive Directors are able to accept one substantive external Board appointment provided that permission is respectively sought from the Board or Chairman. Since 1 January 2006, fees from such appointments are retained for the respective Director's own account, thereby recognising the increasing level of personal commitment and expertise required for non-executive roles.</p>
B.1.5	<p>It is the policy that an Executive Director's one year rolling contract incorporates a provision for a termination or compensation payment in lieu of notice.</p> <p>An Executive Director's compensation payment, in lieu of notice, would comprise: (1) 12 months' salary at his then current base pay; and (2) a cash payment in respect of other benefits under the contract such as medical insurance, or the Company may at its option continue those benefits for a 12 month period. The Committee maintains discretion as to how to deal with any grants or awards made prior to termination under the share option schemes, the Deferred Share Bonus Scheme and the LTIP. Pension entitlements are dealt with in accordance with the terms and conditions of the applicable pension scheme and do not form part of the contractual compensation payment.</p>

	<p>The compensation payment is payable where the requisite 12 months' notice is not given to the Executive Director or when he terminates by giving 12 months' notice and the Company does not wish him to serve his notice. If a period of notice is served, the compensation payment is reduced pro rata. In the unlikely event that the contract is terminated for cause (such as gross misconduct), the Company may terminate the contract with immediate effect and therefore no compensation payment would be payable.</p>
B.1.6	<p>The Remuneration Committee continues to operate a policy of one year rolling contracts for Executive Directors. In addition, the Remuneration Committee also maintains discretion in respect of this policy for those future Executive Directors who may be recruited externally or from overseas, when it may be appropriate to offer a contract with an initial period of longer than one year, reducing to a one year rolling contract after the expiry of the initial period.</p>
B.2	<p>The role of the Remuneration Committee is to determine the framework and policy on terms of engagement (including remuneration) of the Chairman, the Executive Directors and the members of the Management Board. It also determines the specific remuneration of each of them (including awards under share incentive schemes and pension schemes) and any compensation payments.</p> <p>No Executive Director or other member of the Management Board plays any part in determining his remuneration. During the year ended 31 December 2006, the Chief Executive was consulted and invited to attend meetings of the Committee, except when his own remuneration was under consideration. In determining remuneration for the year, the Committee consulted the Chief Executive and the Director, Human Resources and the Head of Reward. The Chairman was also consulted and invited to attend meetings of the Committee. The Committee appointed Towers Perrin as remuneration consultants to provide remuneration services and advice to the Company for 2006, with specific reference to the needs of the Remuneration Committee.</p> <p>The Company maintains contact as required with its principal shareholders about remuneration, as evidenced by its round of consultations in late 2006 in connection with the New LTIP referred to in B.1.1 above.</p>
B.2.1	<p>The Remuneration Committee comprises six Non-Executive Directors, all of whom are independent. The terms of reference of the Remuneration Committee, together with an explanation of its role and the authorities delegated to it by the Board, are available from the Company Secretary (and through the Company's website bat.com).</p> <p>The Remuneration Committee appointed Towers Perrin as remuneration consultants to provide remuneration services and advice to the Company for 2006, with specific reference to the needs of the Remuneration Committee. Towers Perrin is a leading international firm of remuneration and benefits consultants which also provides general consultancy services and advice to British American Tobacco Group companies around the world on pay, pensions and other human resources related issues.</p> <p>In addition, the Remuneration Committee appointed Deloitte & Touche LLP to undertake a comprehensive review of the</p>

	current incentive arrangements for the senior executives. This review culminated in the proposed New LTIP referred to in B.1.1 above.
B.2.2	See B. 2 above.
B.2.3	The fees for the Non-Executive Directors are determined by the Board, on the recommendation of the Chairman and the Chief Executive, within the overall aggregate limit of £2,000,000 authorised by shareholders with reference to the Company's articles of association. The Non-Executive Directors do not participate in discussions with the Board about their own remuneration.
B.2.4	Shareholders are invited to approve the proposed New LTIP, the details of which are set out in the letter from the Chairman of the Remuneration Committee to shareholders dated 26 March 2007.

C. Accountability and Audit

Code Principle or Provision	Company's approach
C.1	The Board is satisfied that it meets its obligation to present a balanced and understandable assessment of the Company's position and prospects in the Directors' Report and Accounts, the Annual Review (including the Operating and Financial Review) and Summary Financial Statement, interim reports, reports to regulators and price-sensitive announcements.
C.1.1	A summary of the Directors' responsibilities for the financial statements and their statement concerning relevant audit information is set out in the Director's Report on page 54 of the Company's 2006 Report and Accounts. The Auditors have stated their reporting responsibilities at page 79 of the 2006 Report and Accounts.
C.1.2	The Directors' statement that it is appropriate to continue to adopt the going concern basis in preparing the accounts is set out in of the Directors' Report at page 54 of the 2006 Report and Accounts.
C.2	The Company maintains a sound system of internal control, with a view to safeguarding shareholders' investment and the Company's assets. The Corporate Governance report provides a description of the Company's system of internal control.
C.2.1	The Board is responsible for the overall system of internal control for the Company and its subsidiaries and for reviewing the effectiveness of the system. It carries out such a review at least annually, covering all material controls including financial, operational and compliance controls and risk management systems, and reports to shareholders that it has done so.

	The Board, with advice from its Audit Committee, has completed its annual review of the effectiveness of the system of internal control for the period since 1 January 2006 in accordance with the updated Turnbull guidance and is satisfied that it is in accordance with that Guidance and that it has been in place throughout 2006 and up to 1 March 2007.
C.3	The Board's obligation to establish formal and transparent arrangements for considering how it should apply the financial reporting and internal control principles, and for maintaining an appropriate relationship with the Company's external auditors, PricewaterhouseCoopers LLP, is met through the Audit Committee.
C.3.1	The Audit Committee is chaired by Robert Lerwill and comprises the remaining independent Non-Executive Directors. Robert Lerwill has recent and relevant financial experience.
C.3.2	The Audit Committee's terms of reference are available from the Company Secretary (and through the Company's website bat.com).
C.3.3	The Corporate Governance Statement describes the activities of the Audit Committee in 2006.
C.3.4	The Company's whistleblowing policy and procedures enable staff, in confidence, to raise concerns about possible improprieties in financial and other matters and to do so without fear of reprisal, provided that such concerns are not raised in bad faith. Details of this policy are set out in the Company's Standards of Business Conduct. The policy is supplemented by local procedures in a number of markets and in the Group's London headquarters, which provide staff with additional guidance and enable them to report matters in a language with which they are comfortable. The Audit Committee remains satisfied that the policy and procedures in place incorporates arrangements for the proportionate and independent investigation of matters raised and for appropriate follow-up action.
C.3.5	The Committee meets regularly with management and with the internal and external auditors to review the effectiveness of internal controls and business risk management and receives reports from the Group's regional audit committees.
C.3.6	The Audit Committee makes recommendations to the Board on the appointment, for approval by shareholders, of the Company's external auditors and approves their fees and terms of engagement. It keeps under review the consistency of accounting policies applied across the Group.
C.3.7	The Audit Committee has established a policy on the appointment of the auditors to perform non-audit services for the Group over and above the external audit and keeps this issue under continual review. It remains confident that the objectivity and independence of the auditors are not in any way impaired by reason of this further work. Moreover, the Committee is satisfied that such work is best handled by them either because of their knowledge of the Group or because they have been awarded it through a competitive tendering process.

D. Relations with Shareholders

Code Principle or Provision	Company's approach
D.1	The Board maintains a dialogue with shareholders, directed towards ensuring a mutual understanding of objectives. Its primary contact with shareholders is through the Chief Executive and Finance Director, but the Chairman and Chief Operating Officer also maintain contact with major shareholders in order to understand their issues and concerns.
D.1.1	The Senior Independent Director and the other Non-Executive Directors remain available to meet with major investors in order to understand their views and concerns.
D.1.2	At least twice a year the Head of Investor Relations presents a report to the Board on the issues considered at meetings between the Company and institutional shareholders. In addition, the Board receives regular reports on developments concerning the holdings of the Company's main institutional shareholders. Where appropriate, major institutional shareholders are consulted on significant changes to the structure of the Directors' remuneration.
D.2	The Annual General Meeting is the principal opportunity for the Board to meet a wide range of investors and for the Chairman to explain the Company's progress and receive questions from its owners, the shareholders.
D.2.1	At the Annual General Meeting on 26 April 2007, the Company will again, in accordance with the Myners Report and best practice, provide for the vote on each resolution to be by poll, using its Registrar's electronic voting system, rather than by show of hands. This provides for greater transparency and allows the votes of all shareholders to be counted, including those cast by proxy. The voting results are announced on the same day through the Regulatory News Service and on the Company's website, bat.com
D.2.2	The Notice of Meeting identifies each resolution which is to be proposed at the Annual general Meeting, including in relation to the 2006 Report and Accounts. A separate resolution is proposed on each substantially different issue.
D.2.3	All Directors attended the Annual General Meeting in 2006, with the exception of Anthony Ruys, who was unable to attend due to a conflicting engagement which had been arranged prior to his appointment to the Board.
D.2.4	The Notice of Meeting and related papers are sent to shareholders at least 20 working days before the Annual General Meeting.