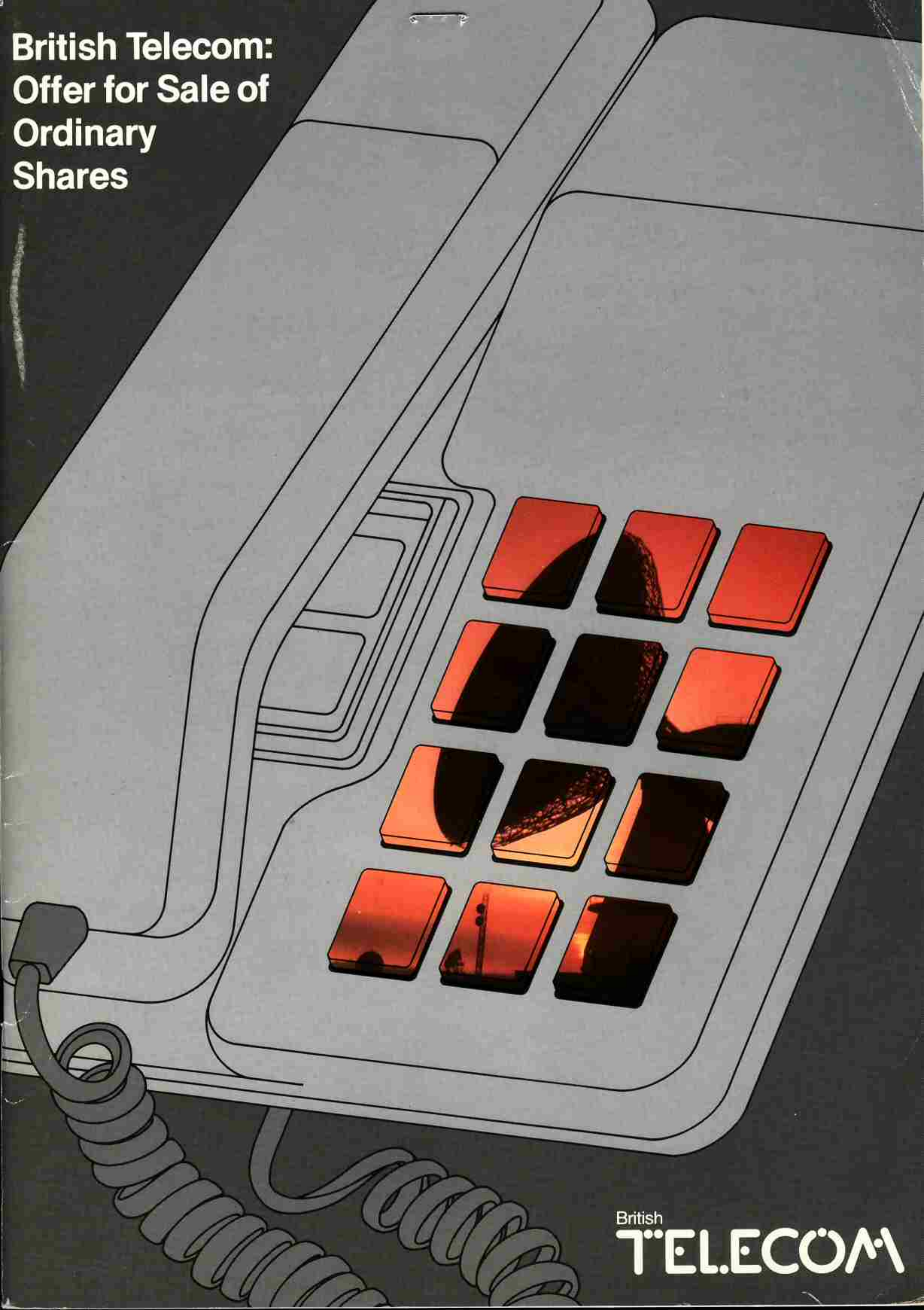
British Telecom: Offer for Sale of Ordinary Shares



British
TELECOM

The Secretary of State has particular responsibility for the information herein concerning the policy and intentions of Her Majesty's Government; the Directors of the Company have particular responsibility for all the other information contained herein concerning British Telecom; and Coopers & Lybrand have particular responsibility for the Accountants' Report set out in Part III. The Secretary of State, as owner of the shares hereby offered for sale, has general responsibility for the whole of this document. All the above mentioned persons have taken all reasonable care to ensure that, to the best of their knowledge, the information given herein, or in those portions for which they have particular responsibility, as the case may be, is in accordance with the facts and nothing is omitted the inclusion of which would affect materially the import of this document.

This document is not for distribution in the United States of America or Canada.

British Telecommunications plc

Offer for Sale

by

Kleinwort, Benson Limited

on behalf of

The Secretary of State for Trade and Industry

of up to

3,012,000,000 Ordinary Shares of 25p each

at 130p per share

50p is payable now
40p is payable on 24th June 1985
40p is payable on 9th April 1986

and underwritten by

Kleinwort, Benson Limited
Barclays Merchant Bank Limited
Charterhouse Japhet plc
Robert Fleming & Co. Limited
Hill Samuel & Co. Limited
Lloyds Bank International Limited
Morgan Grenfell & Co. Limited
S. G. Warburg & Co. Ltd.
Baring Brothers & Co., Limited
County Bank Limited
Hambros Bank Limited
Lazard Brothers & Co., Limited
Samuel Montagu & Co. Limited
N. M. Rothschild & Sons Limited
J. Henry Schroder Wagg & Co. Limited

Arrangements for overseas offerings are being made with Morgan Stanley & Co. Incorporated in the United States of America; McLeod Young Weir Limited in Canada; The Nomura Securities Co., Ltd. in Japan; and Swiss Bank Corporation International Limited in Switzerland.

The application list for the Ordinary Shares now offered for sale will open at 10 am on 28th November 1984 and may be closed at any time thereafter. The procedure for application and the Application Form are set out at the end of this document.

A copy of this document, which comprises the listing particulars relating to the Company required by The Stock Exchange (Listing) Regulations 1984 made under the European Communities Act 1972, has been delivered to the Registrar of Companies in England and Wales for registration in accordance with those Regulations. Application has been made to the Council of The Stock Exchange for the whole of the ordinary share capital of the Company, issued and to be issued, to be admitted to the Official List.

Contents

Share Capital

Authorised		*Issued or to be issued and fully paid or credited as fully paid*
£1,875,000,000	Ordinary Shares of 25p each	£1,500,000,000
£750,000,000	11.95 per cent. (including tax credit) Redeemable Cumulative Preference Shares of £1 each	£750,000,000
£1	Special Rights Redeemable Preference Share of £1	£1

The Ordinary Shares now offered for sale will rank in full for all dividends declared or paid on the ordinary share capital of the Company after the date of this document; special arrangements apply to capitalisation issues and non-cash dividends during the instalment period.

Indebtedness

At the close of business on 30th September 1984, the Company had outstanding short-term borrowings of £126 million, loan stocks of £2,750 million, long-term loans (all in foreign currencies) of £324 million and obligations under finance leases, excluding interest, amounting to £204 million. All the foregoing were unsecured. Except as disclosed above, the Company did not at that date have any loan capital (whether outstanding or created but unissued), mortgages, charges or other borrowings or indebtedness in the nature of borrowings, including bank overdrafts, liabilities under acceptances (other than normal trade bills), acceptance credits, hire purchase commitments or, other than in the ordinary course of business, guarantees or other material contingent liabilities.

The Company had cash, bank balances and short-term investments maturing within six months amounting to £434 million at that date.

For the majority of foreign currency loans, the exchange risk is covered under arrangements with HM Treasury, and the indebtedness in respect of such loans has been translated at the rates of exchange ruling when the original liabilities were incurred. The remainder of foreign currency indebtedness has been translated at rates of exchange ruling at the close of business on 30th September 1984.

Part I
Key Information

The following information is derived from, and should be read in conjunction with, the full text of this document.

British Telecom is the principal supplier of telecommunication services in the United Kingdom. HM Government is now offering for sale up to 3,012,000,000 Ordinary Shares, representing 50.2 per cent. of the Company's issued ordinary share capital.

Historic and Forecast Profit

Actual	*Year ended 31st March 1984*	*Forecast for year ending 31st March 1985*
	£m	£m
Profit before taxation	990	1,350
Taxation	—	486
Preference dividends	—	41
Profit after taxation and preference dividends	990	823

See Section 7 of Part I—"Current Trading and Profit Forecast".

Pro Forma		
	£m	£m
Pro forma profit before taxation	1,151	1,401
Taxation	—	504
Preference dividends	63	63
Pro forma profit attributable to ordinary shareholders	1,088	834
Pro forma earnings per share	18.1p	13.9p

The pro forma figures set out above have been calculated on the assumption that the new capital structure of British Telecom had been in place for the two years ending 31st March 1985 (see Section C of the Accountants' Report).

Offer for Sale Statistics

Offer for Sale price (payable by instalments)	130p
Market capitalisation	£7,800 million
Price/earnings multiple on pro forma forecast earnings per share of 13.9p	9.35 times
Gross dividend yield based on assumed net annual dividends per share of 6.5p	7.14 per cent.

Bill Vouchers and Share Bonus

Individuals buying shares under this Offer for Sale may be eligible to receive free of charge from HM Government either, for a limited period, bill vouchers for use in paying British Telecom telephone bills or a share bonus of one free share for every ten held for three years. Details are set out in Part VI.

Special Dealing Arrangements

Special arrangements have been made for investors to deal at a reduced cost in small numbers of shares after the Offer for Sale until 31st December 1986. Details are set out in Part V.

Secretary of the Company
Malcolm Argent,
British Telecommunications plc,
2-12 Gresham Street,
London EC2V 7AG.

Solicitors to the Company
Philip Ashcroft,
British Telecommunications plc,
2-12 Gresham Street,
London EC2V 7AG.

Slaughter and May,
35 Basinghall Street,
London EC2V 5DB.

Auditors and Reporting Accountants
Coopers & Lybrand,
Chartered Accountants,
Abacus House,
Gutter Lane, Cheapside,
London EC2V 8AH.

Financial Advisers to the Company
S. G. Warburg & Co. Ltd.,
33 King William Street,
London EC4R 9AS.

Financial Advisers to HM Government
Kleinwort, Benson Limited,
20 Fenchurch Street,
London EC3P 3DB.

Solicitors to the Offer
Linklaters & Paines,
Barrington House,
59-67 Gresham Street,
London EC2V 7JA.

Solicitors to the Underwriters
Herbert Smith & Co.,
Watling House,
35-37 Cannon Street,
London EC4M 5SD.

Brokers to the Offer
Hoare Govett Limited,
Heron House,
319-325 High Holborn,
London WC1V 7PB.

Cazenove & Co.,
12 Tokenhouse Yard,
London EC2R 7AN.

de Zoete & Bevan,
25 Finsbury Circus,
London EC2M 7EE.

Scrimgeour, Kemp-Gee & Co.,
20 Copthall Avenue,
London EC2R 7JS.

Registrars and Custodian Bank
Lloyds Bank Plc,
Registrar's Department,
Goring-by-Sea,
Worthing,
West Sussex BN12 6DA.

Definitions

"British Telecom"	British Telecommunications public limited company and its subsidiaries and/or, as the case may be, their respective predecessors in business or any of them
"Company"	British Telecommunications public limited company
"Corporation"	The statutory corporation known as British Telecommunications
"LCS"	Local Communications Services division
"National Networks"	National Networks division
"BT International"	British Telecom International division
"BT Enterprises"	British Telecom Enterprises division
"Instalment Agreement"	The agreement summarised in Part V
"Ordinary Shares"	Fully paid Ordinary Shares of 25p each
"Interim Certificates"	The Interim Certificates, evidencing rights to Ordinary Shares, to be issued pursuant to the Instalment Agreement, pending payment in full of the Offer for Sale price (including, where the context requires, Letters of Acceptance in registered form)
"Special Share"	The Special Rights Redeemable Preference Share of £1
"Preference Shares"	The 750,000,000 11.95 per cent. (including tax credit) Redeemable Cumulative Preference Shares of £1 each
"Loan Stocks"	The twenty two separate series of unsecured loan stock aggregating £2,750,000,000 in principal amount redeemable between 1985 and 2006 and carrying interest at rates from 12¼ per cent. to 12¾ per cent. per annum
"BTSSS"	British Telecommunications Staff Superannuation Scheme
"1984 Act"	The Telecommunications Act 1984
"Licence"	The licence described under "Regulatory and Competitive Framework" in Part I, which came into force on 5th August 1984
"mini-prospectus"	The abridged prospectus also being issued by HM Government in connection with this Offer for Sale

Directors of British Telecommunications plc

Sir George Rowland Jefferson, CBE *(Chairman and Chief Executive)*
Deryk Vander Weyer *(Deputy Chairman)*
James Hodgson, CBE *(Vice Chairman)*
John Alvey, CB
Ronald Eric George Back
Michael Bett
Anthony John Booth
John Arthur Charles King
Francis Douglas Perryman
Iain David Thomas Vallance
John Frederick Goble *(non-executive)*
Sir George Gray Macfarlane, CB *(non-executive)*
Graeme David William Odgers *(non-executive)*
John Michael Raisman, CBE *(non-executive)*

1 Responsibility for Listing Particulars and Audit of Accounts

The Directors of the Company are: Sir George Rowland Jefferson, Deryk Vander Weyer, James Hodgson, John Alvey, Ronald Eric George Back, Michael Bett, Anthony John Booth, John Arthur Charles King, Francis Douglas Perryman, Iain David Thomas Vallance, John Frederick Goble, Sir George Gray Macfarlane, Graeme David William Odgers and John Michael Raisman; all of 2-12 Gresham Street, London EC2V 7AG. The Auditors and Reporting Accountants are: Coopers & Lybrand, Abacus House, Gutter Lane, Cheapside, London EC2V 8AH.

The Secretary of State has particular responsibility for the information herein concerning the policy and intentions of Her Majesty's Government; the Directors of the Company have particular responsibility for all the other information contained herein concerning British Telecom; and Coopers & Lybrand have particular responsibility for the Accountants' Report set out in Part III. The Secretary of State, as owner of the shares hereby offered for sale, has general responsibility for the whole of this document. All the above mentioned persons have taken all reasonable care to ensure that, to the best of their knowledge, the information given herein, or in those portions for which they have particular responsibility, as the case may be, is in accordance with the facts and nothing is omitted the inclusion of which would affect materially the import of this document.

The financial information set out in the Accountants' Report is based on the audited accounts of the predecessors to the Company, being the telecommunication business of the Post Office in respect of the two years to 31st March 1981 and the Corporation in respect of the three years to 31st March 1984. Coopers & Lybrand were auditors of the Corporation and joint auditors of the Post Office.

The financial information set out in the Accountants' Report by Coopers & Lybrand, whose audit reports on the accounts for the four years to 31st March 1983 were qualified, is stated after making such adjustments to the audited accounts as they consider necessary. As a result of these adjustments, and because information has become available to them additional to that at the time the accounts were prepared, Coopers & Lybrand give in the Accountants' Report an unqualified opinion as to the results and source and application of funds for each of the three years to 31st March 1984 and as to the state of affairs at 31st March 1982, 1983 and 1984. Their opinion in respect of the two years to 31st March 1981 remains qualified as set out in their report.

The financial information for the three months ended 30th June 1983 and 1984 is unaudited.

The Ordinary Shares offered for sale are offered solely on the basis of the information contained and representations made herein and in the mini-prospectus when taken with this document. No other information given or representations made by any person should be relied upon and no person responsible for this document, or any part thereof, shall have any liability therefor. (See Section C of Part VI).

2 Admission to Listing, Shares to be Listed and Details of the Offer

Admission to Listing and Shares to be Listed

Application has been made to the Council of The Stock Exchange in London for the whole of the ordinary share capital of the Company, issued and to be issued, to be admitted to the Official List on 23rd November 1984, with a view to its marketing on The Stock Exchange. It is expected that dealings will commence on 3rd December 1984, as described in Part V.

The capital history of the Company is summarised in paragraph 1 of Part IV. In the case of those shares which were issued in connection with the transfer of the assets and liabilities of the Corporation to the Company, the relevant documents, being the 1984 Act and the relevant statutory instruments, directions, orders, consents and appointments thereunder, are available for inspection at the offices of Slaughter and May, 35 Basinghall Street, London EC2V 5DB. The Ordinary Shares now offered for sale have been allotted credited as fully paid to HM Government. They will rank in full for all dividends declared or paid on the ordinary share capital of the Company after the date of this document; further details of the rights attaching to Ordinary Shares are set out in paragraph 2 of Part IV.

Details of the Offer

Introduction

Up to 3,012,000,000 Ordinary Shares are being offered for sale at a price of 130p per share of which 50p per share is payable on application, 40p on 24th June 1985 and 40p on 9th April 1986. The Ordinary Shares now being offered represent 50.2 per cent. of the total Ordinary Shares, issued and to be issued.

Applications must be received by 10 am on 28th November 1984 when the application list will open; it may be closed at any time thereafter. Details of the application procedure and the names of the receiving banks to whom applications should be delivered are set out at the end of this document. Letters of Acceptance will be posted to successful applicants on or as soon as possible after 6th December 1984.

At any time prior to the announcement of the basis of allocation, it may be decided that by reason of a material change in relevant conditions the Offer for Sale should not proceed.

Instalment Arrangements

Until payment of the final instalment, the Ordinary Shares sold on instalment terms will be registered in the name of Lloyds Bank Plc under the terms of the Instalment Agreement. They will be represented initially by Letters of Acceptance which will cease to be valid for any purpose on 31st May 1985, when Interim Certificates evidencing rights to the underlying shares will be issued, together with a notice calling for payment of the second instalment on 24th June 1985. Subject to payment of instalments when they fall due, the rights of the holders with respect to all dividends, voting and return of capital are equivalent to the normal rights of an ordinary shareholder, although special arrangements apply in the case of capitalisation issues and non-cash dividends.

A register will be established as at 9th March 1985, from which date transfers will be by stock transfer form in the normal way and subject to stamp duty. From 9th March to 31st May 1985 special temporary documents of title will be issued to transferees. During this period Letters of Acceptance and such temporary documents, and thereafter Interim Certificates, will serve as documents of title to enable transfers to be effected.

The liability to pay instalments will pass to the transferee upon registration of renunciation or of transfer, as the case may be. On payment of the final instalment due on 9th April 1986, the Ordinary Shares will be transferred (free of stamp duty to him) into the name of the last registered holder or joint holders.

Further details concerning the dealing arrangements and the Instalment Agreement, including the rights of HM Government if the instalments are not paid, are set out in Part V.

Bill Vouchers and Share Bonus

Individual investors may be eligible to receive free of charge from HM Government either bill vouchers or a share bonus but not both; details are set out in Part VI. Under the bill voucher arrangements up to 12 vouchers, each worth £18 for use in paying a British Telecom telephone bill within a limited period, will be made available to eligible investors. Under the share bonus arrangements, one share will be given without further payment for every ten shares held until 30th November 1987, up to a maximum of 400 free shares per investor.

Employee Offers

Ten per cent. of the Ordinary Shares now being offered are reserved for employees of British Telecom and BTSSS pensioners. Of these, 54 shares will be made available free by HM Government to each eligible employee and in addition each eligible employee will be given free by HM Government two Ordinary Shares, up to a maximum of 154 shares, for every share purchased by him under the Offer for Sale. Within the balance of these reserved shares, priority will be given to applications received from employees and BTSSS pensioners; those made by employees will be eligible for a discount of ten per cent. on the Offer for Sale price on up to 1,600 Ordinary Shares per employee. Any reserved shares not taken up under these arrangements will be available for public applications. Further details of these arrangements are contained in paragraph 4 of Part IV.

United Kingdom and Overseas Arrangements

Of the Ordinary Shares now being offered, 2,597,000,000 have been underwritten by a group of United Kingdom banks led by Kleinwort, Benson Limited. On 16th November 1984, a number of United Kingdom institutional investors, together with Swiss Bank Corporation International Limited on behalf of a syndicate of Swiss banks, are being invited to apply for all of these Ordinary Shares ("Priority Applications"). Undertakings are being given to accept up to 55 per cent. of the Priority Applications; the balance of these Priority Applications will be satisfied after all other applications in the Offer for Sale.

The balance of the Ordinary Shares being offered, 415,000,000, has been provisionally allocated to proposed separate offerings in the United States of America, Canada and Japan (the "Foreign Offerings"). Preliminary prospectuses were filed with the Securities and Exchange Commission in Washington D.C. on 26th October 1984 and with the provincial securities commissions in Canada on 26th and 27th October 1984 for offerings of American Depositary Shares (each representing 10 Ordinary Shares) and with the Ministry of Finance in Tokyo on 27th October 1984 for an offering of Ordinary Shares. It is expected that in the week commencing 26th November 1984 underwriting agreements will be entered into with syndicates of banks in the United States, Canada and Japan led by Morgan Stanley & Co. Incorporated, McLeod Young Weir Limited and The Nomura Securities Co., Ltd. respectively. The Bank of England has agreed to purchase any of the 415,000,000 shares provisionally allocated to the Foreign Offerings but not taken up to the extent that these shares are not covered by applications in the Offer for Sale (other than Priority Applications to the extent not already accepted). Additional shares may be made available to the Foreign Offerings from the United Kingdom Offer for Sale at the discretion of the Secretary of State. Application has been made for the Ordinary Shares to be listed on The Stock Exchange in London and for the American Depositary Shares to be listed on the New York and Toronto Stock Exchanges.

Details of these arrangements are set out in paragraph 13 of Part IV.

An agreement dated 16th November 1984 between Kleinwort, Benson Limited, Morgan Stanley & Co. Incorporated, McLeod Young Weir Limited, The Nomura Securities Co., Ltd. and Swiss Bank Corporation International Limited, each acting on behalf of their respective syndicates, provides for restrictions on marketing Ordinary Shares allocated to their respective offerings by each overseas group outside their respective countries.

The prospectuses to be issued in connection with the offerings in the United States and Canada will include statements that, in connection with those offerings, the United States Underwriters and the Canadian Underwriters may over-allot or effect transactions which stabilise or maintain the market prices of the American Depositary Shares or the Ordinary Shares at levels above those which might otherwise prevail in the open market. Such transactions may be effected on the New York Stock Exchange, the Toronto Stock Exchange or otherwise. Any such stabilisation, if commenced, may be discontinued at any time. Stabilisation may, therefore, directly or indirectly affect the price of the American Depositary Shares and the Ordinary Shares on such Stock Exchanges and The Stock Exchange, London.

Proceeds of the Offer and Expenses

The proceeds of the offer will go to HM Government.

In addition to underwriting commissions, HM Government will pay commissions to certain stockbrokers, banks and other intermediaries on successful applications; these are described in paragraph 14 of Part IV.

3 General Information about the Company and its Capital

Formation, Constitution and Share Capital

British Telecom is the principal supplier of telecommunication services in the United Kingdom. The Company's registered office is at 81 Newgate Street, London EC1A 7AJ and its principal administrative establishment is at 2-12 Gresham Street, London EC2V 7AG. It was incorporated on 1st April 1984 as a public limited company under the Companies Acts 1948 to 1981 with the object of succeeding to and carrying on the telecommunication business of the Corporation. The Company is registered with the Registrar of Companies in England and Wales with number 1800000. The documents referred to in Part IV of this document as available for inspection can be inspected at the offices of Slaughter and May, 35 Basinghall Street, London EC2V 5DB.

The authorised share capital of the Company is £2,625,000,001, consisting of 7,500,000,000 Ordinary Shares of which 6,000,000,000 are or will be, following the Offer for Sale, in issue and fully paid, and 750,000,000 Preference Shares and one Special Share, all of which are in issue and fully paid. Further details concerning the constitution and share capital of the Company are set out in paragraphs 1 and 2 of Part IV.

Limitation on Shareholdings

In order to prevent undue influence in the affairs of the Company, as the principal telecommunications operator in the United Kingdom, the Articles of Association of the Company contain restrictions on the interests (as defined in the Articles) of any person in shares in the Company which normally carry voting rights; these include holdings of Ordinary Shares and the rights to the Ordinary Shares evidenced by Interim Certificates. Where any person has such an interest in five per cent. or more of such shares, he must notify the Company. Whether or not such a notification is given, where a person has, or appears to the Directors or is deemed to have, an interest in fifteen per cent. or more of such shares, the Articles require a disposal to be made so as to reduce the interest of such person below fifteen per cent. and, in default, for a disposal to be made by the Directors on such terms as they think fit. This requirement applies whether or not other persons also have interests (even if of less than fifteen per cent.) in the shares concerned. Until this disposal takes place, the holder is unable to vote. Further details of the relevant Article are set out in paragraph 2 of Part IV.

The Minister of State for Industry and Information Technology stated in a letter dated 19th October 1984 that, in view of HM Government's intention not to use its rights as an ordinary shareholder to intervene in the commercial decisions of British Telecom and its expectation not to vote its shareholdings on resolutions moved at General Meetings, the Director General of Fair Trading would be likely to leave HM Government's shareholding out of account in considering, for the purposes of the merger provisions of the Fair Trading Act 1973, whether any shareholder was able materially to influence the policy of the Company and therefore whether he should advise the Secretary of State on a reference to the Monopolies and Mergers Commission. The Minister also drew attention to HM Government's intention to apply the ten per cent. limitation on allocation, as set out in Part VI B.

Relationship with HM Government

HM Government as an Investor

Following the Offer for Sale, HM Government will own 49.8 per cent. of the issued Ordinary Shares together with the Special Share and the Preference Shares. HM Government will provide out of this holding the Ordinary Shares to be given to individual investors under the share bonus arrangement. The £2,750 million Loan Stocks, which were issued to HM Government and then transferred to the Corporation as explained in paragraph 1 of Part IV, may in due course be transferred back to HM Government.

The Special Share, which may only be held by HM Government, does not carry any rights to vote at General Meetings but entitles the holder to attend and speak at such meetings. Certain matters, in particular the alteration of specified Articles of Association of the Company (including the Article relating to Limitation on Shareholdings and the Article which requires that the Chief Executive be a British citizen) require the prior consent of the holder of the Special Share. In addition, the holder may also appoint or nominate two persons as Government Appointed Directors. They are permitted by the Articles of Association to vote on issues relating to contracts in which the Crown is party or in which the Crown is interested. Further details relating to the Preference Shares, the Loan Stocks and the Special Share are set out in paragraphs 1 and 2 of Part IV.

Commercial and Other Relations with HM Government

Following the Offer for Sale, the commercial relationship between British Telecom as supplier and HM Government as customer will be on a normal customer and supplier basis. British Telecom will be treated by HM Government in accordance with the same criteria as other suppliers of telecommunication equipment and services. HM Government's general approach is set out in HM Treasury's published guidelines on public purchasing policy.

HM Government is British Telecom's largest customer for telecommunication services, which are of the greatest importance for the functioning of all Government departments. HM Government estimates that it paid British Telecom approximately £200 million in the year ended 31st March 1984.

British Telecom can be required in law to do certain things and to provide certain services for HM Government. The Licence obliges British Telecom to provide a number of emergency services (for example, priority repair of certain telephone lines) for Government departments. In addition, the Secretary of State has statutory powers to require British Telecom to take certain actions in the interests of national security, international relations or the detection of crime. It is not HM Government's policy to give details of any arrangements of this kind or of the payments, which may at the discretion of the Secretary of State be made, in respect of them.

Letter from HM Government

The following is the text of a letter from the Secretary of State for Trade and Industry to the Chairman of the Company dated 16th November 1984:

"Following the Offer for Sale, HM Government will hold 2,988,000,000 Ordinary Shares in the Company. It will not sell or otherwise dispose of any of this holding (except under the arrangements for the share bonus) before 9th April 1988. Subject to this undertaking, it is HM Government's policy to sell residual shareholdings in privatised companies as the circumstances of the companies and market conditions permit. Before any such sales or disposals and the arrangements therefor are made, HM Government will take into account the views of the Directors of the Company.

Before any sales or disposals of Preference Shares held by HM Government are made, HM Government will take into account the views of the Directors of the Company, and the Company will first have the option to redeem the shareholding in question at par.

HM Government will not dispose, or permit the disposal, of any of the Loan Stocks held by it or by the Corporation before 16th November 1989. If after that date HM Government has any proposals for selling or obtaining a listing for any of these Loan Stocks, before any arrangements for this are made HM Government will take into account the views of the Directors of the Company.

HM Government does not intend to require the Company to redeem the Special Share.

HM Government does not intend to use its rights as an ordinary shareholder to intervene in the commercial decisions of British Telecom. It does not expect to vote its shareholding on resolutions moved at General Meetings, although it retains the power to do so. The Government Appointed Directors have no special powers and their duties, like those of all Directors, are to the Company as a whole.

If the Bank of England purchases any Ordinary Shares in the Company as a result of the arrangements between HM Government and the Bank of England in connection with the Offer for Sale, HM Government will ensure, pursuant to an agreement with the Bank of England, that, in the event that the Bank of England exercises any of the votes attaching to such shares or HM Government exercises any of the votes attaching to its shares, the votes exercised by HM Government will, when added to any votes exercised by the Bank of England in respect of such shares, be less than the aggregate of the votes entitled to be exercised in respect of all other shares.

HM Government will in any case restrict the exercise of the votes attaching to its shareholding to a number less than the aggregate of the votes entitled to be exercised in respect of all other shares where voting rights attach to the Preference Shares because dividends are in arrears."

Attitude of HM Opposition

In its 1983 Manifesto, the Labour Party stated that it would "return to public ownership the public assets and rights hived off by the Tories, with compensation of no more than that received when the assets were denationalised". When the Bill for the 1984 Act was debated in the House of Commons on 18th July 1983, the Rt. Hon. Stanley Orme M.P., speaking from the Opposition Front Bench, indicated that a future Labour Government would "recreate a publicly owned and democratically run telecommunications system in the United Kingdom". The Labour Party conference in October 1984 passed a resolution calling for the renationalisation of British Telecom, and instructed its National Executive Committee to ensure that compensation to be paid on renationalisation should be on the basis of "no speculative gain".

4 The Activities of British Telecom

A. Historical Background

The world's first commercial telecommunication operation began in 1839 with the establishment of a telegraph line between Paddington and West Drayton. Public telegraph services grew rapidly from 1849; the first submarine telegraph cable was laid in 1850 between England and France and the first transatlantic cable in 1858.

The development of the telephone by Alexander Graham Bell, patented in 1876, led to the establishment of private telephone lines; these were linked together for the first time in the United Kingdom by means of a public telephone exchange at Coleman Street in the City of London opened in 1879. Major developments in the United Kingdom which followed in the next fifty years included the laying of the first telephone cable between England and France in 1891, the opening of the first automatic exchange at Epsom in 1912, and the establishment of regular telephone service between the United Kingdom and the United States of America in 1927, using long wave radio. New services were provided in 1936 with the introduction of TIM, the speaking clock, and in 1937 with the '999' emergency service. Subscriber trunk dialling was introduced in 1958 at Bristol; international direct dialling began in 1963 between London and Paris; and the first commercial communications satellite was launched in 1965.

The Origins of British Telecom

In its early days, telephone service was provided by the General Post Office in competition with private sector companies. In 1896, the General Post Office took over the private sector trunk service and in 1912 it became the monopoly supplier of telephone services throughout the United Kingdom except in a few municipalities, including the City of Kingston-upon-Hull (where the local service is still provided by the City Council). In 1969, the Post Office ceased to be a Government department and was established as a public corporation.

In 1981, the postal and telecommunication services of the Post Office became the responsibility of two separate corporations with British Telecom taking over the telecommunication business. At the same time, the first steps were taken to introduce competition into telecommunications in the United Kingdom. In 1982, HM Government announced its intention to sell up to 51 per cent. of British Telecom to the public, and legislation was introduced into Parliament, receiving Royal Assent on 12th April 1984; the business of the Corporation was transferred to the Company on 6th August 1984.

B. Technological Background

During recent years, the rate of technological change in telecommunications has accelerated and exchange equipment, transmission systems and customer apparatus have all developed significantly.

Most existing telephone networks are based on an analogue system. This turns the air pressure waves created by speech into analogous, constantly varying, electrical waves and turns them back to speech again at the receiver. Other forms of telecommunication, such as text, television or computer data, require separate networks or conversion equipment. However, with the development of a digital system of transmission, speech, text, data or television can all be translated into a stream of bits, the binary digits used for computers, and represented in the form of pulses of electricity or light. Further, by operating at high speed it is possible to interleave the pulses relating to separate messages, such as different telephone calls, along a single line, a technique known as time division multiplexing which is important for more efficient use of the network. Conversion to a digital network reduces costs, through the use of recently developed micro-electronic devices, and improves call quality because digital signals are less vulnerable to distortion.

Exchanges

All telephone exchanges were manually operated until 1912 when the electro-mechanical Strowger switching system was first introduced into the United Kingdom and became the standard exchange equipment. Two generations of exchange have been introduced progressively since the 1950s to replace the Strowger system. First, the Crossbar exchange with improved electro-mechanical technology, and secondly, the TXE series of exchanges incorporating electronic control and sealed switching contacts (reed relays).

The most recent development in exchange technology has been the introduction of digital switching equipment incorporating stored program control. Here, the instructions to operate the exchange are contained in software programs, which run on processors similar to data processing computers. Electro-mechanical switching equipment has thousands of moving parts which are costly to maintain and cause faults such as crossed lines, crackles and wrong numbers, whereas digital switching equipment contains almost no moving parts. The development of a new family of digital exchanges, known as System X, was started by the Post Office in the 1970s in collaboration with the three major United Kingdom telecommunication manufacturers. The first prototype System X exchange was opened in London in 1980 and a version with improved performance has been developed, the first of which was opened in Coventry in 1983. When System X becomes more widely available it will offer a wide range of facilities from the public exchange without customers needing special apparatus, while the modular nature of the design allows improvements to be introduced. Additional services can also be offered through improvements in software, often without making alterations to the exchange equipment. For its smallest local exchanges the digital UXD5 has been developed by British Telecom from its Monarch electronic private automatic branch exchange.

Transmission

The traditional method of transmission for inland communications has been by wires or coaxial cables, carried overhead or in underground ducts, or by microwave radio. International communications have been carried by undersea coaxial cables, radio links or international satellites, linked by earth stations.

The most important recent development is the introduction, initially into the trunk network, of optical fibre cables. These are thin strands of extremely pure glass, which carry signals as pulses of light. Use of optical fibre cable instead of coaxial cable (which has a central conductor made of copper or aluminium) has several benefits: its communication capacity is much greater and, being small, more cables can be inserted in existing ducts. In addition, the signals fade less rapidly than in conventional cable and therefore require less frequent amplification, providing substantial savings on the installation and maintenance of amplification equipment. British Telecom's first optical fibre cable was installed in 1977.

Internationally, satellites are increasingly being used not only for voice but also for data, facsimile and broadcasting transmission. Undersea cables will however continue to be important and the first international submarine optical fibre cable is scheduled to be laid between the United Kingdom and Belgium in 1985.

A further development in transmission is cellular radio which, through the use of radio waves of higher frequency and lower power, can provide mobile telephone services with greater capacity than the existing radiophone services.

Customer Apparatus

Advances in customer equipment have stemmed largely from an increasing use of micro-electronics. The telephone has evolved from a wooden box containing many individual components, an electro-mechanical bell and a microphone filled with carbon granules, to a complex electronic device offering a wide range of facilities. Private automatic branch exchanges now incorporate the same digital techniques as are being introduced for public exchanges, reducing cost and size while increasing facilities. New types of telex terminal can display the text on a screen and thereby allow more preparation of the message before transmission. The recently introduced teletex service is similar to telex though messages are transmitted some fifty times faster over the telephone network. Word processors can now be interconnected over the telephone network to provide the basis of an electronic mail system.

Integrated Systems

At present, telephone, telex and private circuit networks are physically separate. Digital equipment and optical fibre cables should enable British Telecom to integrate a wide range of services into a single Integrated Services Digital Network ("ISDN"). A pilot ISDN service will open within a few months and is expected to be introduced over the country as System X is brought into service. It will be capable of handling both the existing and the new forms of traffic which are emerging through the growth of information technology, such as electronic funds transfer, credit card verification, high-speed transmission of data and facsimile and video conferencing. However, certain types of data communications are handled more efficiently in the form of 'packets' which will continue to require a separate network, although this packet switching network will be accessible from appropriate ISDN terminals.

C. Business and Organisation

The principal business of British Telecom is to provide customers in the United Kingdom and the Isle of Man with local, national and international telecommunication services, and to supply customers with apparatus to give access to these services. This is by far the largest part of the business. Within this, the main activity is the provision of voice telephony, supplemented by data services, over a single nationwide public network. British Telecom is also marketing a range of more specialised services in telecommunications and in the related fields of information technology.

Organisation

Reflecting the commercial and operational interdependence of its activities, British Telecom is organised to provide a high degree of corporate co-ordination. Following the introduction of competition into telecommunications, the operational structure is being developed to allow greater devolution of decision making and financial responsibility to local and product managers, consistent with the need for co-ordination and accountability. British Telecom is in transition, changing over a relatively short period from a public sector monopoly to a private sector company which faces growing competition and which operates under a new regulatory regime. Thus, while the main lines of its operational structure have been established in the form of five operating divisions, the organisation both within and between divisions is continuing to develop. There has also been a process of significant change in management approach and personnel practices to meet these developments in organisation and technological change.

The mainly centralised financial accounting systems, currently being replaced, did not provide fully the management information that the Directors see as desirable for the new environment. The work to develop integrated financial and management accounting systems necessary for the new organisation and to meet the requirements of the Licence first started in 1982. Significant progress has already been made to develop these systems which will provide management with revenue, cost and profit information on a decentralised basis.

The activities of British Telecom are described below by reference to each of the operating divisions: LCS, National Networks, BT International, BT Enterprises and Development and Procurement.

Local Communications Services

LCS is by far the largest division in terms of employees, with a staff of about 201,000 representing approximately 84 per cent. of the workforce. The management structure, outside London, is at present being reorganised into twenty four management districts in four territories. LCS is responsible both for the provision of the local telephone service and for the sale, rental, installation and maintenance of customers' apparatus, as well as for a range of activities carried out on behalf of the whole business. These include direct sales, service and accounts contact with customers and the maintenance of much of the network. British Telecom broadly estimates that about one half of its turnover for the year ended 31st March 1984 was derived from line rental, subscribers' local calls and the sale or rental of apparatus.

Local Telephone Service

LCS provides the local telephone service, which is also the gateway to the trunk and international telephone networks. At 31st March 1984, there were about 20 million lines in service linking telephone customers to about 6,300 local exchanges. On average more than 60 million calls per day pass through these exchanges.

The total number of lines in service has grown from 5 million in 1960 to about 20 million in 1984, made up of 16 million residential lines and 3.8 million business lines. During the 1960s and 1970s, the number of residential lines grew at an average annual rate of about 8 per cent. but, as shown in the table below, this growth slowed down in the 1980s, largely due to the level of residential penetration already achieved — 78 per cent. of all households in the United Kingdom now have a telephone. It was also affected by the price increases in 1980 and 1981. The reduction in the growth rate of business lines since 1980, also illustrated below, principally reflects the impact of the recession in 1980 and 1981.

At 31st March	Number of residential lines in service (thousands)	Growth in year %	Number of business lines in service (thousands)	Growth in year %
1980	13,955	8.4	3,422	4.6
1981	14,689	5.3	3,509	2.5
1982	15,177	3.3	3,574	1.9
1983	15,564	2.5	3,646	2.0
1984	16,062	3.2	3,774	3.5

Calls

British Telecom's equipment which is used to charge customers records units and does not count calls. The estimated growth in the number of local calls, trunk calls and total calls in each of the last five years is shown in the following table. These estimates are derived from call meters installed at the trunk exchanges and at a sample of local exchanges. The table should be used as an approximate guide only. In particular, beginning in the year ended 31st March 1984, improved call counting procedures are providing more accurate estimates of numbers of calls and, as a consequence, British Telecom believes the growth rate in that year shown in the table is greater than the actual rate of growth.

Year ended 31st March	Estimated annual growth of local calls %	Estimated annual growth of trunk calls %	Estimated annual growth of total calls %
1980	6	8	6
1981	1	2	2
1982	3	3	3
1983	3	5	3
1984	5	9	6

Growth in the number of calls in the whole network depends upon the increase in the number of lines in service and upon the calling rate—the frequency of calls made by each customer. During the 1970s, call growth resulted from the rapid increase in the size of the network rather than from increased calling rates. Between 1980 and 1982, calling rates declined so that the growth in the number of calls in that period resulted from the continued increase in the size of the network. Total calling rates have since risen gradually.

British Telecom estimates that, on average, residential lines are used for outgoing calls for 40 minutes per week and business lines for approaching 4 hours per week. It believes that the modernisation of exchanges and improved apparatus, which will provide better service and additional facilities, will encourage increased usage of the network. Its pricing strategy is designed to encourage usage of the network outside business hours.

Apparatus

LCS rents, sells, installs and maintains a wide range of products from telephone instruments to branch exchanges. At 31st March 1984, 28.6 million telephones (including extensions) were being rented from LCS. British Telecom began to sell telephones in 1982 and, in the year to 31st March 1984, LCS sold about 219,000 telephones and related telephone terminals. In that year, it added about 380,000 to the number rented. Some 95 per cent. of the telephone apparatus sold or rented by LCS is currently procured for it by BT Enterprises.

British Telecom has had the sole right to supply the first telephone to customers, but this will cease on 1st January 1985. Since 1981, there has been competition in the supply of customer apparatus other than the first telephone. To enable customers to use telephones of their choice, LCS is fitting sockets in customers' premises, on request or at the time of an installation or maintenance visit. About ten million sockets have so far been installed.

Other Services

British Telecom provides private circuits which are lines between fixed points reserved for the exclusive use of a customer. They are leased at a fixed rate irrespective of usage. LCS is responsible for local analogue circuits, while National Networks provides trunk analogue and all inland digital circuits; international circuits are the responsibility of BT International. At 31st March 1984, British Telecom was providing about 360,000 private circuits.

LCS operates public call boxes and rents payphones to customers. At 31st March 1984, there were about 76,500 public call boxes and 293,500 rented payphones in premises such as hotels, restaurants and stores. A new payphone, the Blue Payphone, of which over 11,000 have so far been introduced, incorporates press button dialling and a credit display; it automatically alerts the repair service when a fault occurs. Another new payphone, the Cardphone, accepts special cards instead of coins.

LCS manages the inland telephone operator service, the inland directory enquiries service, the '999' service and the Freefone service by which the cost of the call is met by the called customer, as well as providing a range of recorded services including the speaking clock and new services such as Sportsline, a sports headline service updated hourly.

The City Business System, designed to meet the communication needs of business customers including financial institutions, foreign exchange dealers, airlines and travel agents, was developed by LCS; this system has a single screen which can be used to make telephone calls, to send telexes and to consult information stored in a computer.

LCS is responsible for the nine computerised billing centres which send out annually approximately 80 million bills. Equipment now being introduced on trial in some exchanges enables bills to show the numbers called and the charge per call. British Telecom's motor transport fleet, which totals more than 50,000 vehicles, is also the responsibility of LCS.

National Networks

The trunk telephone service is the most important activity of National Networks; British Telecom broadly estimates that trunk calls contributed about a quarter of its total turnover in the year ended 31st March 1984. National Networks also offers a range of specialised services for business users. In recognition of the importance of large customers to British Telecom's business, National Networks has overall responsibility for relations with about 150 of British Telecom's largest customers. The principal areas of British Telecom's business with the customers, excluding HM Government, whom it considers to be its 100 largest customers (but not necessarily including all their subsidiaries) are estimated to account for not more than one tenth of British Telecom's turnover. Other than HM Government (see "Relationship with HM Government"), no one customer accounts for as much as one per cent. of total turnover. National Networks has about 11,000 employees.

Trunk Services

National Networks runs the trunk switching and transmission network for telephone and other services, connecting with the local and international networks. The telephone network has over 450 trunk exchanges which are connected by some 400,000 cable and radio circuits.

The introduction of subscriber trunk dialling between 1958 and 1975 made trunk calls easier and cheaper. This, together with the increase in the size of the network and national economic growth, contributed to an annual average growth rate for trunk calls of 12 per cent. during this period. From 1975 to 1980, the average growth rate was about 7 per cent. per annum and although from 1981 to 1983 growth was relatively low, mainly because of the recession, it recovered in the year ended 31st March 1984.

Cheaper off-peak rates encourage greater use of the network. Modernisation of local exchanges and improvements to the trunk network, providing better service and additional facilities, should contribute to the growth in calls. New services are planned including the introduction in 1985 of automatic Freefone and, a similar service, Economy Phone, whereby callers contribute a local call charge towards the cost. These two services are designed in particular to increase trunk calls to businesses from residential lines.

Specialised Services

National Networks offers a range of specialised telecommunication services for business customers. At present the most important service is its 47,000 long distance inland analogue private circuits, but in the long term the potential for market growth lies with digital private circuit services. The first of these, introduced in 1983, was Kilostream, which provides services such as high speed links between computers and terminals for text and graphics. This was followed by Megastream, which offers very high speed data transmission or up to 30 voice channels. National Networks also provides specialised networks for the distribution and switching of sound and vision programme material for radio and television broadcasters.

The second major specialised service is the inland telex network. This will be enhanced with the progressive introduction of stored program control telex exchanges, starting at the end of 1984, providing facilities such as the storage of messages until the recipient is ready, transmission to multiple addresses, recorded messages for callers and message redirection. In the year ended 31st March 1984, the number of telex connections increased by 2.7 per cent. to 95,000.

National Networks offers Packet SwitchStream, which enables customers to send and receive certain types of data, for which the conventional telephone network is not suitable, in 'packets' over a separate public network. The number of calls made over this system has grown rapidly since its introduction. It is used for the clearing houses automated payment system to provide same-day clearance of funds in the City of London, and can be used for such applications as credit card verification and, when linked with Prestel, for home banking, shopping or ticket reservation.

BT International

BT International provides international services which, in the year ended 31st March 1984, accounted for approximately one sixth of British Telecom's turnover. International telephone service is its principal activity and this represented about two thirds of international revenues in that year. BT International also provides maritime and offshore communications and specialised international business services. It has a wide range of telecommunication facilities including seven international telephone and two international telex switching centres, 44 radio stations, three satellite earth stations and one microwave radio station; it has interests in 54 submarine cables throughout the world and operates three cableships. It has about 11,000 employees.

International Telephone Service

The international direct dialling facility was introduced first to Paris in 1963. Since then, it has been extended and the volume of international traffic increased during the 1970s at an average rate of approximately 20 per cent. per annum. By October 1984, direct dialling had been extended to 161 out of the 217 countries to which telephone service is available, and 97 per cent. of all international traffic originating from the United Kingdom is now dialled direct. Despite the international economic downturn in the early 1980s, the volume of business has continued to grow, fostered by a substantial reduction in prices in real terms. This growth is illustrated in the table below:

	Annual growth in international traffic		
Year ended 31st March	Outgoing	Incoming	Total
	%	%	%
1980	25	20	22
1981	11	16	13
1982	12	16	14
1983	12	10	11
1984	14	10	12

Note: The annual growth rates are calculated by reference to paid minutes. Incoming traffic includes transit traffic.

In the year ended 31st March 1984, telephone traffic to and from the United Kingdom amounted to 2,012 million paid minutes. The bulk of international telephone traffic is generated from a limited number of routes and some 85 per cent. of United Kingdom traffic is with 20 countries; the largest single route, to the United States, accounts for 22 per cent. The United Kingdom is one of the world's principal transit centres, enabling traffic originating and terminating outside the United Kingdom to be routed via this country. BT International estimates that it handled more than 48 million paid minutes of transit traffic in the year ended 31st March 1984.

BT International maintains an operator service for directory enquiries and other assistance to customers such as personal call facilities. International telegram and telemessage services are also provided. Telemessage, which replaced the inland telegram service in 1982, provides delivery by local mail within the United Kingdom and in the United States of messages transmitted electronically.

Business Services

Telex is available to 198 countries of which 186 can be reached by direct dialling. Telex traffic has continued to grow and, in the year ended 31st March 1984, totalled about 500 million paid minutes.

BT International provides about 5,000 international leased private circuits and, in competition with continental telecommunication networks, provides an estimated 55 per cent. of the private circuits between Europe and North America. Other international services provided include data transmission, including the packet switching service, facsimile transmission, satellite relay facilities for television, videoconferencing, the design, installation and maintenance of private networks and consultancy services. Satstream is a recently introduced private leased service using satellites and small dish earth terminals. The expertise and equipment of British Telecom are marketed overseas by Telconsult and Teletrade.

BT International's maritime services provide telephone, telex and telegram services to ships at sea via radio links and through the Inmarsat satellite system. Services are also provided to offshore oil and gas production platforms.

BT International also represents British Telecom's interests in United Satellites Limited, a consortium formed with a view to establishing a system for direct broadcasting from satellites.

International Agreements

The division has responsibility for British Telecom's membership of international consortia which provide, own and maintain submarine cable systems. It is also involved in various international telecommunication organisations and maintains bilateral relations with other telecommunication operators worldwide to foster and improve international services.

Some of British Telecom's activities fall within the scope of a number of international treaties; under these treaties, HM Government has certain obligations and responsibilities in relation to telecommunications and, in a number of cases, British Telecom is also party to arrangements made under them. British Telecom acts as United Kingdom signatory for the operating agreements of the Intelsat, Eutelsat and Inmarsat international satellite organisations which supply global, European regional and maritime satellite services respectively. The United Kingdom is the second largest shareholder after the United States in the Intelsat system, the joint largest with France in Eutelsat and the third largest, after the United States and the USSR, in Inmarsat.

International Accounting

Revenues are derived from outgoing calls made by customers in the United Kingdom and from receipts from overseas telecommunication administrations for incoming traffic which use the facilities of British Telecom. In turn, British Telecom makes payments to overseas administrations for the use of their facilities. The rates for payments are agreed bilaterally, under the general auspices of the International Telecommunication Union. The practice amongst telecommunication administrations is for payments due for the use of overseas networks to be recorded by the administration from which the call is made. Hitherto, British Telecom, in common with most other administrations, has been unable to check all the amounts due from other administrations, but additional equipment is now being installed which will greatly increase the ability to record incoming traffic. The currency in which payments are denominated is agreed bilaterally. British Telecom's exposure in foreign currency under these arrangements only arises on any imbalances between the value of incoming and outgoing traffic with overseas telecommunication administrations. As a result, British Telecom's profits have not been materially affected by movements in exchange rates.

BT Enterprises

BT Enterprises includes Merlin and Consumer Products which supply, principally through other divisions, a range of customer apparatus procured mostly from outside manufacturers. Also included are Mobile Systems and Services, Value Added Systems and Services and British Telecom Factories (Telephones); the external activities of these three groups together accounted for about two per cent. of the turnover of British Telecom in the year ended 31st March 1984. BT Enterprises has about 3,000 employees.

Merlin (Business Products and Systems)

Merlin develops, procures and markets business products and systems generally supplied by outside manufacturers. Some products are supplied exclusively but most are sold by other suppliers and, in certain cases, directly by the manufacturer. As well as business telecommunication systems, teleprinters and data communications equipment which are mainly distributed by LCS, Merlin has begun to supply office automation products and services.

The range of business systems introduced to the market by British Telecom in the last five years covers the needs of the smallest to the largest businesses. Products including Herald and Monarch offer advanced features such as abbreviated dialling for frequently used numbers, call diversion and automatic recall from busy extensions. In the year ended 31st March 1984, Merlin sold 75,000 such systems through LCS and National Networks.

Consumer Products

Consumer Products develops, procures, markets and supplies telephones and related equipment for the consumer market, generally obtained from outside manufacturers, mainly through LCS but also through major high street chains, independent retailers and other outlets.

The major products are dial telephones, either new or refurbished, and push button electronic telephones. The range has recently been extended to include sophisticated electronic and decorative telephones, including the Sceptre 100 which incorporates a visual display, a call timer and a clock and memorises up to ten numbers; the newly launched Slimtel one piece telephone manufactured by British Telecom; and the Hawk cordless telephone. In addition, Consumer Products sells related equipment including answering machines, meters, callmakers and a range of small electronic switching systems for the home or small business. Some of these products are exclusive to British Telecom.

Mobile Systems and Services

Mobile Systems and Services operates national radiopaging and radiophone networks and provides terminals for rent and sale, and services using these networks. Connections to its national radiopaging network have grown more than four-fold since 1981 and, by 31st March 1984, there were more than 200,000 pagers. The existing manual radiophone system will be closed in 1986 but the automatic radiophone system is continuing to grow. There were about 11,500 subscribers to these services at 31st March 1984. British Telecom owns 51 per cent. of Telecom Securicor Cellular Radio Ltd. which is licensed to operate a cellular radio system; this is known as Cellnet and is marketed by Mobile Systems and Services and others.

Value Added Systems and Services

By far the largest element of this group of services is Yellow Pages which is the biggest directory advertising medium in the United Kingdom. In the year ended 31st March 1984, 22 million copies were distributed free to telephone users, with revenue coming from about 200,000 advertisers.

Prestel is a public viewdata service supplied over the telephone network, offering to both business and residential customers a wide range of computer-based information and communication services. The principal business services are Prestel Travel for travel agents and Prestel Citiservice for the investment community. The main residential services are Prestel Microcomputing for home computer users and Homelink which provides home banking facilities.

The National Data Processing Service provides computer services to cargo, air freight and other industries. New Information Services develops and supplies interactive and other services mainly for use over cable systems. Spectrum's services, many in the early stages of development, include electronic mail, alarms and security services, telephone answering services and telephone marketing services.

British Telecom Factories (Telephones)

With about 1,000 employees, it manufactures and refurbishes telephones. Almost all the output is supplied to other parts of British Telecom, mainly Consumer Products. The manufacture of the new Slimtel telephone is a recent development, and these are now being produced at the rate of 8,000 a week.

Development and Procurement

This division, which has about 10,000 employees, is divided into two groups, one responsible for research and development and the other for procurement. Most of the research and development is conducted at the British Telecom research establishment at Martlesham, Suffolk where about 2,400 staff are employed; it is widely regarded as one of the leading telecommunication research centres in the world.

Research and Development

British Telecom's total costs for research and development were £158 million, £172 million and £179 million respectively in the three years ended 31st March 1984. Somewhat over one third of this was contracted out to industry and to universities. Of the work done by British Telecom, the majority was undertaken by this division, although the other divisions do some mainly short-term development work on existing systems. All research and development activity is co-ordinated by a planning committee of senior management staff.

The principal categories of the total expenditure in the year ended 31st March 1984 were about £90 million on exchange systems, primarily the new digital network including System X, £30 million on transmission and £30 million on customer systems and services. These proportions are not expected to be the same in future years, since the peak of research and development expenditure on System X is now past. However, the percentage of turnover devoted to research and development is expected to remain approximately the same, but with greater emphasis on the expanding fields of information technology equipment and services for the home and office.

In recent years, British Telecom's research activity has led to many important advances in the field of telecommunications. Among these advances are the work on the principles of time division multiplexing which made possible the development of the digital telephone exchange, and the 'voice guidance' service which instructs customers how to make easy use of the advanced facilities on System X. Much of the equipment for Satstream, the high-speed satellite data service, was designed at Martlesham, along with the new terrestrial radio system needed for Kilostream and Megastream, National Networks' private circuit services. British Telecom played an important role in the development of a video system which compresses the bandwidth of television signals and has allowed a transatlantic videoconferencing service to be opened.

Research at Martlesham also led to the Prestel viewdata system, which received the Queen's Award for Technology in 1984, the Monarch digital private branch exchange, which received a Design Council Award in 1983, and the new Sceptre and Slimtel telephones. British Telecom is recognised as a world leader in optical fibre technology and associated devices. Martlesham has also developed long life transistors and integrated circuits for undersea cables where extremely high standards of reliability are required.

Procurement

The procurement group is responsible for the purchase of major systems and for the purchase, warehousing and distribution of a wide range of telecommunication engineering and other stores. The group has factories with about 2,400 employees which are responsible for the production of items, such as test equipment, almost all of which are supplied to other divisions of British Telecom.

Three United Kingdom manufacturers supply the majority of British Telecom's equipment: The General Electric Co. plc ("GEC"), the Plessey Co. plc ("Plessey") and Standard Telephones and Cables plc ("STC"). British Telecom estimates that, in the year ended 31st March 1984, out of contracts amounting to £1,740 million (excluding certain contracts with a value of less than £1,000), such contracts totalled about £340 million with GEC, £380 million with Plessey and £220 million with STC.

In 1982, the arrangements for the development and manufacture of certain exchanges supplied to British Telecom by these three main United Kingdom suppliers changed. STC withdrew from the System X programme and in practice became the principal manufacturer for subsequent orders of the large TXE (TXE4A) exchanges with an agreed minimum amount of orders. A further change was that British Telecom undertook, for the following five years, that if it were to place orders for digital exchanges for the inland network, and if Plessey and GEC proved to be satisfactory suppliers for System X, it would place with them very substantial orders; pursuant to individual purchase orders, some 400 System X exchanges have now been ordered. Although there have been delays in commissioning the first production models of the latest type of System X exchanges, British Telecom expects the delivery programme of trunk and local exchanges to accelerate rapidly and reach maximum volumes in the year ending 31st March 1987. In addition, British Telecom intends to introduce an alternative supplier for digital switching equipment and has invited three other manufacturers to tender for the supply of equipment that would meet performance specifications comparable with those of System X.

In all major areas of procurement, British Telecom considers that there are sufficient alternative manufacturers to make it unlikely that interruption of any one source would cause more than a temporary delay to its plans; short-term disturbance of its operations by such an interruption could be reduced by expedient measures.

British Telecom may seek equipment internationally where appropriate in order to provide an efficient and competitive service, although it will always have regard to the benefits of domestic supply.

As with other telecommunications operators within the EEC, it is likely that British Telecom's procurement policies will be influenced by new EEC Recommendations encouraging the liberalisation of European telecommunication equipment supply. The practical effects of this are as yet difficult to predict.

Broadband Services

British Telecom has for some years provided cable TV to six towns in the United Kingdom. It has shareholdings in five of the eleven pilot cable TV ventures. Broadband Services are managed separately from the other divisions under the Director for Personnel and Corporate Services.

International Comparisons

British Telecom operates one of the largest telephone networks in the world. As shown in the table below for 1982/3, the United States had by far the largest network, although the highest level of lines per capita was in Sweden.

	Number of lines in service (millions)	Number of lines in service per 100 population	Number of telephones (millions)
United States of America	95	41	182
Japan	42	35	61
Federal Republic of Germany	23	37	31
France	19	36	29
United Kingdom	19	35	29
Italy	15	26	22
Canada	10	42	17
Spain	8	21	13
Australia	6	36	8
Netherlands	5	37	8
Sweden	5	60	7

Note: The table gives data derived from information published by overseas administrations relating to various dates between December 1982 and June 1983 (United Kingdom March 1983), being the latest figures available to enable comparison to be made between the systems of certain major economies.

The wide variation in penetration reflects differing economic conditions, tariffs and social patterns, but the comparisons indicate that the level of penetration in the United Kingdom was similar to that of several other European countries but below the level of North America.

As regards calls and calling rates, on which less information is available, the number of calls per line in service in the United Kingdom was about one third of the number in North America, and was broadly comparable with Australia, Japan and most of the other European countries for which information is available.

Prices

British Telecom's turnover is mainly derived from calls and the supply of customers' lines and apparatus. The price structure for call charges is complex, varying with distance, duration, route and time of day, although based on a uniform unit charge of 4.7 pence. The quarterly rental for residential lines is £15.15 and for business lines £23.50; a quarterly rebate of up to £3.84 is granted to residential customers with low usage of the telephone. These prices reflect the recent changes mentioned below.

In the past, prices for the Corporation's services were set in the light of financial targets agreed with HM Government, and following consultation with the Post Office Users' National Council. Now, British Telecom operates under a number of licences, the most important of which is the Licence granted under the 1984 Act to run its public telecommunication system, described under "Regulatory and Competitive Framework" below.

Under the Licence, there are restrictions on the extent to which the Company can increase the prices of some of its telephone services until 31st July 1989. The price control covers business and residential line rentals and subscribers' dialled inland calls taken together, which British Telecom estimates represented 55 per cent. of turnover in the year ended 31st March 1984. In any of the five years beginning 1st August 1984, the weighted average increase in prices charged for these services must be at least three points below the percentage increase in the retail price index over the twelve months ending on the previous 30th June ("RPI-3"). For the purposes of calculating the increase in these prices, each item is weighted in proportion to the contribution it made to the Company's total turnover in the previous financial year. Provision is made for any permitted increase foregone in one year to be carried forward for two years. If the retail price index increases by less than three per cent. or falls, the Company is obliged to lower its prices accordingly. There is no price control on any element of international services, calls from public call boxes, apparatus supply, private circuits or other services, which together account for the balance of turnover.

In addition to the control provided by the Licence, the Board of the Company has said that during the same five year period it intends to hold increases in the rental for residential lines (which British Telecom estimates represented 12.5 per cent. of turnover in the year ended 31st March 1984) within a ceiling of two points per annum over the percentage increase in the retail price index ("RPI+2"); the Board further intends during that period to continue to give rebates to low volume users, broadly comparable in overall financial effect to the present scheme.

Control of prices through the Licence after 31st July 1989 would require a licence modification either agreed by the Company or imposed on it on the grounds of public interest under the 1984 Act, as described below under "Regulatory and Competitive Framework".

Subject to these controls, British Telecom's pricing policy is gradually to adjust prices for its various services in line with costs and to price its products competitively. Prices for line rentals and local calls have risen in the period from January 1980 significantly more than those for trunk calls, while prices for some international calls have been reduced over the same period. The price control provided by the Licence and the concomitant statement of intention made by the Board of the Company are not expected to impede the application of the Company's pricing policy. In accordance with this policy, British Telecom announced on 5th October 1984 certain price changes that came into effect from 1st November 1984. For example, residential line rentals increased by 7.1 per cent. and prices of local and international dialled calls by 6.8 per cent., while prices of dialled trunk calls were reduced on average by 5.3 per cent. The minimum charge for calls from public call boxes was raised to 10p. The increase in the prices governed by the Licence was 2.1 per cent. against a rise of 5.14 per cent. in the retail price index in the twelve months ended 30th June 1984.

Supplementary Financial Information

British Telecom is primarily a unitary business. Whilst certain costs may be directly attributed to an individual service, the majority of British Telecom's assets and costs relate to the provision of the main inland telecommunication network. The costs incurred in the operation of this network are for the common benefit of all the services which make use of it. Nevertheless, British Telecom has carried out a detailed review to enable those costs that are not directly attributable to a single service to be allocated to services on bases considered by management to be appropriate. The attribution of such costs and of some categories of income is carried out by statistical apportionment and involves a degree of judgement. The results are not susceptible to audit and should be treated as indicative only.

Unaudited estimates of financial results by service for the years ended 31st March 1983 and 31st March 1984 prepared on this basis are set out below. It should be noted that the categories of service do not align with the organisational structure of the Company.

	Year ended 31st March			
	1983		1984	
	Turnover £m	Profit/(loss) £m	Turnover £m	Profit/(loss) £m
Inland Services				
Public Telephone Service:				
Telephone rentals:				
business	334		350	
residential	887		908	
Subscribers' calls	2,547		2,725	
Apparatus	791		894	
	4,559	1,233	4,877	1,155
Public call boxes	97	(50)	102	(50)
Private circuits, telex, miscellaneous	617	90	672	108
Total Inland Services	5,273	1,273	5,651	1,213
International Services	1,141	307	1,225	321
Total	6,414	1,580	6,876	1,534
Less: net interest payable		549		544
Profit after Interest		1,031		990

Notes:

Telephone rentals represent rental charges for each line in service and the first telephone on customers' premises, and connection and installation charges. British Telecom classifies its customers as those with business lines and those with residential lines.

Subscribers' calls comprise all local or trunk calls made on either business or residential lines, including calls made from rented payphones, and other services that use the public telephone network. These do not include the inland element of international telephone calls.

Apparatus turnover is derived from the supply, sales and rental, installation and maintenance of telephone and telex equipment, with the exception of the rental of the first telephone on customers' premises and from apparatus attached to private leased circuits.

Public call boxes turnover comprises local and trunk calls made from call boxes operated by British Telecom. Call income includes credit calls, freephone and reverse charge calls made from call boxes, as well as the cash collected from containers.

Private circuits, telex and miscellaneous covers all other inland services provided by British Telecom including private leased circuits, telex rental and call charges and value added systems and services, and other operating income.

International services comprise all international telephone, telegraph and telex calls made from the United Kingdom, all international leased circuit turnover, and turnover derived from other international services such as maritime and offshore telecommunications; they include the inland element of international telephone calls. Also included are the amounts derived from overseas administrations for telephone and telex calls made to the United Kingdom from overseas.

Since the publication of the annual accounts of British Telecom for the year ended 31st March 1984, a review of the basis of allocation of turnover and results to certain services has led to certain figures being restated so as to provide a greater degree of accuracy.

D. Regulatory and Competitive Framework

In recent years, there have been far-reaching changes in the legislative and regulatory framework for telecommunications. A system of regulation has now been adopted, designed to ensure that all reasonable demands for telecommunication services, including in particular certain socially important services, are met, that operators are able to finance the provision of these services, that customers are provided with a variety of good quality services at reasonable prices, that competition is encouraged and that various specific objectives relating to international services and the supply of apparatus and services are met.

The 1984 Act

Under the 1984 Act, a licence is, in general, required for the running of a telecommunication system. Responsibility for licensing rests with the Secretary of State, after consultation with the Director General of Telecommunications (the "Director General"), although he may delegate that responsibility to the Director General, a new office whose functions were established by the 1984 Act. The Secretary of State can thus retain control of the number of major telecommunications operators and the way they are licensed. He also retains certain powers to give directions to those who have been designated as public telecommunications operators in the interests of national security and international relations.

The Director General is responsible for enforcing licence conditions and may make orders, enforceable in the Courts, requiring compliance; contravention of an order can also result in a liability for damages to third parties. He is also responsible for monitoring the telecommunications market, investigating complaints about services or apparatus and exercising certain functions under the Fair Trading and Competition Acts in relation to telecommunications. On 7th November 1984, he announced the publication of a consultative document on the promotion of effective competition in the supply of telecommunications apparatus and related services by public network operators.

The Director General may modify licence conditions with the licensee's agreement and must impose modifications if, following a reference by him to the Monopolies and Mergers Commission, the latter considers any matter to operate against the public interest and recommends a modification; in either case the 1984 Act provides for prior public consultation. The Secretary of State may prevent modifications but only in the interests of national security or international relations and can require any agreed modification to be referred to the Monopolies and Mergers Commission. He may also give the Director General general directions as to the matters to which he is to have particular regard. The Secretary of State may also be involved in determining whether the functions under the Fair Trading and Competition Acts referred to above should be exercised by the Director General or the Director General of Fair Trading and has the power to veto investigations by either Director General or references by them to the Monopolies and Mergers Commission under these Acts. Subject to the above, the Director General, the Director General of Fair Trading and the Monopolies and Mergers Commission are independent of the Secretary of State and consequently the manner in which they may be carrying out their functions is not necessarily known to the Secretary of State.

Both the Secretary of State and the Director General have a duty to act in the manner best calculated to secure, so far as practicable, the provision throughout the United Kingdom of telecommunication services which satisfy all reasonable demands for them, including certain community services, and the ability of operators to finance those services. Subject to this duty, they must exercise their functions to achieve various other objectives including the promotion of the interests of United Kingdom consumers in the price, quality and variety of services and apparatus, the maintenance and promotion of competition and the promotion of research and development. The Monopolies and Mergers Commission must also have regard to all these matters in considering any licence modifications referred to it.

The Director General

The first Director General, Professor Bryan Carsberg, a Chartered Accountant and Professor of Accounting at the London School of Economics, was appointed by the Secretary of State for a three year period from 1st July 1984. Professor Carsberg had previously advised HM Government on telecommunications matters.

The Director General is supported by the Office of Telecommunications which has a staff of about 80, including its own technical advisers, with access, where appropriate, to external specialist advice.

Wireless Telegraphy Act 1949

The Wireless Telegraphy Act 1949 requires users of radio, including microwave and satellite, to be licensed; licences under this Act may be revoked or varied at any time by the Secretary of State.

British Telecom operates services using radio under licences issued under this Act on which British Telecom's trunk and international systems are dependent. A comprehensive licence covers all British Telecom's fixed terrestrial and satellite links and also its maritime uses of radio. Its radiopaging services are covered by a separate licence. British Telecom's radiophone service, currently covered by the comprehensive licence, is to be separately licensed.

HM Government has indicated to British Telecom that under the provisions of section 74 of the 1984 Act it is prepared to amend British Telecom's comprehensive licence to include terms restricting the exercise by the Secretary of State of his power to revoke or vary it. Any such amendment might specify a period of notice or security of tenure; the licence would however need to continue to permit the Secretary of State to vary or withdraw frequencies without British Telecom's consent because of, for example, underutilisation of the radio spectrum, promotion of technological development, the need to accommodate fairly other radio users or the maintenance of consistency with the Licence if it were to be modified and will be subject in any case to the Secretary of State's statutory right to vary or withdraw frequencies because of overriding considerations of national security or international relations.

HM Government is considering what new land mobile radio services might be licensed to use a part of the radio spectrum becoming available from 1985. These services might compete with existing cellular radio operators, although HM Government has said it will have regard to the latter's public service obligations and investment already undertaken in reaching its decision. In addition, the overall availability of such services may mean that after 1989 the frequencies used by British Telecom's existing radiophone service could be allocated to other uses.

A feasibility study is shortly to be commissioned by HM Government on the possibility of introducing in the future some form of pricing for the radio spectrum in place of or in addition to the present licence fee basis. The Directors are unable to take account of this possibility in considering the Company's prospects. It is the view of HM Government that it is not certain that such pricing will be introduced and that, in any event, any change in the cost to British Telecom of spectrum is unlikely to be material, in the context of British Telecom's financial position, in the next three years at least.

The Licence

British Telecom operates under a number of licences granted under the 1984 Act the most important of which is the Licence to run its public telecommunication system.

The Licence contains terms and conditions designed principally to ensure the provision of widespread telecommunication services and to encourage the development of effective competition. It also contains provisions enabling the Director General to monitor the Company's activities.

The Company is required by the Licence to provide telecommunication services, including rural and international services, throughout the United Kingdom (other than in the area where services are provided by Kingston-upon-Hull City Council or, in certain circumstances, where services are provided by another operator) which satisfy all reasonable demands, to the extent that it is practicable to provide them. In addition, the Company is obliged specifically to provide certain services including the '999' service, certain facilities for the disabled, directory enquiries and, save in limited circumstances, the existing public call box facilities. In order to enable the Company to comply with its obligations, special powers under the 1984 Act are given to it to install telecommunication apparatus both in streets and on private land subject to certain exceptions and conditions which can be modified by the Secretary of State under the 1984 Act.

In addition to the constraint on prices during the first five years of the Licence referred to above, the Licence contains a number of provisions to ensure that the Company's dominant position does not operate against the interests of consumers or competitors. For example, the Company is required to publish standard terms for providing certain services, and for a limited period to make a uniform charge for the maintenance of exchange lines for premises served by a single line and to apply a published scale of charges for installing residential exchange lines on premises to be served by a single line. Other provisions impose commercial constraints on the Company, including prohibiting the Company from showing undue preference to or discrimination against others for services it is bound to provide or unfairly favouring any part of its own business, restricting the cross-subsidy of certain parts of the Company's business by other parts of British Telecom and restricting the Company's ability to impose linked sales on customers and certain exclusive dealing arrangements on suppliers.

The Licence also contains terms designed to give effect to the liberalisation of the supply of both telecommunication apparatus and services. The Company must permit the connection to its system of any other appropriately licensed system. In the case of certain special systems providing services to the public the connection must be made in such a way as to enable any customer of either system to communicate with any customer of any other system connected to the Company's network. In the case of Mercury Communications Limited ("Mercury"), and public telecommunications operators running lines more than 50 kilometres long, the connection must be made in such a way as to enable customers of each system to choose the extent to which their messages are carried along each system subject to practical considerations. If the Company and the operator of the other system cannot agree on any aspect of the terms of the connection, the Director General may impose terms relating to that aspect within specified guidelines. These are designed to ensure fair competition and a balance between the operators, but also to enable the Company to recover costs plus a reasonable profit for anything done pursuant to the interconnection, and to ensure that the Company remains able to finance the other services which the Licence requires it to provide. The Licence also permits the Company to levy uniform additional interconnection (access) charges on other operators to recover a portion of its costs incurred in providing certain obligatory services. In addition, the Company has to connect to its system any apparatus which meets independent approval standards (and which is appropriately licensed) on standard terms and conditions, and in due course, to install separate wiring for its network and for customers' apparatus in customers' premises so as to enable private systems and apparatus to be separate from the Company's system.

In order to enable the Director General to monitor its compliance with the Licence, the Company has to supply him with such information as he may request concerning its activities, to notify him in advance of any joint ventures and to maintain segregated accounts for certain parts of its business. Any substantial production of apparatus is required to be carried on in a separate company.

The Licence gives the Director General important discretions in determining the extent of the Company's obligations under the Licence and other discretions relevant to its operations. It is revocable by ten years' notice given after 3rd August 1999 and may also be revoked at any time on various grounds including non-compliance and the liquidation or insolvency of, or cessation of business by, the Company.

Competition Policy of HM Government

On 17th November 1983, the Minister of State for Industry and Information Technology outlined in the House of Commons HM Government's policy, started in 1981, of seeking to introduce competition into the three main sectors of the telecommunications market: the supply of apparatus for connection to networks, the provision of services over networks and the running of networks themselves.

As part of the continuing policy of introducing competition into the supply of apparatus, the Minister described the developing arrangements, independent of British Telecom, for setting standards under the British Standards Institution and the related approvals system for apparatus under the British Approvals Board for Telecommunications. He drew particular attention to the ending from the end of 1984 of British Telecom's right to supply the first telephone to customers and, over a period, of its right to maintain certain types of call routing apparatus.

As far as public networks were concerned, the Minister outlined HM Government's proposals to grant licences to British Telecom, Mercury and the Kingston-upon-Hull City Council. He said that HM Government did not intend to license other operators to provide the basic telecommunication service of conveying messages over fixed links, whether cable, radio or satellite, either domestically or internationally until November 1990.

In the field of more specialised telecommunication services, the Minister stated that HM Government had already licensed two national cellular mobile radio telephone networks both of which have to cover 90 per cent. of the population of the United Kingdom by 1990; as described above under "BT Enterprises", the Company is a participant in one of these licensees. The Minister stated that HM Government would consider granting further radio telecommunication licences when additional bands of frequencies became available and would keep under consideration ways of introducing new specialised services by satellite.

On the development of broadband cable networks, the Minister stated that cable companies would be licensed to offer a full range of telecommunication services within their licensed areas, though he drew attention to the qualification in the White Paper, "The Development of Cable Systems and Services", that they would only be permitted to offer voice telephony services (and data services in a number of business centres) in association with the Company or Mercury.

The Minister also outlined HM Government's policy on arrangements for interconnecting different telecommunication systems, and in particular HM Government's intention that any subscriber to one public telecommunication system should be able to call any subscriber to other public telecommunication systems.

On 20th July 1984, the Minister made a further statement concerning resale, being the sale by lessees of capacity on private circuits leased from British Telecom, Mercury or Kingston-upon-Hull City Council. This practice could in some circumstances lead to the creation of competing networks. This contrasts with the provision of capacity on private circuits for value added services which had already been authorised in 1982 by a general licence. The Minister stated that as a general principle, simple resale (that is the sale of capacity on private circuits connected at both ends to public switched networks) would not be licensed before July 1989. In certain limited circumstances however, it would be permissible for any person to use inland private circuits to link his premises to those of others. In addition to these limited exceptions which apply generally to all private systems, licences may be granted to individual applicants whose proposals for private circuits significantly enhance the economic performance or the mutual business interests of a defined but closed group of users, or which provide significant facilities not otherwise available, but whose purpose or main predictable effect is not to divert revenues from the public switched systems.

Loss of Immunity from Legal Proceedings

Under the British Telecommunications Act 1981 and for many years before that, British Telecom provided services to the great majority of its customers on the terms of a statutory scheme, rather than a contract. Accordingly, the customers could have no claim for breach of contract for services, although the Corporation has since 1981 been contractually liable for supply of apparatus and special directory entries. Actions in tort in respect of the provision of telecommunication services and associated apparatus and services were also precluded.

These immunities were repealed by the 1984 Act so that, since 5th August 1984, the Company has had a contractual relationship with all its customers and no longer has any immunity in tort.

In the opinion of the Board, it is not possible accurately to assess the likely effect of removing the immunity from legal proceedings in contract or tort previously enjoyed by British Telecom. However, the Board is of the opinion, as far as it can presently judge, that, having regard to, *inter alia*, the insurance arrangements made by the Company, it is unlikely that the financial position of British Telecom will be adversely affected to a material extent by the removal of the immunity.

Mercury

A new licence granted to Mercury under the 1984 Act came into effect on 8th November 1984, superceding an earlier licence granted in 1982 to Cable and Wireless plc to operate solely through the agency of Mercury. The new licence is broadly similar to the Licence granted to the Company, but differs from it in some significant respects. For example, because of its market position Mercury is not subject to the restrictions on price increases which apply to some of British Telecom's services, nor is there a universal service obligation although Mercury is licensed to operate throughout the United Kingdom. However, Mercury is required within two years to provide certain services in the vicinities of fifteen out of a list of nineteen places in England which include London, Birmingham, Bristol, Leeds and Manchester, and also within five years in the vicinities of Cardiff, Edinburgh, Glasgow and Swansea.

It was stated in the last Report and Accounts of Cable and Wireless plc that Mercury had started operations in the United Kingdom and was steadily extending its network both by microwave radio and fibre optic cable. Its first international service started operations in August 1984 following the commissioning of a satellite communications centre in London's dockland. It was announced on 14th August 1984 that Mercury is to become a wholly owned subsidiary of Cable and Wireless plc, which operates telecommunication systems in many overseas territories. The Chairman of Cable and Wireless plc spoke of how his company could provide Mercury with the best possible base for Mercury's expansion into a major and profitable telecommunication company before 1990. He said that completion and development of the basic network would continue as planned and was expected to cost £200 million.

Neither HM Government nor British Telecom has any direct knowledge of Mercury's plans or knows the extent to which these plans have changed since the statements were made.

As described above, under the terms of the Licence British Telecom will be providing for interconnection of its system with the Mercury system. An interconnection agreement was entered into in 1982 between British Telecom and Mercury which is being renegotiated in the light of the new regulatory regime.

E. The Assets of British Telecom

Properties

British Telecom divides its properties into two categories, general purpose and specialised. The 14 principal properties represented 18 per cent. of the total historic net book values at 31st March 1984. General purpose properties, which had an historic net book value of £334 million at 31st March 1984, consist chiefly of offices, store depots, computer centres and workshops. There are approximately 1,700 general purpose buildings of which some 1,000 are freehold, some 200 are on long leases and some 500 are on short leases. General purpose land and buildings were valued by professionally qualified employees of British Telecom on an open market value basis in the year ended 31st March 1984. This valuation was not materially different from historic net book value.

The specialised properties, which had an historic net book value of £1,036 million at that date, consist mainly of properties designed and located specifically for use by British Telecom together with certain plots of land held for future development purposes. There are over 7,700 specialised properties, virtually all of which are freehold. Over three quarters of specialised properties house telephone exchanges, sometimes more than one in a building. There are also about two hundred radio stations, three communications satellite earth stations and a large number of small buildings for transmission equipment such as repeater stations. The largest single property is British Telecom's research establishment at Martlesham, Suffolk. It is not intended to carry out any professional valuation of specialised land and buildings because of the need for their continued specialised use as part of British Telecom's operations.

Plant and Equipment

The principal categories of British Telecom's equipment are exchanges and transmission equipment. As at 31st March 1984, the numbers and types of telephone exchanges, which had an historic net book value of £3,450 million, were as follows:

	Local exchanges	Trunk exchanges	International exchanges
Strowger	3,708	331	—
Crossbar	571	126	6
TXE	1,965	—	—
Digital	48	2	1
	6,292	459	7

There are four major categories of inland transmission equipment: cabling with a net book value of £1,162 million at 31st March 1984; underground ducts for cables with a net book value of £1,011 million; repeater equipment with a net book value of £589 million; and radio equipment with a net book value of £85 million. In addition BT International has two large earth stations at Goonhilly and at Madley and a smaller earth station in London's dockland. It also has investments in 54 undersea cable systems and in three satellite systems.

Capital Expenditure

British Telecom's capital expenditure programme over the last five years, shown in the table below, has been concentrated on the expansion of the network and the replacement of transmission and exchange equipment.

	Year ended 31st March				
	1980	1981	1982	1983	1984
	£m	£m	£m	£m	£m
Land and buildings	125	135	120	169	159
Plant and equipment					
Inland transmission equipment	237	323	373	440	526
Inland exchanges	368	566	695	671	572
Other	257	226	288	270	276
	987	1,250	1,476	1,550	1,533

Note: Other includes international transmission equipment and exchanges, customer equipment, investment in satellites, materials awaiting installation, motor vehicles and computers.

Some of British Telecom's capital expenditure programmes have been delayed because of late delivery of equipment. Improved procurement procedures, and widening of sources of supply, have led to a reduction in delays.

British Telecom's plans allow for capital expenditure of about £1,800 million in the current financial year and it expects to fund such capital expenditure out of funds generated from operations. British Telecom's plans for the next two to three years are for a broadly similar level of expenditure.

The modernisation programme which British Telecom is now undertaking involves the installation of digital transmission and switching throughout the whole trunk network during the 1980s, and replacement of electro-mechanical local exchanges by TXE and, increasingly, digital local exchanges over the next ten years. Modernisation will result in a trunk network of about 60 exchanges instead of the 459 shown above. Ordering of TXE exchanges will be phased out over the next few years as delivery of digital exchanges is increased. The first prototype System X digital exchange was opened in London in 1980 and eight of this type are now in service or at the final commissioning stage. A developed version of System X with improved performance has been introduced, the first of which opened in Coventry in 1983 and a further 400 of this type have been ordered, the majority of which are expected to be brought into service by the end of 1986. In addition about 50 UXD5 small local digital exchanges have been installed.

Expenditure on transmission equipment has been concentrated on the re-equipment of the transmission network and on an increase in capacity. For the trunk network, a substantial proportion of the orders for cabling is for new high capacity optical fibre.

5 Profits and Financial Position

Financial information for the five years to 31st March 1984 is set out in more detail in the Accountants' Report. Throughout this period British Telecom was in the public sector and subject to significant influence by HM Government. British Telecom operated in response to financial targets which were agreed with HM Government reflecting the relative importance attached by HM Government to the prices charged for services and products supplied by nationalised industries, to the need for these industries to generate cash from operations to finance investment and to the need for these industries to operate efficiently.

These arrangements no longer apply to British Telecom. The business of the Corporation was transferred to a public limited company and its balance sheet was restructured on 6th August 1984. Previously, the business was financed by medium and long-term government debt and there was no equity capital. British Telecom is now financed by Ordinary Shares, the Preference Shares and the Loan Stocks. Furthermore, the Company now operates in a new regulatory and competitive framework.

The following table sets out the results of British Telecom under the historical cost convention for the five years to 31st March 1984 which have been extracted from the Accountants' Report. Also set out are the unaudited results for the three months to 30th June 1983 and 30th June 1984.

	Year ended 31st March					*Unaudited three months ended 30th June*	
	1980 £m	1981 £m	1982 £m	1983 £m	1984 £m	*1983 £m*	*1984 £m*
Turnover							
Rentals	1,129	1,531	1,993	2,276	2,334	*585*	*613*
Calls: telephone	2,192	2,691	3,301	3,433	3,697	*880*	*976*
telex and other	200	233	276	299	292	*61*	*81*
Sales and other operating income	80	115	193	406	553	*109*	*142*
Total Turnover	**3,601**	**4,570**	**5,763**	**6,414**	**6,876**	***1,635***	***1,812***
Operating costs							
Staff costs	1,609	2,110	2,394	2,571	2,715	*660*	*678*
Depreciation	410	475	647	765	907	*217*	*214*
Other operating costs	928	1,154	1,538	1,826	2,036	*485*	*538*
	2,947	3,739	4,579	5,162	5,658	*1,362*	*1,430*
Less: own work capitalised	(200)	(283)	(308)	(328)	(316)	*(82)*	*(71)*
Total operating costs	2,747	3,456	4,271	4,834	5,342	*1,280*	*1,359*
Profit on Ordinary Activities before Interest	**854**	**1,114**	**1,492**	**1,580**	**1,534**	***355***	***453***
Net interest payable	537	544	556	549	544	*138*	*134*
Profit before Taxation and Extraordinary Items	**317**	**570**	**936**	**1,031**	**990**	***217***	***319***
Taxation	—	—	—	—	—	—	*115*
Extraordinary items	107	—	—	—	—	—	—
Net Profit	**424**	**570**	**936**	**1,031**	**990**	***217***	***204***

Results for the Five Years Ended 31st March 1984

From the year ended 31st March 1980 to that ended 31st March 1984, turnover increased by 91 per cent. and profit before taxation and extraordinary items increased by 212 per cent. The results for the three years ended 31st March 1983 benefited from the substantial price increases made in 1980 and 1981. The fall in profits in the year ended 31st March 1984 reflected the fact that prices of the main services were held steady or reduced in the two years up to November 1983.

Increases in turnover due to additional revenues from price changes were approximately 23, 17, 3 and under 1 per cent. respectively in the four years to 31st March 1984. Volume growth (the increase in turnover attributable to growth in business volume) was approximately 5, 6, 5 and 8 per cent. respectively, which primarily reflected the continuing expansion of the network and the growth of the international telephone service. This reflects, to some extent, changes in the level of activity in the economy. Gross domestic product, after having declined by 3.7 per cent. in the year to 31st March 1981, increased by 0.1, 2.3 and 3.4 per cent. in the following three years.

Operating costs increased by 26, 24, 13 and 11 per cent. in the four years to 31st March 1984 respectively. A significant portion of these are fixed costs which do not vary substantially with the number of calls made through the system. Staff costs comprise the largest item of operating costs. These rose by 31, 13, 7 and 6 per cent. in the four years to 31st March 1984 respectively, substantially all as a result of increases in wage rates. The rise in the year ended 31st March 1981 was particularly high reflecting a 20 per cent. basic settlement with unions in July 1980 and a further arbitration award in their favour. Basic wage rate increases in the following three years were generally commensurate with movements in the retail price index. Of the total staff costs of £2,715 million in the year ended 31st March 1984, £316 million were capitalised, reflecting staff employed on construction—mainly on exchange and cabling projects.

Depreciation increased by 121 per cent. during the four years to 31st March 1984 reflecting the substantial investment in the telephone network made in the period. Additional non-recurring depreciation charges of £104 million have been made for obsolete customers' apparatus in each of the three years to 31st March 1984.

Other operating costs include the provision to customers of lines and equipment, payments to overseas telecommunication administrations and accommodation costs. The largest element is payments to these administrations for outgoing calls which have increased by 153 per cent. to £529 million during the four years to 31st March 1984. Receipts from overseas administrations for incoming calls, included in turnover, have increased by 185 per cent. to £513 million during the same period. Contributing to the increase of operating costs during the period was the expansion of the telephone system and, especially in the last two financial years, the cost of apparatus sold.

The net interest charge has not fluctuated significantly during the five years as the level of borrowing has not varied greatly and as most borrowings are with medium and long-term maturity dates with fixed interest rates.

No United Kingdom corporation tax liability has been incurred in the five financial years because of the availability of capital allowances accruing from British Telecom's capital expenditure programme. No provision for deferred taxation was required and, at 31st March 1984, unrelieved tax losses amounting to approximately £1,200 million were available for offset against future taxable profits.

Pro Forma Profit for the Year Ended 31st March 1984

On the assumption that the new capital structure adopted by the Company on 6th August 1984 had been in place for the whole of the year ended 31st March 1984, the pro forma profit attributable to ordinary shareholders for that year would be £1,088 million (see Section C of the Accountants' Report).

Profit for the Three Months Ended 30th June 1984

The unaudited results for the three months ended 30th June 1984 are set out above. Turnover was 11 per cent. higher than in the corresponding quarter of the previous year, of which 7 per cent. is attributable to continued volume growth.

The profit before taxation of £319 million was £102 million higher than in the corresponding period of the previous year. Contributing to this increase was the reduction in the level of pension contributions from 1st April 1984 referred to below. The increase was also affected in comparison with the corresponding quarter by the ending of the exceptional depreciation charge for obsolete customers' apparatus in each of the last three years.

The unaudited balance sheet at 30th June 1984 together with comparative figures is set out in paragraph 11 of Part IV.

Taxation

Substantial changes to the basis of corporation tax have been made in the Finance Act 1984 enacted in July 1984. In particular, mainstream corporation tax rates were reduced from 52 per cent. applicable in the year ended 31st March 1983 to 50 per cent. in the year ended 31st March 1984, and will fall to 45 per cent. and 40 per cent. in the years to 31st March 1985 and 1986 respectively and to 35 per cent. thereafter. Allowances given in the first year on eligible capital expenditure will be reduced from 100 per cent. to 25 per cent. in stages over the same period, with allowances being given in the second and subsequent years at 25 per cent. on the balance brought forward.

The reduction in capital allowances is likely to cause accumulated tax losses to be virtually extinguished in the year ending 31st March 1985. The Company therefore expects to pay mainstream corporation tax for the first time on its profit for the year ending 31st March 1986.

In addition, for the first time, a provision for deferred taxation will be made in the accounts for the year ending 31st March 1985. An appropriate proportion of this provision (£115 million) based on an expected effective tax rate of 36 per cent. has been provided in the first quarter of the year.

British Telecom will incur advance corporation tax on dividends payable and this will be offset against future mainstream corporation tax liabilities.

6 Administration, Management and Employees

British Telecom is organised to provide a high degree of corporate co-ordination under the overall direction of the Board. The Chairman is the Chief Executive, and is assisted by a Deputy Chairman and a Vice Chairman who are executive Directors with responsibilities for co-ordinating all its activities. In addition, there are three executive Directors with functional responsibility for finance, marketing and corporate strategy, and personnel. Legal and secretarial duties, property services, public relations activities and relations with the regulatory bodies are also organised on a corporate basis. The Managing Director, Development and Procurement, is also the Engineer-in-Chief and has responsibility for co-ordinating technical activities and standards.

British Telecom's management has long-standing and varied experience of its core business of telecommunications. Its management resources in information technology, marketing and finance have recently been supplemented by recruitment at senior levels. It is supported by a skilled workforce. More than 500 different training courses are provided in each year at about 50 centres in the divisions.

Directors

The Directors of the Company are as follows:

Sir George Jefferson (aged 63) is the Chairman and Chief Executive. He became the first Chairman of the Corporation in 1981. He was appointed Deputy Chairman of the Post Office in September 1980, prior to which he was a Member of the Board of British Aerospace and Chairman and Chief Executive of its Dynamics Group. He was previously a Director of the British Aircraft Corporation Limited and is currently a Director of Babcock International plc.

Mr D Vander Weyer (aged 59) is Deputy Chairman. He was appointed Deputy Chairman of the Corporation in October 1983, having been appointed a non-executive Corporation Board Member in October 1981. He is the Director responsible for BT Enterprises. Prior to his appointment, he was Chairman of Barclays Bank UK and a Deputy Chairman of the Barclays Group in which he had worked for 42 years. He remains a Director of Barclays Bank PLC.

Mr J Hodgson (aged 59) is Vice Chairman. He was appointed Vice Chairman of the Corporation in October 1983 having become a Corporation Board Member in 1981. He joined the Post Office in 1950 and in December 1969 became responsible for all its international and maritime telecommunication services. From 1970 to 1977 he was also a non-executive Director of Cable and Wireless Limited.

Mr J Alvey (aged 59) is Managing Director Development and Procurement and Engineer-in-Chief. He was appointed to this post in August 1983 when he also became a Corporation Board Member. After 30 years in the Ministry of Defence Scientific Service, he moved in 1980 to British Telecom as Senior Director of Technology with responsibility for the development of future technology relevant to telecommunications.

Mr R E G Back (aged 58) is Managing Director National Networks. He was appointed to this post in November 1983 when he also became a Corporation Board Member. He joined the Post Office in 1942, became Senior Director, Networks in 1979 and was appointed Assistant Managing Director in 1982.

Mr M Bett (aged 49) is the Director responsible for Personnel and Corporate Services. He is also responsible for Broadband Services. He became the Corporation's first Board Member for Personnel in 1981. He was previously the Personnel Director of GEC from 1972 to 1977 and the Personnel Director of the British Broadcasting Corporation from 1977 to 1981.

Mr A J Booth (aged 45) is Managing Director BT International. He was appointed to this post in November 1983 and to the Board of the Company in September 1984. He joined the Post Office in 1957, and became Director International Networks in 1979 and Director British Telecom London from 1980 to 1983.

Mr J A C King (aged 51) is the Director responsible for Marketing and Corporate Strategy. He was appointed to the Corporation Board in January 1984. Prior to this appointment, he was a Director of Philips International BV Business Communications Systems Division based in Holland. His previous experience includes the post of Marketing Director for ITT Business Systems UK and Director of ITT Business Systems and Communication Group Europe in Brussels.

Mr F D Perryman (aged 54) is a Chartered Accountant and the Director responsible for finance. He joined the Board of the Post Office as Finance Member in February 1981, and moved to the Corporation Board at its inception in 1981. Previously, he spent 23 years with the National Coal Board in their finance department, his last position being Director General of Finance.

Mr I D T Vallance (aged 41) is the Managing Director of Local Communications Services. He was appointed in 1981 to the Corporation Board as Member for Organisation and Business Systems and subsequently became Deputy Managing Director, Inland Division. He joined the Post Office in 1966 and held a number of executive positions.

Mr J F Goble (aged 59) is a non-executive Director. He was appointed a non-executive Member of the Corporation Board in November 1983. He is a Solicitor and senior partner of Herbert Smith & Co. where he has spent the whole of his professional life. He held part-time appointments with the Crown Agents for Oversea Governments and Administrations from 1974 to 1982 and was Deputy Chairman of the Crown Agents from 1975 to 1982. He is also a non-executive Director of Holt Lloyd International plc.

Sir George Macfarlane (aged 68) is a non-executive Director. He was appointed as a part-time member of the Post Office Board in 1977, moving to the Corporation Board in 1981. Until 1975 he worked in the Civil Service where his responsibilities included control of research programmes and of research and development establishments for the Ministry of Defence. In 1980 he was appointed to the Boards of the National Enterprise Board and National Research Development Corporation, now the British Technology Group.

Mr G D W Odgers (aged 50) is a non-executive Director. He was appointed a non-executive Member of the Corporation Board in August 1983. He is a Group Managing Director of Tarmac plc, where his principal area of responsibility is Group Finance. Prior to joining Tarmac in 1979, he was Associate Director (Finance) of GEC and before that the Director of the Industrial Development Unit at the Department of Industry.

Mr J M Raisman (aged 55) is a non-executive Director. He was appointed in September 1984. He is Chairman and Chief Executive of Shell UK Limited. He joined the Royal Dutch Shell Group in 1953 and has served in Brazil, Netherlands, Panama, Turkey and Japan. He is also a non-executive Director of Vickers plc and Glaxo Holdings plc.

The Articles of Association require that the Chairman or other chief executive officer of the Company should be a British citizen within the meaning of the British Nationality Act 1981. They also empower HM Government to appoint two persons to be Government Appointed Directors; these are Mr Odgers and Mr Raisman.

In the years ended 31st March 1983 and 1984, the aggregate emoluments of the Members of the Corporation Board were £453,640 and £489,010 respectively. Information concerning the service contracts of the Directors is shown in paragraph 3 of Part IV.

Employees

British Telecom had approximately 241,000 employees at 31st March 1984, of whom 10,000 were part-time. This total included approximately 33,000 management or professional staff, 114,000 technical and engineering staff (of whom 34,000 are technical officers) and 34,000 telephone operators and supervisors, with the remainder in clerical and other functions.

The number of employees reached a peak of 253,000 in March 1981. It has declined in accordance with a policy announced in Spring 1982 for a 15,000 reduction in the March 1982 workforce of 252,000 over a three year period. By 30th September 1984, a reduction of 13,000 since March 1982 had been achieved, almost entirely by natural wastage and by early retirement, during a period of growth in the business of British Telecom. Approximately 90 per cent. of British Telecom's employees, including 80 per cent. of managers, belong to five main unions which are recognised by the Company. These are the Civil and Public Servants Association ("CPSA"), the Communication Managers Association, the Post Office Engineering Union ("POEU"), of which more than half British Telecom's staff are members, the Society of Telecom Executives, and the Union of Communication Workers. The British Telecom members of the CPSA are expected to transfer to the POEU in 1985. Wage negotiations with these unions have taken place annually during the summer. Settlements have been negotiated with these unions which added 5.2 per cent. to pay rates from 1st July 1984. The Company would not expect these pay arrangements to change prior to the summer of 1985.

Over the last ten years, there have been few instances of significant industrial action in British Telecom. In this period the number of days lost has been substantially lower than the yearly average in British industry with the exception of 1982 and 1983 when industrial action was taken against Government policy on the privatisation of British Telecom and on the interconnection of Mercury with the British Telecom network. The 1982 industrial action consisted of a one day protest strike by about 60 per cent. of British Telecom staff. The 1983 strike action was by the POEU with up to 2,600 staff on strike over a period of 9 weeks but telecommunication services were maintained. The POEU has since complied with a court injunction not to prevent interconnection with Mercury. In 1979 selective strike action in the computer centres significantly delayed customer billing, seriously damaging British Telecom's cash flow. Alternative procedures are available which will to some extent mitigate the effects of such action should it recur. In 1978, the POEU took limited action in support of its claim for a shorter working week until the issue was referred to an independent inquiry.

Following the reductions in staff numbers in recent years, further reductions are expected by the Board, offset to some extent by the staffing requirements of new business activities. Traditionally, there have been good relations with the unions with well established arrangements for consultation and negotiation. The British Telecom unions, like others, have continued to express their opposition to job losses (in particular to redundancies arising out of modernisation) coupled with their desire for a shorter working week. It is British Telecom's practice to explore, in consultation with the unions, ways of dealing with surplus staffing including redeployment and retraining. The sequence and nature of the procedures used are contained in separate agreements with the POEU and other unions. British Telecom has a continuing commitment to good communication with staff generally and with a view to helping the introduction of new technology and organisational change.

Employee Share Schemes

The Company has established an employee share ownership scheme which is being operated in conjunction with the Offer for Sale. It has also adopted a savings-related share option scheme for all eligible employees and a share option scheme to be operated for a limited number of senior employees. Details of these schemes are contained in paragraph 5 of Part IV. It is intended to operate the option schemes shortly after the Offer for Sale.

Pensions

Following the division of the postal and telecommunications services of the Post Office, BTSSS was established with effect from April 1983 as a separate scheme from the Post Office Staff Superannuation Scheme ("POSSS") which had applied to British Telecom staff until that time.

Most employees of British Telecom are members of BTSSS and are contracted out of the earnings-related State Scheme. The benefits provided for members at the age of sixty are in two parts, being first a lump sum of three eightieths of pensionable pay for each year of service payable immediately on retirement, and secondly an index-linked pension of one eightieth of pensionable pay for each year of service. The maximum pension normally available to members of the scheme is limited to one half of pensionable pay. The exposure of BTSSS to index-linked increases is reduced both by the size of the lump sum and the fact that the indexing is not applied after the State retirement age to that element of the pension representing the State Guaranteed Minimum Pension. After this age, indexing of this element of the pension is effectively met by the State.

Valuations of POSSS by its Actuary, R. Watson & Sons, have disclosed shortfalls relating to past service. An amount of £1,250 million, representing that part of the shortfall assessed at 31st March 1976 which related to service by both British Telecom and Post Office employees before 1st October 1969, was being met under a deed of covenant by a series of payments from British Telecom to POSSS terminating in 1992. From April 1983 these payments were apportioned between POSSS and BTSSS. The liability for these payments did not transfer to the Company in August 1984 but remained with the Corporation. This liability is referred to in the 1984 Act as the Excepted Liabilities.

For the four years from 1st April 1979 to 31st March 1983 British Telecom paid to POSSS on the advice of the Actuary a total annual contribution of $21\frac{1}{2}$ per cent. of contributory pay. Of this percentage, British Telecom bore $15\frac{1}{2}$ per cent. and the members 6 per cent. These contributions included additional contributions payable until 1992 which were expected to fund the remaining shortfall in POSSS after taking account of the payments under the deed of covenant. For the year ended 31st March 1984, on the advice of the Actuary to BTSSS, R. Watson & Sons, and pending completion of an initial valuation, the total annual contribution to BTSSS continued at $21\frac{1}{2}$ per cent.

An initial valuation of BTSSS was made by its Actuary as at 1st April 1983 and a report was issued to the Trustees in August 1984. This valuation showed that the assets of BTSSS together with future payments under the deed of covenant were expected to finance 88 per cent. of the past service liabilities. These liabilities were assessed on a basis which took full account of future earnings progression and pension increases.

In the valuation report, the Actuary concluded that greater stability in the overall level of contribution to BTSSS would be achieved if the 12 per cent. shortfall were to be met by contributions at a uniform rate over the working lifetime of the current members, a procedure commonly adopted in the United Kingdom, rather than over the fixed period to 1992. The Directors decided to implement these revised funding arrangements. The Actuary consequently recommended a reduction in the total rate of contribution from $21\frac{1}{2}$ per cent. to $19\frac{1}{2}$ per cent. of contributory pay (of which 6 per cent. would continue to be met by the members) as being sufficient to meet all the liabilities of the scheme, including the past service shortfall, over the future working lifetime of the existing employees. The reduced contribution rate took effect on 1st April 1984.

Compared to the contribution rate paid by British Telecom to POSSS prior to 1st April 1983 and thereafter to BTSSS until 31st March 1984, there is a reduction of $1\frac{1}{2}$ per cent. in the rate required to finance future service liabilities. There is also a reduction of $\frac{1}{2}$ per cent. in the contribution rate required to meet the past service shortfall, but the reduced rate will be paid over the working lifetime of the existing employees rather than over the fixed period to 1992. As a result of the April 1983 valuation the overall contribution requirements for British Telecom from 1st April 1984 are lower than they were previously.

The Directors have reviewed the pension arrangements in the context of British Telecom moving out of the public sector. They have decided that staff who join the Company after 1st April 1986 should not have unrestricted guaranteed index-linked benefits. They are consulting the Trustees of BTSSS and the unions about the new arrangements to come into effect as from this date.

7 Prospects

Current Trading and Profit Forecast

The unaudited results for the first three months of the current financial year ending 31st March 1985 showed turnover of £1,812 million and profit before taxation of £319 million.

Trading conditions since the first quarter have been satisfactory. The profit forecast is prepared on the basis that volume growth will continue at rates broadly equivalent to those achieved in the year to 31st March 1984 and in the first six months of the current financial period. The forecast takes into account the price changes in November 1983 and those announced for the current year. The forecast also reflects depreciation charges at the current level and the agreed increases in pay rates. Increases in other operating costs are expected to be broadly in line with those of the previous year after allowing for costs of apparatus sales increasing with revenues.

Profit Forecast

On the assumptions set out in Part II, the Directors consider that, in the absence of unforeseen circumstances, the profit before taxation for the year ending 31st March 1985 is unlikely to be less than £1,350 million. By comparison with the previous year, £104 million of the increase in profit is attributed to the ending of the special provision for depreciation of obsolete customers' apparatus, £40 million to the reduction in pension contributions and £110 million to lower interest charges from August 1984 arising from the new capital structure.

On the basis of a profit before taxation of £1,350 million, after providing for estimated deferred taxation thereon of £486 million and the cost of preference dividends of £41 million, the profit attributable to ordinary shareholders would be £823 million.

Pro Forma Profit and Earnings per Share

If the new capital structure had been in place for the whole of the year ending 31st March 1985 (see Section C of the Accountants' Report), instead of from August 1984, interest costs for the year would be £51 million lower. On the basis set out above, the pro forma profit before taxation for the year ending 31st March 1985 would therefore be £1,401 million.

After providing for estimated deferred taxation thereon of £504 million and the cost of preference dividends for the full year of £63 million, the pro forma profit attributable to ordinary shareholders would be £834 million or 13.9 pence per Ordinary Share.

Dividends

As almost eight months of the current financial year have already passed, the Directors expect to pay a single dividend for this year which, in the absence of unforeseen circumstances, is expected to be 3.9 pence per Ordinary Share net (equivalent to 5.5714 pence per Ordinary Share inclusive of tax credit), payable in August 1985.

Subsequently, the Directors expect to recommend in respect of each year ending 31st March an interim and a final dividend which will normally be payable in February and September respectively. If the Offer for Sale had taken place at the beginning of this financial year and the new capital structure had been in place throughout the year, the Directors would have expected to recommend dividends totalling 6.5 pence per Ordinary Share net (equivalent to 9.2857 pence per Ordinary Share inclusive of tax credit) of which they would have expected to pay 2.6 pence per share as an interim dividend. Such assumed dividends represent a gross yield, at the Offer for Sale price, of approximately 7.14 per cent. They would have been covered 2.1 times by the pro forma forecast earnings per Ordinary Share of 13.9 pence shown above.

Business Prospects in a Competitive Environment

The Board believes that the market for telecommunication products and services will continue to grow, that telecommunications will converge increasingly with computing and other information services and that telecommunications and information technology will become increasingly an international business. British Telecom is responding positively to the stimulus of these developments while adapting to the new competitive situation, the new regulatory arrangements and rapidly changing technology.

In accordance with Government policy and the 1984 Act, these changes will be made in an increasingly competitive environment. Competition will come not only from Mercury and the cellular radio networks but also, in due course, from a variety of sources, including the provision of telephone and data services by cable TV operators, from the unlimited resale of capacity on private circuits when licensed and perhaps from other networks. The precise terms upon which the new competitors will enter the market remain to be decided. However, the conditions of the licences of new operators can be expected to be less restrictive than those of the Company's Licence, as is the case with the new Mercury licence. In the longer term, British Telecom may wish, in the light of the development of competition, to request the Director General to consider making a modification of its Licence.

The Board is, however, confident that British Telecom's market share of network traffic will remain high. The Board believes that there is still scope for the enlargement of the telephone network in the United Kingdom, and greater scope for enhanced use of the network. It intends to stimulate use of that network by improving the quality of service, providing modern network equipment, making new facilities available through the network and on customers' apparatus, and giving close attention to customers' requirements. Because of the high proportion of fixed costs in running the existing network it is not expected that such extra use will give rise to commensurate operational cost. The Board will seek to take advantage of the growth potential of other telecommunications services, such as data, text and facsimile communications.

In the Board's view competition in the local network is likely to develop slowly. However, LCS is preparing to face significant competition in some areas in due course. The trunk telephone and specialised services operated by National Networks face competition more immediately, initially over the routes between major cities and for the largest customers. To meet this British Telecom is already bringing in new digital private circuit services and working to replace the present analogue trunk network by a digital network before the end of this decade. It is also developing an increasing range of modern, specialised communications and related services for business customers.

International services for both telephone and data communications offer opportunities for continued growth. BT International should be well placed to face competition by virtue of its experience in competing with other international carriers for transit traffic and private circuits.

British Telecom will continue to sell into the new competitive market for customers' apparatus and, through BT Enterprises, to develop and supply a range of technologically advanced products including business systems. British Telecom will compete in value added network services, some of which may become major businesses in their own right.

In support of these activities, the Board intends to maintain a strong research and development effort, building on the expertise of the Martlesham Laboratories.

The Board believes that there is scope for greater cost efficiency, both through better use of resources and through the benefit of new technology; the Board intends to introduce further modern equipment and to bring in improved management information systems, so as to identify and control more closely costs and contributions from particular services and operating divisions.

Management will continue to discuss necessary changes with the unions concerned in order to mitigate any industrial relations problems which arise especially as the pace of modernisation accelerates.

Regulation

British Telecom is not subject to price ceilings under the Licence on services and products that currently provide over 45 per cent. of its turnover, in particular international services, apparatus supply, private circuits, data communication services and value added services. The "RPI-3" constraint described above applies only to a "basket" comprising telephone line rentals and subscribers' inland telephone call charges. This will last until 1989, with the possibility of renewal or of some other form of regulation. This form of price control protects the customers of these services but does not set limits to the Company's rate of return on capital employed. There is also flexibility within this "basket", subject to the pressures of competition and to the Board's intention not to increase residential rentals by more than "RPI+2".

The Director General has considerable discretion under the 1984 Act and the Licence. An important factor in the impact on the Company of the new regulatory system will be the manner in which this discretion is exercised, and the manner in which the Secretary of State and the Director General exercise their licensing power.

Conclusion

The developments described above, and the move out of the public sector, offer the Company new opportunities in growing telecommunication and information technology markets. The Board feels that there are good prospects for the future development of the business.

Part II

Assumptions and Letters Regarding Forecast Profits

Assumptions

The profit forecast set out in Part I includes results shown by unaudited accounts for the three months ended 30th June 1984, takes account of operating results for the three months to 30th September 1984 and is made on the basis of the following principal assumptions:

(a) There will be no significant change in the currently prevailing economic conditions in the United Kingdom, or in those overseas territories which are material to the international turnover of British Telecom.

(b) There will be no change in United Kingdom legislation or regulations or actions by the Director General which will have an unexpected effect on the business of British Telecom.

(c) There will be no material changes in any of the existing arrangements with overseas telecommunication administrations.

(d) There will be no material increases in overtime, staff or other costs resulting from prolonged exceptionally adverse weather conditions.

(e) There will be no material abnormal stock obsolescence resulting from technological change.

(f) There will be no material change in the pattern of claims against British Telecom as a result of its loss of immunity from legal proceedings.

(g) There will be no industrial disputes, or political or other disturbances which would materially affect the operations or turnover of British Telecom.

(h) There will be no major interruption in the supplies of equipment or components to British Telecom or major damage to its installations or to those of interconnecting overseas operators.

(i) There will be no material change in the current basis or rates of taxation.

Letters

The following letters relate to the profit forecast for the Company for the year ending 31st March 1985:

Letter from Coopers & Lybrand

The Directors,
British Telecommunications plc,
2-12 Gresham Street,
London EC2V 7AG.

Gentlemen, 16th November 1984

The profit forecast of British Telecommunications plc, for which the Directors are solely responsible, as set out in Section 7 of Part I of the Offer for Sale dated 16th November 1984, includes results shown by unaudited accounts for the three months ended 30th June 1984 and forecasts for the nine months ending 31st March 1985.

We have reviewed the accounting policies and calculations adopted in arriving at the profit forecast. In our opinion the profit forecast, so far as the accounting policies and calculations are concerned, has been properly compiled on the basis of the assumptions made by the Directors set out in Part II of the Offer for Sale and is presented on a basis consistent with the accounting policies adopted by the Company according to the historical cost convention.

Yours truly,
COOPERS & LYBRAND
Chartered Accountants

Letter from Kleinwort, Benson Limited and S. G. Warburg & Co. Ltd.

The Directors,
British Telecommunications plc,
2-12 Gresham Street,
London EC2V 7AG.

Gentlemen, 16th November 1984

We have discussed with you and with Coopers & Lybrand the forecast of profit before taxation of British Telecommunications plc, together with the bases and assumptions upon which the forecast is made, as set out in the Offer for Sale dated 16th November 1984. We consider that the profit forecast (for which the Directors are solely responsible) has been made after due and careful enquiry.

Yours faithfully,

For Kleinwort, Benson Limited
Rockley
David Clementi
Directors

For S. G. Warburg & Co. Ltd.
Michael Valentine
Nicholas Fry
Directors

Part III

Accountants' Report

The Secretary of State for Trade and Industry,
The Directors, British Telecommunications public limited company,
The Directors, Kleinwort, Benson Limited,
The Directors, S. G. Warburg & Co. Ltd.

Coopers & Lybrand,
Abacus House,
Gutter Lane,
Cheapside,
London EC2V 8AH.

16th November 1984

Gentlemen,

British Telecommunications public limited company was established to continue the business previously carried on by British Telecommunications, a statutory corporation, which in 1981 had assumed the telecommunications business of the Post Office, a statutory corporation responsible at that time for both posts and telecommunications.

We have examined the audited accounts of the Post Office, which included separately the accounts of the telecommunications business, for the two years ended 31st March 1981 and of British Telecommunications for the three years ended 31st March 1984. Audited accounts have not been prepared in respect of any subsequent period. We acted as joint auditors of the Post Office, with particular responsibility for the telecommunications business, and as sole auditors of British Telecommunications. We are auditors of British Telecommunications public limited company. In this report we refer to the statutory corporation, British Telecommunications, and where appropriate its predecessor telecommunications business, as the Corporation and to British Telecommunications public limited company and its subsidiaries as British Telecommunications plc.

The financial information set out in this report is based on the audited accounts for the five years ended 31st March 1984, after making such adjustments to the audited accounts as we consider necessary. The financial information has been restated to reflect the bases of accounting currently adopted by British Telecommunications plc, as explained under Section A of this report, Accounting Policies.

Historical Cost Financial Statements
1980 and 1981

As a result of industrial action which disrupted normal accounting procedures for billing, estimates were used to a significant extent in preparing the financial information set out in this report in respect of the year ended 31st March 1980 and it has not been possible to determine that there has been a proper allocation of results between the years ended 31st March 1980 and 1981.

Conventional fixed asset accounting procedures have been progressively introduced over the period covered by our report, but were absent to a significant extent in respect of the two years ended 31st March 1981. It has not been possible to quantify the adjustments which would be required to the profit and loss accounts for the years ended 31st March 1980 and 1981 if the conventional accounting practice of writing plant out of the accounts at the expiry of its actual achieved life had been followed.

Because of the significance of these uncertainties we are unable to form an opinion on whether the financial information set out in Section B below, Historical Cost Financial Statements, gives a true and fair view of the profit and source and application of funds for the years ended 31st March 1980 and 1981.

1982, 1983 and 1984

In our opinion the financial information set out in Section B below, Historical Cost Financial Statements, gives a true and fair view of the profit and source and application of funds for the years ended 31st March 1982, 1983 and 1984 and of the state of affairs at those dates.

Pro Forma Financial Statements, 1984

Pro forma financial statements for the year ended 31st March 1984, incorporating the effects, provided for under the Telecommunications Act 1984, of: (a) vesting the property, rights and liabilities (other than the excepted liabilities described in Note 12 to the Historical Cost Financial Statements) of the Corporation in British Telecommunications plc and, (b) implementation of the new capital structure determined for British Telecommunications plc, are set out in Section C below.

In our opinion, the Pro Forma Financial Statements have been properly prepared on the bases set out in the notes thereto.

Current Cost Financial Statements, 1983 and 1984

Current cost financial statements for the two years ended 31st March 1984 are set out in Section D below.

In our opinion they have been properly prepared, on the bases and subject to the limitations set out in the notes thereto, to give the information required by United Kingdom Statement of Standard Accounting Practice No. 16 (Current Cost Accounting).

Structure of our Report

Our report is set out under the following sections:

A Accounting Policies
B Historical Cost Financial Statements
C Pro Forma Financial Statements, 1984
D Current Cost Financial Statements, 1983 and 1984

A. Accounting Policies

Changes in bases of accounting

The financial statements for all years presented in this report have been prepared using the bases of accounting currently adopted by British Telecommunications plc, which differ in certain respects from those which were applied by the Corporation in previously published accounts. Adjustments have been made to the results and balance sheets shown by previously published accounts in order to apply present policies consistently throughout the five years ended 31st March 1984.

The previously reported profit, the adjustments and the profit shown in these financial statements can be summarised as follows:

	Year ended 31st March				
	1980 £m	1981 £m	1982 £m	1983 £m	1984 £m
Net profit as previously reported in the accounts	236	181	458	365	990
Costs previously capitalised now charged to profit and loss account:					
Installation costs (note (a) below)	(27)	(57)	—	—	—
Other categories of fixed assets (note (b) below)	(76)	(45)	(13)	22	—
Changes in depreciation:					
Supplementary depreciation (note (c) below)	361	518	541	626	—
Shortening of asset lives (note (d) below)	(70)	(27)	(50)	18	—
Profit reported in the Historical Cost Financial Statements	424	570	936	1,031	990

Notes:

(a) For the two years ended 31st March 1981 the irrecoverable costs of installing connections to customers' premises, which were capitalised in the accounts, have been charged to the profit and loss account as incurred.

(b) For the four years ended 31st March 1983 expenditure on certain categories of fixed assets (including in particular telephone instruments) which was capitalised in the accounts, has been charged to the profit and loss account as incurred.

(c) For the four years ended 31st March 1983 an additional depreciation charge ("supplementary depreciation"), made in the accounts in order to reflect the replacement cost of fixed assets, has been eliminated. This brings the policy into line with that generally adopted by public limited companies in the United Kingdom.

(d) The estimated useful lives of a number of fixed assets were shortened in certain years, principally in the year ended 31st March 1984. Adjustments have been made to the previously reported results for the four years ended 31st March 1983 to reflect the new asset lives. Had the accounting treatment required by United Kingdom Statement of Standard Accounting Practice No. 12 (Accounting for Depreciation) been followed, previously reported results would not have been adjusted. However, the Corporation concluded, with our concurrence, that, since the shortening of asset lives took place in the exceptional circumstances of the change from a statutory corporation to a public limited company, operating in a new regulatory environment, it was appropriate to depart in this instance from this accounting standard. Departures from an accounting standard are permitted under accounting principles generally accepted in the United Kingdom where, having regard to the circumstances, it would be inappropriate or give a misleading view to apply that standard.

Since 31st March 1984 British Telecommunications plc has adopted the basis of accounting for finance leases set out in United Kingdom Statement of Standard Accounting Practice No. 21 (Accounting for Leases and Hire Purchase Contracts). No material adjustment is required to net profit in the five years ended 31st March 1984 from the application of this accounting policy.

Accounting policies

We set out below the significant accounting policies adopted in arriving at the financial information in this report:

(i) Accounting convention

The financial statements set out under Sections B and C have been prepared under the historical cost convention and those in Section D under the current cost convention, as described in the notes thereto.

Consolidated financial statements have not been prepared because the operations of subsidiary companies are in aggregate wholly immaterial.

(ii) Turnover

Turnover comprises the value of all services provided and equipment sold to third parties and is exclusive of value added tax.

(iii) Operating costs

Expenditure charged to revenue comprises the costs of providing services and selling equipment to customers including: (a) staff costs arising from the installation and maintenance of revenue earning services, and (b) the costs of small value equipment and consumable items.

(iv) Research and development

Expenditure on research and development is written off as incurred.

(v) Interest

All interest is dealt with through the profit and loss account.

(vi) Foreign currencies

Assets and liabilities in foreign currencies, other than borrowings with exchange guarantees, are translated into sterling at year end exchange rates, and differences arising are dealt with through the profit and loss account.

Exchange risks on most foreign borrowings incurred by the Corporation before the transfer date (as described in the Introduction to Section C, Pro Forma Financial Statements), and on the related interest, will continue to be borne by HM Treasury under an exchange cover guarantee scheme. The remaining balances of such borrowings are translated at the rates of exchange ruling when the original liabilities were incurred.

(vii) Tangible assets

Tangible assets are stated in the Historical Cost Financial Statements at historical cost less depreciation, and in the Current Cost Financial Statements at replacement cost less depreciation, on the bases described in the notes thereto. Cost in the case of network services comprises expenditure up to and including the last distribution point before customers' premises and includes contractors' charges, materials, direct labour and related overheads.

Depreciation is provided on tangible assets on a straight-line basis so as to write off cost over their estimated useful lives. No depreciation is provided on freehold land. The lives assigned to tangible assets are:

	Years		Years
Freehold buildings	40	Telephone exchange equipment	
Leasehold land and buildings	unexpired portion of lease or 40 years, whichever is shorter	Strowger	6—20
		Crossbar	8—17
		Semi-electronic	8—15
Transmission equipment		Digital	10
Duct	45—60	Customer equipment	3—4
Cable	10—40	Other equipment including cableships, motor vehicles and computers	3—40
Radio and repeater equipment	4—25		

Included under tangible assets are materials awaiting installation. These are stated at cost, less provision for excess and obsolete items. The majority of items are used in the construction of new plant and the remainder for maintenance. When issued for installation, materials are either added to the cost of specific plant or charged to the profit and loss account as appropriate.

(viii) Investments

Investments in communication satellite organisations are stated at the cost of British Telecommunications plc's share of the net assets of those organisations.

(ix) Stocks

Stocks comprise goods held for resale, small value equipment mainly chargeable to the profit and loss account, and consumable items. They are stated at the lower of cost and net realisable value.

(x) Insurance

British Telecommunications plc has cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise British Telecommunications plc generally carries its own insurance risk; provision is made when claims are notified.

(xi) Pension scheme

Substantially all permanent employees of British Telecommunications plc are members of the British Telecommunications Staff Superannuation Scheme (BTSSS) which is, with a few exceptions, contributory.

The Actuary to the scheme and its predecessor scheme, the Post Office Staff Superannuation Scheme (POSSS), advises the Trustees regarding the appropriate rate of contributions to fund all BTSSS liabilities. These rates of contribution are adopted by British Telecommunications plc and are included within staff costs.

(xii) Leases

(a) Cost

Leases which transfer substantially all the benefits and risks inherent in the ownership of the property (finance leases) are recorded in the accounts as assets and as obligations to pay future rentals. Rentals applicable to lease agreements where substantially all the benefits and risks of ownership remain with the lessor are charged to the profit and loss account as incurred.

(b) Depreciation

Equipment acquired under finance leases is depreciated over the shorter of the lease term and the useful life of the asset.

(xiii) Deferred taxation

Deferred taxation is provided in respect of all timing differences except where they are not expected to reverse. Timing differences arise mainly from the excess of capital allowances given for corporation tax purposes over the depreciation charge. Any provision for deferred taxation is calculated on the liability method and is reduced, where appropriate, by tax losses.

B. Historical Cost Financial Statements

Profit and Loss Accounts

We set out below profit and loss accounts for the five years ended 31st March 1984:

	Notes	Year ended 31st March 1980 £m	1981 £m	1982 £m	1983 £m	1984 £m
Turnover						
Rentals		1,129	1,531	1,993	2,276	2,334
Calls: telephone		2,192	2,691	3,301	3,433	3,697
telex and other		200	233	276	299	292
Sales and other operating income		80	115	193	406	553
Total turnover		3,601	4,570	5,763	6,414	6,876
Operating Costs						
Staff costs		1,609	2,110	2,394	2,571	2,715
Depreciation		410	475	647	765	907
Other operating costs		928	1,154	1,538	1,826	2,036
		2,947	3,739	4,579	5,162	5,658
Less: own work capitalised		(200)	(283)	(308)	(328)	(316)
Total operating costs	1	2,747	3,456	4,271	4,834	5,342
Profit on Ordinary Activities before Interest		854	1,114	1,492	1,580	1,534
Net interest payable	2	537	544	556	549	544
Profit before Taxation and Extraordinary Items		317	570	936	1,031	990
Taxation	3	—	—	—	—	—
Extraordinary items	4	107	—	—	—	—
Retained Profit for the Year		424	570	936	1,031	990
Movements in Reserves						
Reserves at beginning of each year		749	1,173	1,743	2,679	3,710
Retained profit for the year		424	570	936	1,031	990
Reserves at end of each year		1,173	1,743	2,679	3,710	4,700

Source and Application of Funds

We set out below statements of source and application of funds for the five years ended 31st March 1984:

	Year ended 31st March				
	1980	1981	1982	1983	1984
	£m	£m	£m	£m	£m
Source of Funds					
Profit before taxation and extraordinary items	317	570	936	1,031	990
Add: depreciation	410	475	647	765	907
Funds generated from operations	727	1,045	1,583	1,796	1,897
Funds from other sources					
Foreign loans	171	51	99	43	30
HM Government loans	—	44	203	—	—
Lease finance	36	34	80	70	79
Sale of land and buildings	76	—	—	—	—
	1,010	1,174	1,965	1,909	2,006
Application of Funds					
Tangible assets	980	1,239	1,458	1,517	1,513
Investments	7	11	18	33	20
Repayment of					
Foreign loans	113	115	79	72	23
HM Government loans	127	55	95	112	154
Lease finance	11	16	29	38	45
	1,238	1,436	1,679	1,772	1,755
Increase/(decrease) in working capital					
Stocks	15	24	(3)	65	71
Debtors	495	(98)	240	269	210
Creditors	(389)	(229)	126	(417)	(171)
	121	(303)	363	(83)	110
Increase/(decrease) in net liquid funds	(349)	41	(77)	220	141
	1,010	1,174	1,965	1,909	2,006

Balance Sheets

We set out below balance sheets as at 31st March 1982, 1983 and 1984:

	Notes	At 31st March 1982	1983	1984
		£m	£m	£m
Fixed Assets				
Tangible assets	5	7,367	8,119	8,725
Investments	6	62	95	115
Total fixed assets		7,429	8,214	8,840
Current Assets				
Stocks		72	137	208
Debtors				
Trade debtors		742	1,027	1,212
Accrued income		657	652	693
Prepayments		67	56	40
Short-term investments		—	124	252
Cash at bank and in hand		49	38	55
		1,587	2,034	2,460
Creditors: Amounts Falling Due Within One Year				
Short-term borrowings		221	114	118
Foreign loans	9	162	113	145
Lease finance	10	18	24	40
Trade creditors		750	1,003	1,170
Other creditors including taxation and social security	7	249	277	306
Accrued expenses		69	74	40
Deferred income		140	271	280
		1,609	1,876	2,099
Net Current Assets (Liabilities)		(22)	158	361
Total Assets less Current Liabilities		7,407	8,372	9,201
Creditors: Amounts Falling Due After More Than One Year				
HM Government loans	8	3,057	2,944	2,790
Foreign loans	9	317	338	313
Lease finance	10	104	130	148
		3,478	3,412	3,251
		3,929	4,960	5,950
Reserves	15	2,679	3,710	4,700
Long-Term (Excepted) Liabilities				
Deed of covenant to pension fund trustees	12	1,250	1,250	1,250
		3,929	4,960	5,950

Notes to the Historical Cost Financial Statements

1. Total operating costs

(a) Staff costs comprise the following:

	Year ended 31st March 1980 £m	1981 £m	1982 £m	1983 £m	1984 £m
Wages and salaries	1,315	1,726	1,952	2,117	2,239
Social security	120	162	187	175	176
Pension contributions (Note 11)					
Current service	124	172	198	216	233
Shortfall	50	50	57	63	67
	1,609	2,110	2,394	2,571	2,715

(b) Other operating costs comprise the following:

	Year ended 31st March 1980 £m	1981 £m	1982 £m	1983 £m	1984 £m
System maintenance and support	140	180	200	224	248
Provision to customers of lines and equipment	51	76	146	221	314
Marketing and sales	37	73	61	103	131
Payments to overseas telecommunication administrations	209	224	383	503	529
Supplies and transport	107	150	215	211	216
Billing and computing	106	77	133	139	138
Accommodation costs	169	244	279	303	331
Other	109	130	121	122	129
	928	1,154	1,538	1,826	2,036

(c) Other operating costs include the following amounts for rental costs relating to operating leases:

Year ended 31st March	£m
1980	35
1981	49
1982	59
1983	62
1984	65

(d) Total operating costs include the following amounts in respect of research and development:

Year ended 31st March	£m
1980	96
1981	123
1982	158
1983	172
1984	179

(e) In each of the five years ended 31st March 1984 there were differences, between the balances in the financial control accounts and the stores records for materials awaiting installation and stocks, which were charged to operating costs. Differences identified in the year ended 31st March 1984 amounted to £44 million. Management considers that of this amount at least £25 million is attributable to previous years. These differences have arisen because of weaknesses in accounting procedures and not physical stores discrepancies. Management is confident that the new accounting procedures which have been introduced or are in the final stages of implementation will prevent further significant accounting differences.

(f) Auditors' remuneration did not exceed £1 million in any of the five years ended 31st March 1984.

2. Net interest payable

Net interest payable is analysed as follows:

	Year ended 31st March				
	1980	1981	1982	1983	1984
	£m	£m	£m	£m	£m
Loan capital maturing in full within five years					
HM Government loans (Note 8)	47	42	45	43	35
Foreign loans (Note 9)	32	23	24	28	19
	79	65	69	71	54
Short-term borrowings	28	21	21	1	2
	107	86	90	72	56
Loan capital maturing in full after five years					
HM Government loans (Note 8)	261	243	253	259	255
Foreign loans (Note 9)	23	42	25	37	40
	284	285	278	296	295
Lease finance (Note 10)	3	5	7	9	12
Deed of covenant to pension fund trustees (Note 12)	151	169	185	198	212
	545	545	560	575	575
Less: interest receivable	8	1	4	26	31
	537	544	556	549	544

3. Taxation

(a) The Corporation did not incur a liability for corporation tax in respect of any of the five years ended 31st March 1984, due to the availability of tax allowances on capital expenditure. At 31st March 1984 capital allowances resulted in unrelieved tax losses, available for carry forward indefinitely, of £1,200 million.

(b) No provision for deferred taxation is required because the timing differences are not expected to reverse. If deferred taxation had been provided, the accumulated provision would have been as follows:

	At 31st March	
	1983	1984
	£m	£m
Timing differences	6,500	7,050
Less: unrelieved tax losses	(1,700)	(1,200)
	4,800	5,850
Full potential deferred taxation liability at 35%	1,680	2,050

The Finance Act 1984 provided for a reduction in the standard rate of corporation tax to 35% from 1st April 1986.

4. Extraordinary items

The extraordinary items arising in the year ended 31st March 1980 comprise:

	£m
Discount on early repayment of HM Government loans	55
Profit on sale of land and buildings	52
	107

5. Tangible assets

(a) The movement in tangible assets in the year ended 31st March 1984 and the balances at that date are set out below:

	Land and buildings (note (b)) £m	Plant and equipment £m	Leased plant and equipment £m	Total £m
Cost				
Balances at 1st April 1983	1,518	10,189	259	11,966
Additions	162	1,302	79	1,543
Disposals, write outs and adjustments	(4)	(782)	—	(786)
Total cost at 31st March 1984	1,676	10,709	338	12,723
Depreciation				
Balances at 1st April 1983	267	3,817	77	4,161
Charge for year	40	826	41	907
Disposals, write outs and adjustments	(1)	(789)	—	(790)
Total depreciation at 31st March 1984	306	3,854	118	4,278
Net book value at 31st March 1984	1,370	6,855	220	8,445
Materials awaiting installation	—	280	—	280
Total tangible assets at 31st March 1984	1,370	7,135	220	8,725
The comparable total at 31st March 1983 comprised:				
Net book value at 31st March 1983	1,251	6,372	182	7,805
Materials awaiting installation	—	314	—	314
Total tangible assets at 31st March 1983	1,251	6,686	182	8,119

(b) Land and buildings comprise freehold, long leasehold (50 years or more unexpired) and short leasehold as follows:

	Freehold £m	Leasehold long £m	Leasehold short £m	Total £m
Cost				
Balances at 1st April 1983	1,332	95	91	1,518
Additions	140	11	11	162
Disposals and adjustments	(6)	(4)	6	(4)
Total cost at 31st March 1984	1,466	102	108	1,676
Depreciation				
Balances at 1st April 1983	231	15	21	267
Charge for year	32	2	6	40
Disposals and adjustments	2	(2)	(1)	(1)
Total depreciation at 31st March 1984	265	15	26	306
Net book value at 31st March 1984	1,201	87	82	1,370
Net book value at 31st March 1983	1,101	80	70	1,251

During the year ended 31st March 1984 professionally qualified employees of the Corporation carried out a valuation of general purpose land and buildings on an open market value basis; the total valuation arrived at was not materially different to the net book value of £334 million at 31st March 1984. It is not intended to carry out a valuation of the remaining land and buildings, with a net book value of £1,036 million, which are specialised buildings primarily related to telephone exchanges used within the network.

6. Investments

British Telecommunications plc is a participating member in various international consortia for telecommunication satellites and contributes to the capital cost of the satellite programmes. Thereafter a rental is payable to the consortia for the circuits utilised. Each year British Telecommunications plc's investment participation is recalculated on the basis of its utilisation of the satellite. At 31st March 1982, 1983 and 1984, the cost of the Corporation's share of the net assets of satellite organisations, and its percentage participation, comprised:

	Cost at 31st March			Participation
	1982	1983	1984	1982, 1983, 1984
	£m	£m	£m	%
Intelsat	60	92	110	11
Inmarsat	1	1	1	9
Eutelsat	1	2	4	16
	62	95	115	

The investment in subsidiary and related companies at 31st March 1984 was £0.2 million (1983 £0.1 million). The results of these companies are not consolidated in view of the insignificant amounts involved.

7. Other creditors including taxation and social security

Other creditors including taxation and social security comprise:

	At 31st March	
	1983	1984
	£m	£m
Value added tax and payroll taxes including social security	223	225
Other creditors	54	81
	277	306

8. HM Government loans

HM Government loans consist of borrowings of a long-term nature from the National Loans Fund. These loans were extinguished by order of the Secretary of State on 6th August 1984 when the capital structure was changed in accordance with the Telecommunications Act 1984.

9. Foreign loans

(a) Foreign loans (including that portion payable within the current year) comprise foreign currency borrowings repayable as follows:

	At 31st March 1983 £m	At 31st March 1984 £m	Spread of interest rates %
Maturing in full within five years and repayable:			
by instalments	66	52	8.87–12.60
in full at maturity	144	174	12.15–16.56
Maturing in full after five years and repayable:			
by instalments	241	232	11.39–15.17
	451	458	
Amounts falling due within one year	113	145	
Amounts falling due after more than one year	338	313	
	451	458	

(b) An analysis by date of repayment of foreign loans at 31st March 1984 is as follows:

Year ending 31st March	£m
1985	145
1986	31
1987	45
1988	87
1989	35
1990 to 1994	115
	458

(c) Exchange risks on loans totalling £442 million (1983 £429 million) are borne by HM Treasury under the exchange cover guarantee scheme.

(d) The overall average interest rate, including the cost of HM Treasury's exchange cover guarantee scheme where applicable, is 13.73% per annum (1983 13.04%).

(e) Foreign loans include commercial paper of £120 million (1983 £90 million) all of which is repayable within one year.

10. Lease finance

(a) The obligations under finance leases represent the total present value of future minimum lease payments discounted at the interest rates inherent in each lease.

(b) Future minimum lease payments, including interest, at 31st March 1984 are as follows:

	Finance leases £m	Operating leases £m
Year ending 31st March		
1985	52	67
1986	48	64
1987	40	61
1988	32	57
1989	16	52
Thereafter	48	707
Minimum lease payments	236	1,008
less: amounts representing interest	(48)	
	188	
Amounts falling due within one year	40	
Amounts falling due after more than one year	148	
	188	

11. Pension scheme information

(a) The British Telecommunications Staff Superannuation Scheme (BTSSS) was established with effect from 1st April 1983 on which date it assumed the liabilities previously identified with the telecommunications section of the Post Office Staff Superannuation Scheme (POSSS). BTSSS received its share of the assets of POSSS together with the appropriate right to the income under the deed of covenant described in Note 12 below.

(b) Actuarial valuations of POSSS were carried out by the Actuary, R. Watson & Sons, as determined by the Trustees, at intervals not exceeding five years. In the intervening years the Actuary reviewed the continuing appropriateness of the rates of contribution payable.

(c) For the four years ended 31st March 1983 the Corporation paid to POSSS a total annual contribution of 21½% of contributory pay. This contribution included an element payable until 1992 expected to fund the remaining past service shortfall in POSSS after taking account of payments under the deed of covenant described in Note 12 below. Of the total percentage of 21½% the Corporation bore 15½%, which was charged to profit and loss account, and the members 6%. Pending the completion of the first actuarial valuation of BTSSS by R. Watson & Sons, the Corporation adopted their recommendation that contributions for the year ended 31st March 1984 should be at the same overall rate as was paid to POSSS.

(d) The first actuarial valuation of BTSSS was carried out as at 1st April 1983 and the Actuary's report together with their recommendations was issued to the Trustees of the scheme in August 1984. Following this British Telecommunications plc adopted, with effect from 1st April 1984, the recommendations that a total contribution of 19½% of contributory pay, including 6% employees' contributions, would be sufficient to meet all the liabilities of the scheme, including the past service shortfall, over the future working lifetime of the existing employees.

(e) Pension cost comprises current service and shortfall contributions, as shown in Note 1(a). In addition, interest was payable on the long-term liability described in Note 12 below.

12. Long-term (excepted) liabilities—deed of covenant to pension fund trustees

With effect from 1st April 1978, liquidation of part of a past service shortfall disclosed by valuations of POSSS was being effected by payments by the Corporation to the Trustees first of POSSS and then, in appropriate proportions, to the Trustees of POSSS and BTSSS under a deed of covenant, calculated to fund a liability of £1,250 million over fourteen years. This liability of £1,250 million represented a shortfall assessed at 31st March 1976, which related to service by both Corporation and Post Office employees before 1st October 1969.

The liability of £1,250 million was not transferred to British Telecommunications plc in August 1984 and is thus not its liability. It is referred to in the 1984 Act as the "excepted liabilities". Interest payable in the five years ended 31st March 1984 included interest on this long-term liability, as shown in Note 2 above.

13. Commitments for capital expenditure

Commitments for capital expenditure at 31st March 1984 not provided in the financial statements were:

	£m
Contracts placed	1,207
Expenditure authorised but not contracted for	434
	1,641

14. Contingent liabilities

At 31st March 1984 there were no contingent liabilities or guarantees other than those arising in the ordinary course of the Corporation's business, and on these no material losses are expected.

15. Post balance sheet events

Since 31st March 1984 there have been major changes in the corporate and capital structure of British Telecommunications plc. These changes are not reflected in the Historical Cost Financial Statements but are described, together with their effect, in Section C, Pro Forma Financial Statements.

C. Pro Forma Financial Statements, 1984

Introduction

On 1st April 1984, British Telecommunications plc was formed as a public limited company. The Telecommunications Act 1984 ("the 1984 Act") provided for the vesting in British Telecommunications plc on a day appointed by the Secretary of State ("the transfer date") of the property, rights and liabilities (other than the excepted liabilities described in Note 12 to the Historical Cost Financial Statements) of the Corporation. The transfer date was 6th August 1984. The 1984 Act also provided that the assets, liabilities and reserves should be included in the opening balance sheet of British Telecommunications plc at the values shown in the balance sheet of the Corporation at 31st March 1984.

As provided for in the 1984 Act, changes have been or will be made, as described in Note 7 below, to the capital structure of British Telecommunications plc, involving the extinguishment of indebtedness in respect of HM Government loans, the capitalisation of a proportion of reserves into ordinary and preference share capital and the issue to HM Government of ordinary shares, redeemable preference shares and unsecured loan stock. The Corporation paid interest on the excepted liabilities until 31st July 1984 and on the HM Government loans until 5th August 1984. Thereafter, British Telecommunications plc is required to pay interest on the unsecured loan stock and dividends in respect of the preference shares.

We set out below financial statements showing the actual results for the year ended 31st March 1984 and balance sheet at that date, the adjustments made to reflect the position as if the new capital structure had been in force throughout the year and the resultant pro forma profit for the year ended 31st March 1984 attributable to ordinary shareholders, and pro forma balance sheet at that date.

Pro Forma Profit and Loss Account

	Notes	Year ended 31st March 1984 Actual £m	Adjustments £m	Pro forma £m
Profit on ordinary activities before interest		1,534	—	1,534
Net interest payable	2	544	(161)	383
Profit before taxation		990	161	1,151
Taxation	3	—	—	—
Preference dividends	4	—	(63)	(63)
Profit attributable to ordinary shareholders		990	98	1,088
Pro forma earnings per ordinary share	5			18.1 pence

Pro Forma Balance Sheet

	Notes	At 31st March 1984 Actual £m	Adjustments £m	Pro forma £m
Total fixed assets		8,840	—	8,840
Current assets		2,460	—	2,460
Creditors: amounts falling due within one year	6	2,099	44	2,143
Net current assets		361	(44)	317
		9,201	(44)	9,157
Creditors: amounts falling due after more than one year				
HM Government loans	1(a)	2,790	(2,790)	—
Unsecured loan stock	1(b), 6	—	2,706	2,706
Foreign loans		313	—	313
Lease finance		148	—	148
		3,251	(84)	3,167
		5,950	40	5,990
Ordinary share capital	1(d), 7	—	1,500	1,500
Reserves	8	4,700	(960)	3,740
Ordinary shareholders' funds		4,700	540	5,240
Preference shares	1(d), 7	—	750	750
Long-term (excepted) liabilities				
Deed of covenant to pension fund trustees	1(c)	1,250	(1,250)	—
		5,950	40	5,990

Notes to Pro Forma Financial Statements

1. Basis of preparation

The figures in the column headed "Actual" have been extracted from the Historical Cost Financial Statements for the year ended 31st March 1984, presented in Section B above. Adjustments have been made to reflect the capital restructuring effected under the 1984 Act as follows:

(a) The extinguishment of all liabilities to the Secretary of State in respect of borrowings from the National Loans Fund.

(b) The issue to the Secretary of State of £2,750 million unsecured loan stock as a consequence of the extinguishment of the liabilities referred to in (a) above.

(c) The retention by the Corporation of the liability of £1,250 million under the deed of covenant to the pension fund trustees, which was not transferred to British Telecommunications plc (see Note 12 to the Historical Cost Financial Statements).

(d) The issue of share capital described in Note 7 below.

No other adjustments have been made to the Historical Cost Financial Statements.

2. Net interest payable

Pro forma net interest payable has been calculated as follows:

	£m	£m
As reported in the Historical Cost Financial Statements		544
Less: interest in respect of liabilities not assumed by British Telecommunications plc:		
HM Government loans	(290)	
Deed of covenant to pension fund trustees	(212)	
	(502)	
Add: interest on unsecured loan stock	341	
Adjustments		(161)
Net interest payable as shown in the Pro Forma Financial Statements		383

The interest of £290 million eliminated in this table was in respect of HM Government loans which totalled £2,944 million at 31st March 1983 reducing to £2,790 million at 31st March 1984. The interest charge of £341 million added in the table is in respect of the unsecured loan stock totalling £2,750 million set out in Note 6 below.

3. Taxation

Payment of preference dividends (Note 4 below) will involve the payment of advance corporation tax (ACT). Such ACT will be carried forward for recovery against future mainstream corporation tax liabilities of British Telecommunications plc.

4. Preference dividends

These represent the cost of a full year's dividend, as calculated below:

	£m
Dividend on 750 million preference shares of £1 each at 11.95% including tax credit	90
Less: ACT (Note 3)	(27)
	63

5. Pro forma earnings per ordinary share

Pro forma earnings per ordinary share have been calculated by dividing the pro forma profit for the year attributable to ordinary shareholders of £1,088 million by the 6,000 million ordinary shares issued and to be issued and credited as fully paid as described in Note 7 below.

6. Unsecured loan stock

The repayment dates and interest rates attaching to the unsecured loan stock are as follows:

Interest rate %	Date of maturity 31st March	Amount £m	Interest rate %	Date of maturity 31st March	Amount £m
$12\frac{3}{4}$	1985	44		brought forward	931
	1986	61	$12\frac{1}{2}$	1996	130
	1987	53		1997	130
	1988	23		1998	130
	1989	85		1999	140
$12\frac{1}{2}$	1990	92	$12\frac{1}{4}$	2000	150
	1991	100		2001	160
	1992	106		2002	170
	1993	113		2003	180
	1994	124		2004	190
	1995	130		2005	210
				2006	229
	carried forward	931			

Total unsecured loan stock	2,750
Amounts falling due within one year	44
Amounts falling due after more than one year	2,706
	2,750

7. Share capital

The ordinary and preference share capital of British Telecommunications plc will be, if the conditional allotment described in Part IV of the Offer for Sale dated 16th November 1984 becomes effective, as follows:

Authorised:

7,500 million Ordinary Shares of 25p each	£1,875 million
750 million 11.95% (including tax credit) Redeemable Cumulative Preference Shares of £1 each	£750 million

Issued and fully paid:	£m
6,000 million Ordinary Shares of 25p each	1,500
750 million 11.95% (including tax credit) Redeemable Cumulative Preference Shares of £1 each	750
	2,250

In addition one Special Rights Redeemable Preference Share of £1 has been issued to HM Government. It carries no right to participate in capital (beyond the sum of £1) or profits of British Telecommunications plc.

British Telecommunications plc has the right to redeem at par, subject to paying any arrears of dividend, all or any of the preference shares by giving not less than three months notice in writing to the holders thereof and shall, on 30th September 2019, redeem all outstanding preference shares at par. The holders are entitled to priority over any other existing class of share in payment of dividend and on a return of assets on a winding up or on a reduction of capital.

8. Reserves

Reserves have been arrived at as follows:

	£m	£m
As reported in the Historical Cost Financial Statements		4,700
Add: Extinguishment of HM Government loans (Note 1(a))	2,790	
Deed of covenant to pension fund trustees not transferred (Note 1(c))	1,250	
Less: Issue of unsecured loan stock in August 1984 (Note 1(b))	(2,750)	
Converted or to be converted into:		
ordinary shares (Note 1(d))	(1,500)	
preference shares (Note 1(d))	(750)	
		(960)
		3,740

D. Current Cost Financial Statements, 1983 and 1984

We set out below the Current Cost Financial Statements for the two years ended 31st March 1984 which have been prepared on the basis set out in Note 1 below:

Current Cost Profit and Loss Accounts

	Notes	Year ended 31st March 1983 £m	1984 £m
Turnover		6,414	6,876
Profit on the historical cost basis on ordinary activities before interest		1,580	1,534
Less: current cost operating adjustments	1, 2	591	418
Current cost profit before interest		989	1,116
Net interest payable		549	544
Retained current cost profit for the year without gearing adjustment	1(d)	440	572
Retained pro forma current cost profit for the year	1(e)		833

Current Cost Balance Sheets

	Notes	At 31st March 1983 £m	1984 £m
Fixed assets			
Tangible fixed assets	3	14,940	13,961
Investments		95	115
		15,035	14,076
Net current assets			
Monetary working capital		374	461
Other net current liabilities		(216)	(100)
		158	361
Creditors: amounts falling due after more than one year			
HM Government loans		(2,944)	(2,790)
Foreign loans		(338)	(313)
Lease finance		(130)	(148)
		(3,412)	(3,251)
		11,781	11,186
Reserves			
Current cost reserve	4	8,476	7,309
Other reserves		2,055	2,627
		10,531	9,936
Long-term (excepted) liabilities			
Deed of covenant to pension fund trustees		1,250	1,250
		11,781	11,186

Notes to Current Cost Financial Statements

1. Basis of preparation

Changes in telecommunications technology are having an increasing impact on the business of British Telecommunications plc. These changes will lead in the next few years to major categories of tangible assets being replaced by equipment which provides the same service capacity at substantially lower costs and more efficiently. In reviewing the bases of valuation of its tangible assets, for the purposes of the current cost statements, the Corporation took into account these circumstances as described in detail in paragraph (a) below.

The approach, for the year ended 31st March 1984, was in principle to value assets used in the network by reference to the net replacement cost of the new equipment that is currently available to replace the assets in use. The speed of technological change is expected to increase and, for that reason, estimates made in arriving at appropriate bases of valuation must be subjective in nature in a number of instances. Further material changes in the bases of valuation may be necessary in the next few years.

(a) Tangible fixed assets valuation

(i) Land and buildings

At 31st March 1984. General purpose land and buildings are included at open market existing use valuations made by professionally qualified employees of the Corporation.

Specialised buildings are stated at the current cost of construction, calculated by applying internally generated cost factors to the floor areas of the buildings. Replacement cost for related land is calculated by applying a general price index to original historical cost.

At 31st March 1983. The replacement cost of both general purpose and specialised land and buildings was calculated by applying published indices to original historical cost; a general price index was used for land and a construction price index for buildings.

(ii) Plant and equipment

The replacement cost of plant and equipment is calculated by applying internally generated indices to original historical cost.

At 31st March 1984. Where modern equivalent technology is proven and prices are available the indices used assume total replacement of existing assets with the most modern available equipment. Where necessary, allowance is made for costs of temporary interface equipment. No regard is taken of the possible operational savings that would result from the use of new technology.

Where there is no proven modern equivalent technology or where the future prices of modern technology cannot be realistically assessed, the cost indices assume, as at 31st March 1983 (see below), that replacement will mirror current purchasing arrangements at that time.

At 31st March 1983. The replacement cost of these assets was calculated on the basis of indices reflecting contemporary purchasing arrangements.

(iii) The changes resulting from these methods of valuation are given in Note 4 below.

(b) Tangible fixed assets depreciation

Depreciation is provided on tangible fixed assets on a straight-line basis so as to write off replacement cost over their useful lives. The same asset lives as those adopted in the Historical Cost Financial Statements are used. No regard is taken of the possible different lives of modern equivalent equipment.

The depreciation adjustment, as set out in Note 2 below, represents the additional charge against profits as a result of depreciating fixed assets on the basis of their replacement cost rather than their historical cost.

(c) Monetary working capital adjustment

To allow for the impact of price changes on working capital the monetary working capital adjustment, as set out in Note 2 below, is calculated by reference to appropriate price indices. The adjustment is based on the excess of trade debtors, stock and certain liquid assets over trade creditors; no adjustment is made where there is an excess of trade creditors.

(d) Gearing adjustment

No gearing adjustment has been made, in accordance with United Kingdom Statement of Standard Accounting Practice No. 16 (Current Cost Accounting) which states that in view of the special nature of their capital structure, no gearing adjustment need be made in the profit and loss accounts of nationalised industries.

(e) Pro forma current cost profit

The pro forma profit for the year ended 31st March 1984, under the historical cost convention, of £1,151 million (see Section C, Pro Forma Financial Statements) would, under the current cost convention, and after making a gearing adjustment on the basis of the new capital structure, be £833 million.

2. Current cost operating adjustments

	Year ended 31st March 1983	1984
	£m	£m
Depreciation (Note 1(b))	571	376
Monetary working capital (Note 1(c))	16	16
Fixed asset disposals	4	26
Current cost operating adjustments	591	418

3. Tangible fixed assets

	At 31st March 1984 Gross replacement cost	Accumulated depreciation	Net replacement cost	At 31st March 1983 Net replacement cost
	£m	£m	£m	£m
Land and buildings	4,423	1,537	2,886	3,245
Plant and equipment	20,341	9,486	10,855	11,513
Leased equipment	338	118	220	182
	25,102	11,141	13,961	14,940

4. Current cost reserve

	£m	£m
Current cost reserve at 1st April 1983		8,476
Current cost adjustments		
Valuation changes (Note 1(a))		
Land and buildings	(583)	
Plant and equipment subject to technological change	(1,311)	
Other plant and equipment	711	
	(1,183)	
Monetary working capital (Note 1(c))	16	
Total current cost adjustments		(1,167)
Current cost reserve at 31st March 1984		7,309

Yours truly,

COOPERS & LYBRAND

Chartered Accountants.

Part IV

Additional Information

1 Share and Loan Capital

Share Capital

The Company was incorporated on 1st April 1984 with an authorised share capital of £50,000, divided into 50,000 ordinary shares of £1 each, of which two were subscribed at par by, and the remainder issued for cash at par on 28th June 1984 to, nominees of the Secretary of State. The principal objects of the Company are set out in Clause 4 of the Memorandum of Association. On 2nd July 1984, a certificate to do business was granted to the Company by the Registrar of Companies under section 4 of the Companies Act 1980.

On 24th July 1984, the 50,000 ordinary shares of £1 each were subdivided into 200,000 ordinary shares of 25p each and the authorised share capital of the Company was increased from £50,000 to £1,250,000,001 by the creation of 1,999,800,000 ordinary shares, the 750,000,000 Preference Shares and the Special Share.

On 6th August 1984, pursuant to the 1984 Act the property, rights and liabilities of the Corporation (other than the "excepted liabilities" as described below) vested in the Company. Pursuant to a direction given by the Secretary of State under the 1984 Act and by resolution of a Committee of the Board, 999,800,000 ordinary shares, all the Preference Shares and the Special Share were issued, credited as fully paid, by the Company to a nominee of the Secretary of State.

On 15th November 1984, conditionally upon the UK Underwriting Agreement and the Bank of England Agreement referred to below being executed, becoming unconditional and not being terminated pursuant to the terms thereof:

(a) the authorised share capital was increased from £1,250,000,001 to £2,625,000,001 by the creation of an additional 5,500,000,000 new ordinary shares;

(b) the Directors were generally and unconditionally authorised, pursuant to section 14(1) of the Companies Act 1980, to allot relevant securities (as defined in section 14(10) of the said Act) up to an aggregate nominal amount of £1,625,000,000 (including the allotment referred to in (d) below), such authority to expire on the date of the Annual General Meeting of the Company in 1989 unless previously revoked or varied;

(c) the Directors were given power to allot equity securities (as defined in section 17 of the Companies Act 1980) for cash, pursuant to the authority referred to in sub paragraph (b) above, as if section 17(1) of the said Act did not apply to the allotment, provided that such power, which was expressed to expire on the date of the Annual General Meeting to be held in 1985, was limited to (i) the allotment of equity securities in connection with a rights issue in favour of the holders of ordinary shares where the equity securities attributable to the interests of all the holders of ordinary shares are proportionate (as nearly as may be) to the respective numbers of ordinary shares held by them and (ii) the allotment (otherwise than pursuant to (i) above) of equity securities up to an aggregate nominal value of £93,750,000; and

(d) 5,000,000,000 ordinary shares were allotted, credited as fully paid, to nominees of the Secretary of State by way of capitalisation of part of the sum standing to the credit of the reserves of the Company.

On the same date, the Company was authorised to enter into the agreement referred to in 13(h) below.

The provisions of section 17 of the Companies Act 1980 (which, to the extent not disapplied, confer on shareholders rights of pre-emption in respect of the allotment of equity securities which are, or are to be, paid up in cash) apply to the 1,125,000,000 authorised but unissued ordinary shares which are not the subject of the disapplication referred to in sub-paragraph (c) above. In addition, notwithstanding such disapplication, the provisions of The Stock Exchange Listing Agreement require that, unless special Stock Exchange dispensation or the approval of ordinary shareholders in General Meeting is obtained, further issues of equity securities for cash are to be made on a pro rata basis.

Save as disclosed in this Part IV:

(i) no share or loan capital of the Company since its incorporation or of any of its subsidiaries within two years before the date of this Offer for Sale has been issued or been agreed to be issued or is now proposed to be issued fully or partly paid, either for cash or for a consideration other than cash;

(ii) no commissions, discounts, brokerages or other special terms have been granted by the Company or any of its subsidiaries, since those respective dates, in connection with the issue or sale of any share or loan capital of such companies; and

(iii) no share or loan capital of the Company or of any of its subsidiaries is under option or agreed conditionally or unconditionally to be put under option.

No material issue of shares of the Company (other than to shareholders pro rata to their existing shareholdings) will be made within one year of the date of this Offer for Sale, and no issue will be made which would effectively alter the control of the Company without the prior sanction of the ordinary shareholders of the Company in General Meeting.

Loan Stocks

On 6th August 1984, pursuant to the 1984 Act, the then existing loans of the Company repayable to the Secretary of State (previously being loans repayable by the Corporation to the Secretary of State and forming part of the National Loans Fund amounting to £2,789,865,772.48) were extinguished and the Company issued to the Secretary of State twenty-two separate series of unsecured loan stock aggregating £2,750,000,000 in principal amount redeemable from 1985 to 2006 and carrying interest from $12\frac{1}{4}$ per cent. to $12\frac{3}{4}$ per cent. per annum. They are constituted by a Trust Deed dated 6th August 1984 made between the Company and The Law Debenture Trust Corporation p.l.c. as Trustee. On the same date, they were transferred to the Corporation on terms which require the Corporation to exercise all rights in respect of the Loan Stocks as directed by the Secretary of State and to transfer the Loan Stocks as he may direct.

The Trust Deed imposes a limit on the borrowings of the Company and its subsidiaries (computed as provided in the Trust Deed) of an amount equal to 1.75 times the Adjusted Capital and Reserves (as defined in the Trust Deed). It also imposes a narrower limit on certain Priority Borrowings (as defined in the Trust Deed).

On 6th August 1984, the Secretary of State, The Law Debenture Trust Corporation p.l.c. and the Company entered into a Loan Stock Moratorium Agreement and a Trustee Side Agreement. The Loan Stock Moratorium Agreement permits the Company to require the Secretary of State and the Corporation and their respective nominees to exchange one or more series of Loan Stocks redeemable between 1985 and 1989 for one or more series of loan stock with a redemption date or redemption dates falling between 1990 and 2006, carrying the same rate of interest as the existing series of Loan Stocks with a redemption date in the same year. The Trustee Side Agreement provides for substantially all of the powers and discretions of the Trustee to be exerciseable by the Secretary of State for so long as all of the Loan Stocks (including any issued pursuant to the Loan Stock Moratorium Agreement) are held by or on behalf of the Secretary of State and/or the Corporation.

Excepted Liabilities

The "excepted liabilities" comprised the Corporation's liability of £1,250 million to the Post Office and British Telecom Staff Superannuation Schemes which arose by virtue of a Deed of Covenant dated 22nd November 1978 to make good certain deficiencies in the Post Office Staff Superannuation Scheme. The Corporation is obliged under the 1984 Act to discharge the excepted liabilities out of sums received by it in respect of the Loan Stocks transferred by the Secretary of State to the Corporation. The Corporation is prohibited from disposing of any of the Loan Stocks without the consent of the Secretary of State given with the approval of HM Treasury. Where any sums received by the Corporation in respect of the Loan Stocks exceed the excepted liabilities to be discharged by the Corporation on any day, the excess is to be applied as directed by the Secretary of State; where any deficiency arises, it is to be made good by the Secretary of State out of moneys provided by Parliament.

2 Articles of Association

The Articles of Association of the Company contain, *inter alia*, provisions to the following effect:

Special Share

The Special Share may only be held by or transferred to the Secretary of State or another Minister of the Crown or any person acting on behalf of the Crown. The registered holder for the time being of the Special Share (the "Special Shareholder") may require the Company to redeem the Special Share at its nominal amount at any time.

The Special Shareholder is entitled to receive notice of and attend and speak at all General Meetings and meetings of any class of shareholders but not to vote at such meetings. The Special Share confers no right to participate in the capital or profits of the Company save that on a winding-up the Special Shareholder is entitled to repayment of £1 in priority to other shareholders. However, each of the following proposals is deemed to be a proposed variation of the rights attaching to the Special Share and is only effective with the consent in writing of the Special Shareholder:

(a) The amendment, or removal, or alteration of the effect of all or any of certain specified Articles, being the Articles setting out certain definitions; the rights attaching to the Special Share; the limitation on shareholdings; the rights of the Special Shareholder to appoint any person or nominate any existing Director as a Government Appointed Director and other provisions relating to Government Appointed Directors including the provision that the removal of Directors by resolution of a General Meeting shall not apply to Government Appointed Directors; the right of a Director to vote in respect of resolutions of the Board concerning certain matters in which he is interested; the right of a Government Appointed Director to vote in respect of resolutions of the Board concerning matters in which the Crown may be interested; and certain of the procedures for the proceedings of the Directors including the appointment of a Chairman, Deputy Chairman, and managing and executive Directors, their removal from such positions and their qualifications, in particular the requirement that any Executive Chairman or Chief Executive must be a British citizen.

(b) The issue of any shares with voting rights not identical to those of the ordinary shares subject to an exception for any shares which do not constitute equity share capital and which when aggregated with all other such shares carry the right to cast less than 15 per cent. of the maximum number of votes capable of being cast on a poll at any General Meeting.

Preference Shares

(a) Dividends: The Preference Shares entitle the holders thereof (in priority to any payment of dividend on any other existing class of shares) to a cumulative preferential dividend payable half-yearly at a rate which, when added to any tax credit available in respect of the dividend in question, is equal to 11.95 per cent. per annum.

(b) Return of Capital: On a return of assets on a winding-up or on a reduction of capital, the assets of the Company available for distribution are (subject to any provision made under section 74 of the Companies Act 1980 and to the rights attached to the Special Share and any other shares ranking *pari passu* with the Preference Shares) to be applied first in repaying to the holders of the Preference Shares the amounts paid up on such shares together with any arrears of dividend.

(c) Voting: The preference shareholders are not entitled to vote upon any resolution (other than a resolution for winding-up the Company or reducing its share capital) unless at the date of the notice convening the meeting at which such resolution is to be proposed the dividend on such shares is six months in arrears, when each preference shareholder present in person shall have one vote on a show of hands and, on a poll, each such holder present in person or by proxy shall have one vote for every £1 nominal amount of preference shares of which he is the holder. The preference shareholders are not entitled to receive notice of or to attend any General Meeting of the Company unless they are entitled to vote at such meeting.

(d) Redemption: Subject to the Companies Acts, the Company has the right to redeem all or any of the Preference Shares by giving not less than three months' notice in writing to the holders thereof and, subject as aforesaid, the Company shall on 30th September 2019 redeem all outstanding Preference Shares, in each case at par together with any arrears of dividend.

(e) Further Preference Share Issues: The Company may issue further preference shares ranking as regards participation in profits and assets of the Company *pari passu* with (but not in priority to) the Preference Shares, provided that the Auditors certify that, following such issue, the aggregate nominal amount of the total issued preference shares on a return of capital in the event of a winding-up would not exceed an amount equal to 20 per cent. of the Adjusted Capital and Reserves (as defined in the Articles of Association).

(f) Other Restrictions: Except with such consent of any preference shareholders as is required for a variation of the special rights of such shares, no debentures or shares redeemable before 30th September 2019, ranking in priority to or *pari passu* with the Preference Shares, may be paid up by way of capitalisation of profits or reserves; the maximum amount of borrowings permitted by the Articles of Association shall not be enlarged and the borrowing powers Article (see below) shall not be varied (except so as to include as borrowed moneys sums which would not otherwise be included) and no reduction of the share capital of the Company involving a return of capital on shares ranking after the Preference Shares which would require the consent of the Court shall be effected.

Ordinary Shares

(a) Dividends: Subject to the dividend rights of the holders of the Preference Shares and to the rights of holders of future shares having priority, the holders of ordinary shares are entitled to the profits of the Company available for dividend and resolved to be distributed.

(b) Return of Capital: On a winding-up the balance of the assets available for distribution, after deduction of any provision made under section 74 of the Companies Act 1980 and repayment of the amounts paid up on the Special Share and the Preference Shares (together with any arrears of dividend thereon), and subject to any special rights attaching to any other class of shares, shall be applied in repaying to the holders of ordinary shares the amounts paid up on such shares and any surplus assets will belong to the holders of ordinary shares according to the respective numbers of shares held by them.

(c) Voting: Subject to the provisions summarised in "Restrictions on Voting" below, on a show of hands every holder of ordinary shares who is present in person at any General Meeting shall have one vote and on a poll every such holder who is present in person or by proxy shall have one vote for every 25p in nominal amount of the ordinary shares of which he is the holder.

Limitation on Shareholdings

The limitation on interests in voting shares of the Company is described briefly below:

(a) For the purpose of these provisions, the expression "interest" is widely defined; it generally follows, but is more extensive than, the definition used in deciding whether a notification to the Company would be required under Part IV of the Companies Act 1981 and thus includes the interest of an Interim Certificate holder. Any person who has an interest in voting shares of 5 per cent. or more is required to notify the Company of that interest and is otherwise obliged to give notices in relation to interests in voting shares as currently provided in Part IV of the Companies Act 1981.

(b) If any person has, or appears to the Directors to have or (if the Directors are unable to ascertain whether such a person has an interest in those shares and so resolve) is deemed to have, an interest in shares which carry 15 per cent. or more of the total votes attaching to relevant share capital (as that expression is defined in the Companies Act 1981), the Directors shall serve a written notice on all persons (other than persons referred to in (e) below) who appear to them to have interests in and, if different, on the registered holder(s) of the shares concerned. Such notice will set out the restrictions referred to below and will call for the interest concerned to be reduced to less than 15 per cent. by disposal of shares within 21 days of the service of the notice on the registered holder(s) (or such longer period as the Directors consider reasonable). No transfer of the shares comprised in the interest may be made except for the purpose of reducing such interest to less than 15 per cent.

(c) If such a notice is served and is not complied with in all respects to the satisfaction of the Directors and has not been withdrawn, the Directors shall themselves effect such a disposal on such terms as they may determine, based upon advice obtained by them for the purpose.

(d) A registered holder on whom a notice referred to above has been served is not entitled in respect of the share or shares comprised in the interest, until such notice has been withdrawn or complied with to the satisfaction of the Directors, to attend or vote at any General Meeting of the Company or meeting of the holders of voting shares and such rights will vest in the chairman of any such meeting, who may act entirely at his discretion.

(e) The Directors are not obliged to serve notice on any person if they do not know either his identity or his address. The absence of serving such a notice in such a case and any accidental error in or failure to give any notice to any person upon whom notice is required to be served will not prevent the implementation of or invalidate any procedure under the relevant Article.

(f) Any resolution or determination of, or decision or exercise of any discretion or power by, the Directors shall be conclusive and binding on all persons concerned and shall not be open to challenge.

(g) The Secretary of State and certain other specified shareholders are not subject to these restrictions.
The full text of these provisions is to be found in Article 37 of the Articles of Association which are available for inspection (see paragraph 15 below).

General

(a) Restrictions on Voting: No member shall, unless the Directors otherwise determine, be entitled to attend or vote at any General Meeting or to exercise any other right conferred by membership at or in relation to meetings of the Company in respect of any shares in the capital of the Company held by him if (i) he or any person appearing to be directly or indirectly interested in those shares has been duly served with a notice under section 74 of the Companies Act 1981 and he or any such person is in default in supplying to the Company the information thereby requested within the time specified in such notice for compliance therewith, being not less than 28 days from the date of the notice, and the Directors resolve that those shares be disqualified until the notice is complied with or, if earlier, until the Directors resolve to remove the disqualification or (ii) the circumstances described under "Limitation on Shareholdings" above apply.
(b) Record Dates and Unclaimed Dividends: Any resolution of the Company or the Directors declaring a dividend may specify any date as the record date, whether or not prior to the date on which the resolution is passed. All dividends (which will not bear interest) unclaimed for a period of twelve years after having been declared will, unless the Directors otherwise resolve, be forfeited and revert to the Company.
(c) Variation of Rights: The rights attached to any class of shares may, subject to the provisions of the Companies Acts, be varied or abrogated with the consent in writing of the holders of three-quarters in nominal value of the issued shares of that class, or with the sanction of an Extraordinary Resolution passed at a separate General Meeting of the holders of the shares of the class. Unless otherwise expressly provided by the terms of issue of the shares of that class or by the terms upon which such shares are for the time being held, the rights attached to any class of shares are deemed to be varied by the allotment of further shares ranking in priority thereto for payment of a dividend or repayment of capital but are deemed not to be modified, abrogated or varied by the creation or issue of further shares ranking *pari passu* therewith or subsequent thereto.
(d) If a very large number of persons are allocated shares, the Company may need to seek authority to restrict or regulate, so far as necessary, attendance at General Meetings on a basis as fair as possible to all members and without prejudice to voting rights.

Directors

(a) The Special Shareholder has the right from time to time to appoint or nominate and remove not more than two Government Appointed Directors who may not hold any executive office or the office of Chairman or Deputy Chairman in the Company or any subsidiary of the Company. The provisions of the Articles relating to retirement by rotation, removal and appointment of Directors do not apply to Government Appointed Directors. In the absence of some other material interest, the Government Appointed Directors may vote in respect of any resolution concerning any matter in which the Crown may be interested or to or in which a Government Appointed Director may be a party or be interested on behalf of the Crown. For this purpose the Crown includes any representative, Minister or person acting on behalf of the Crown and any company or corporation of which any share or other capital is owned directly or indirectly by the Crown or any such representative or over which the Crown or any such representative has any control or power of direction.
(b) Excluding remuneration referred to below, each Director shall be paid such remuneration for his services as the Directors may from time to time determine (not exceeding £20,000 per annum or such larger amount as the Company may by Ordinary Resolution determine). The Directors may be paid their expenses properly incurred in connection with the business of the Company.

Any Director who holds the office of Chairman or Deputy Chairman or any executive office or who otherwise performs services which in the opinion of the Directors are outside the scope of the ordinary duties of a Director may be paid such extra remuneration as the Directors may determine.

The Directors may grant pensions or other benefits to, among others, any Director or former Director or persons connected with them. However, no such benefit may be granted to any Director or former Director who has not been an employee or held any other office or place of profit under the Company or any of its subsidiaries or to a person who has no claim on the Company except as a connected person of such Director or former Director without the approval of an Ordinary Resolution of the Company.

Except for the position of auditor of the Company or any of its subsidiaries, a Director may hold any other office or place of profit with the Company or with any other company or may be interested in any other company whether directly or indirectly in conjunction with his office of Director.

No Director is disqualified by his office from entering into any contract or arrangement whatsoever with the Company. No such contract or arrangement is liable to be avoided, nor is any Director who enters into any such contract or arrangement, or who is so interested, liable to account to the Company for any profit realised thereby by reason of such Director holding that office or of the fiduciary relationship established thereby.
(c) A Director must declare the nature of his interest in any contract or arrangement to the board. No Director may vote or be counted in the quorum at a meeting in relation to any resolution in respect of any contract or arrangement in which he has any material interest otherwise than by virtue of his interests in shares or other securities of or otherwise in or through the Company. A Director may, however, vote and be counted in a quorum in respect of certain matters in which he is interested as specified in the Articles of Association.

The Company may, subject to the Companies Acts, by Ordinary Resolution suspend or relax, *inter alia*, the provisions relating to the declaration of the interest of a Director in any contract or arrangement or relating to a Director's right to vote and be counted in a quorum on resolutions in which he is interested to any extent or ratify any particular contract or arrangement carried out in contravention of those provisions.
(d) The provisions of section 185 of the Companies Act 1948 (relating to the appointment and retirement as Directors of persons who are aged 70 or more) do not apply to the Directors.
(e) At each Annual General Meeting, one-third of the Directors, other than Government Appointed Directors, the Chairman, the Deputy Chairman and one other Director holding such executive office as the Directors may from time to time resolve (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) shall retire from office by rotation.
(f) The office of Executive Chairman or Chief Executive or Joint Chief Executive may only be held by a British citizen within the meaning of the British Nationality Act 1981.

Borrowing Powers

The Directors may exercise all the powers of the Company to borrow money and to mortgage or charge its undertaking, property and assets and uncalled capital and subject to the Companies Acts to issue debentures and other securities, whether outright or as collateral security for any debt, liability or obligation of the Company or of any third party.

The Directors shall restrict the borrowings of the Company and exercise all voting and other rights or powers of control exerciseable by the Company in relation to its subsidiaries so as to secure (but, as regards its subsidiaries, only in so far as by such exercise they can secure) that the aggregate principal amount for the time being outstanding of all borrowings of the Company and its subsidiaries for the time being owing to persons other than the Company and its subsidiaries, computed as provided in the Articles of Association, shall not, without the previous sanction of an Ordinary Resolution of the Company and also such consent or sanction on the part of the holders of the Preference Shares as is required for a variation of the special rights attached to such shares, exceed an amount equal to 1.75 times the Adjusted Capital and Reserves (as defined in the Articles of Association).

3 Directors' Interests

Apart from the supply of telecommunications services and apparatus, no Director of the Company has, or has had within two years before the date of this Offer for Sale, any interest in any assets which have been, or which are proposed to be, acquired or disposed of by or leased to the Company or any of its subsidiaries. No contract or arrangement subsists,or subsisted within two years before the date of this Offer for Sale, in which a Director is or was materially interested and which is or was significant in relation to the business of the Company and its subsidiaries taken as a whole. No loans are outstanding from the Company to any Director. No Director has any interest in the share capital of the Company or its subsidiaries; executive Directors may participate in the employee share schemes described below, including the special employee arrangements for applying under the Offer for Sale or may apply, like any other member of the public, under the Offer for Sale.

It is estimated that the aggregate emoluments of the Directors receivable from British Telecom during the year ending 31st March 1985 under the arrangements in force on the date of the Offer for Sale would be £693,000 (1984—£489,010), within which Directors' emoluments would fall within the following ranges:

Ranges of emoluments	Number of Directors	Ranges of emoluments	Number of Directors
up to £5,000	1	£35,001 to £40,000	1
£5,001 to £10,000	2	£55,001 to £60,000	2
£10,001 to £15,000	1	£60,001 to £65,000	4
£30,001 to £35,000	1	£65,001 to £70,000	2

The Chairman's emoluments are estimated at £94,000. However, it is the intention of the Board, following the Offer for Sale, to implement substantial increases in the salaries of executive Directors to levels commensurate with those prevailing in other commercial companies. All the executive Directors have entered into service agreements with the Company. Such agreements expire, in the case of Sir George Jefferson and Mr. Vander Weyer on 5th August 1987; in the case of Mr. Alvey and Mr. Back on 31st August 1986; in the case of Mr. Hodgson on 31st October 1985; and in those cases contain no express provisions for extension. The initial term of the agreements for the remaining executive Directors is three years commencing on 5th August 1984; on the first anniversary of each agreement, the Company may offer to extend that agreement for a further three year term commencing on that date, and may also do so on the first anniversary of any such extended term, with final termination at the age of 60. There are no other service agreements, existing or proposed, between any of the Directors and British Telecom.

Mr. J. F. Goble, a non-executive Director of the Company, is also a partner in Herbert Smith & Co. which will receive fees for its professional services in acting for Kleinwort, Benson Limited and the other underwriters in connection with the underwriting agreements and certain other matters.

4 Special Arrangements for Employees and Pensioners

Up to 301,200,000 Ordinary Shares (representing ten per cent. of those now being offered for sale) are reserved for British Telecom employees and BTSSS pensioners. From this number, all applications received in respect of the 'Free Offer' and 'Matching Offer' described below will be met in full.

Under the Free Offer, each employee of British Telecom who is eligible to join the British Telecom Employee Share Ownership Scheme (the "Employee Share Ownership Scheme"), having been in continuous employment with British Telecom from 2nd April 1984 until 9th November 1984 and at any time in that period having been contracted to work 16 hours or more per week (excluding overtime), and who does so by 28th November 1984 will be given by HM Government, free of charge, 54 Ordinary Shares worth £70.20 at the Offer for Sale price. Under the Matching Offer, eligible employees may also purchase at the Offer for Sale price (payable in full on application) up to 77 Ordinary Shares worth £100.10 at the Offer for Sale price; for each Ordinary Share so purchased and held under the Employee Share Ownership Scheme, an employee will be given by HM Government, free of charge, two Ordinary Shares. All shares acquired and held under the Employee Share Ownership Scheme must be vested in the Trustees of that Scheme, and participants will be subject to the restrictions on dealing with those shares described in paragraph 5 below.

The remaining reserved shares will be available for application on special priority forms from all employees and BTSSS pensioners, subject to scaling down in the event of over application (the "Priority Offer"). A discount equal to 10 per cent. of the Offer for Sale price will be given on the final instalment payable in respect of the number of shares continuously held by an employee (up to a maximum of 1,600 shares) until the date on which the final instalment is payable (the "Discount Offer"). The aggregate value of all discounts available is limited to £10,000,000 in total, and applications in the Discount Offer may therefore be scaled down.

5 Employee Share Schemes

The Company has established three employee share schemes. Certain provisions of these schemes may be amended by the Directors, but their basic structure (and in particular the limitations on participation and on the number of ordinary shares that may be issued thereunder indicated below) cannot be altered without the prior sanction of the Company in General Meeting.

Employee Share Ownership Scheme

This Scheme, constituted by a Trust Deed dated 22nd October 1984 between the Company and British Telecom Employee Shares Trustees Limited as Trustees, has been approved by the Board of Inland Revenue under the provisions of the Finance Act 1978 (as amended) and will be used in conjunction with the Offer for Sale as described above.

The Scheme may also be operated to acquire shares on behalf of eligible employees in future years when the Trustees may be provided either with funds paid by the Company and participating subsidiaries and/or with funds or shares contributed by employees but (i) the total funds made available in any year by the Company and participating subsidiaries for the benefit of employees may not exceed 5 per cent. of the profit before corporation tax and extraordinary items of the preceding financial year attributable to the United Kingdom operations of British Telecom and (ii) the maximum value of ordinary shares appropriated to any individual participant in any year may not exceed the greater of £1,250 or 10 per cent. of salary (subject to a maximum of £5,000). Any further use of the Scheme will be at the discretion of the Directors, but it is not intended to operate it again before 1986, in respect of the year ending 31st March 1986, at the earliest.

Any ordinary shares subscribed for and issued under the Scheme will (subject to dividend and other entitlements arising by reference to a date prior to their issue) rank *pari passu* in all respects with the ordinary shares then in issue and will be subscribed at the average market value for the three dealing days on which ordinary shares are quoted ex-dividend following the relevant record date for eligibility. Application will be made to the Council of The Stock Exchange for their admission to the Official List.

As required by the Finance Act 1978, shares acquired by the Trustees at the expense of the Company and participating subsidiaries will be held by them for a minimum of two years during which they may not be sold except on death, the attainment of statutory pensionable age or cessation of service by reason of redundancy, injury or disability. For the following five years, the Trustees will retain such shares unless the employee concerned wishes to dispose of them, and thereafter they may be transferred to the employee. Shares provided by employees will be held by the Trustees for two years and may then be transferred to the employee. While any shares are so held in trust, the respective employees will be the beneficial owners and will be entitled to receive dividends and direct the exercise of voting rights.

Employee Sharesave Scheme

The Company has adopted a Savings-Related Share Option Scheme (the "Sharesave Scheme"), which has been submitted for approval to the Inland Revenue under the provisions of the Finance Act 1980.

To join the Sharesave Scheme, an eligible employee must enter into a Save-As-You-Earn contract ("Savings Contract"), thereby agreeing to make sixty monthly contributions of such amount as the employee shall determine, with a minimum of £10 and a maximum of £100 or such greater amount (not exceeding £150) as may from time to time be permitted by Statute.

Each employee so joining will be entitled to apply for options to subscribe for ordinary shares at a price determined by the Directors, being not less than the higher of (i) 90 per cent. of the market value of such shares (as agreed with the Inland Revenue) on the date of the invitation to take up options and (ii) their nominal amount. At the election of the Directors, options may be granted with maturities of 5 or 7 years provided that the number of shares is limited to that number which may be purchased at the subscription price out of the repayment proceeds (including bonus) of the relevant Savings Contract.

Options may only be offered by the Directors within six weeks of the date of the Offer for Sale and subsequently within six weeks of the announcement of the Company's interim or final results in any year.

Options will normally only be exercisable for a period of six months commencing on the appropriate fifth or seventh anniversary of the starting date of the related Savings Contract. Options may, however, be exercised earlier than this in the event of death, retirement by reason of injury or disability, redundancy, or at statutory or contractual retirement age (or, after three years from the date of grant, on early retirement, or on the transfer of the option holder's employing company out of British Telecom). In these circumstances, however, options may only be exercised in an amount not exceeding such part of the proceeds of an option holder's Savings Contract as represents repayments of contributions made together with any bonus or interest paid. Options are not transferable and will lapse if an option holder leaves the service of British Telecom other than in the circumstances referred to above. Options are also exercisable in the event of winding-up or liquidation of the Company.

Within 30 days of the exercise of an option, ordinary shares will be allotted and issued to the option holder concerned and such shares will rank (subject to dividend and other entitlements arising by reference to a date prior to their issue) *pari passu* with the ordinary shares in issue. An application will be made to the Council of The Stock Exchange for their admission to the Official List.

The Company will first operate the Sharesave Scheme shortly after the Offer for Sale when up to 2¼ per cent. of the then issued ordinary share capital will be made available for such options. Eligible employees who apply to join the Sharesave Scheme at this time will be granted options to subscribe for the shares at a subscription price of 90 per cent. of the market value of such shares using the proceeds (including the bonus) of a 5 year Savings Contract, but subject to scaling down in the event of over-application. The subscription price of the shares placed under option will be based on the average market value of the Interim Certificates and on the value of the outstanding instalments on the date of invitation to take up options or such earlier date or dates, not being before 10th December 1984, as may be agreed with the Inland Revenue.

Share Option Scheme

The Company has adopted a Share Option Scheme (the "Option Scheme"), which has been submitted for approval to the Inland Revenue under the provisions of the Finance Act 1984.

All full-time employees (including executive Directors) of the Company and its subsidiaries are eligible to be nominated for participation in the Option Scheme at the invitation of the Directors, who have a discretion in selecting employees to whom options are to be granted and in determining the number (subject to the limitations set out below) and terms of options to be so granted.

Options so granted will be for a period of 10 years and will entitle the recipient to subscribe for ordinary shares in the Company at a price determined by the Directors, being not less than the higher of (i) the market value of such shares (as agreed with the Inland Revenue) on the date of grant of the options and (ii) their nominal amount. Each individual's participation will be limited so that the aggregate prices of all shares issued and remaining issuable under options granted to him will not exceed four times the relevant individual's salary.

Options may only be granted by the Directors within six weeks of the date of the Offer for Sale and subsequently within six weeks of the announcement of the Company's interim or final results in any year.

An option will normally be exercisable only after the expiry of three years from the date of its grant. Options may, however, be exercised earlier than this in the event of death, retirement by reason of injury or disability, redundancy, or (at the discretion of the Directors) if the employee ceases to be employed by British Telecom otherwise than by reason of retirement or of any of these events. Options are not transferable and will lapse if an option holder leaves the service of British Telecom other than in the circumstances referred to above. Options are also exercisable in the event of winding-up or liquidation of the Company.

Within 30 days of the exercise of an option, ordinary shares will be allotted and issued to the option holder concerned and such shares will rank (subject to dividend and other entitlements arising by reference to a date prior to their issue) *pari passu* with the ordinary shares in issue. Application will be made to the Council of The Stock Exchange for their admission to the Official List.

The Company will first operate the Option Scheme shortly after the Offer for Sale when up to one-third of one per cent. of the issued ordinary share capital will be made available for such options. About 200 senior employees (including executive Directors) will be offered options in multiples not exceeding four times salary at the time of the Offer for Sale. The participants will be selected by a committee of the Chairman and non-executive Directors. The subscription price of the shares placed under option will be based on the average market value of the Interim Certificates and on the value of the outstanding instalments on the date of the grant of options or such earlier date or dates, not being before 10th December 1984, as may be agreed with the Inland Revenue.

Share Scheme Limits

The three schemes are subject to the following limits on the number of shares which may be acquired by subscription:

(a) not more than 600,000,000 ordinary shares (representing 10 per cent. of the issued ordinary share capital of the Company following the Offer for Sale) may be subscribed by the Trustees under the Employee Share Ownership Scheme using funds provided by the Company and participating subsidiaries;

(b) not more than 600,000,000 ordinary shares (representing 10 per cent. of the issued ordinary share capital of the Company following the Offer for Sale) may be issued pursuant to options granted under the Sharesave Scheme;

(c) not more than 300,000,000 ordinary shares (representing 5 per cent. of the issued ordinary share capital of the Company following the Offer for Sale) may be issued pursuant to options granted under the Option Scheme;

(d) in any year not more than 1 per cent. of the issued ordinary share capital of the Company may be subscribed by the Trustees of the Employee Share Ownership Scheme using funds provided by the Company and participating subsidiaries;

(e) in any 3 year period not more than 3 per cent. of such issued capital may in aggregate be so subscribed by the Trustees or placed under option under the Option and Sharesave Schemes;

(f) in any 10 year period not more than 10 per cent. of such issued capital may in aggregate be so subscribed by the Trustees or placed under option under the Option and Sharesave Schemes; and

(g) in any 10 year period not more than 5 per cent. of such issued share capital may be placed under option under the Option Scheme.

The limits in (a), (b) and (c) above, but not the percentages, may be adjusted in the event of capital reorganisations.

6 HM Government Investment Limit

The 1984 Act requires that as soon as the Company ceases to be wholly-owned by the Crown the Secretary of State shall fix a target investment limit for the Government shareholding in the Company. The first target investment limit will require the Secretary of State to ensure that the proportion of voting rights which are carried by the Government shareholding and which are exercisable in all circumstances at General Meetings of the Company is not increased beyond the proportion carried by the Government shareholding immediately following the Offer for Sale. The Secretary of State may from time to time fix a new target investment limit, which must be lower than the one previously in force.

7 United Kingdom Taxation

Taxation of Dividends

When paying a dividend, the Company has to remit to the Inland Revenue an amount of advance corporation tax ("ACT") at a rate which is related to the basic rate of income tax and is currently 3/7ths of the dividend paid. Accordingly the ACT related to a dividend currently equals 30 per cent. of the sum of the cash dividend plus the ACT.

For shareholders resident in the United Kingdom, the ACT paid is available as a tax credit, which individual shareholders who are so resident may set off against their total income tax liability or, in appropriate cases, reclaim in cash. A United Kingdom resident corporate shareholder will not be liable to United Kingdom corporation tax on any dividend received.

Whether holders of shares in the Company who are resident in countries other than the United Kingdom are entitled to a payment from the Inland Revenue of a proportion of the tax credit in respect of dividends on such shares depends in general upon the provisions of any double tax convention or agreement which exists between such countries and the United Kingdom. Persons who are not resident in the United Kingdom should consult their own tax advisers on the possible applicability of such provisions, the procedure for claiming payment and what relief or credit may be claimed in the jurisdiction in which they are resident for such tax credit.

The foregoing applies equally to holders of Interim Certificates.

Stamp Duty with respect to Interim Certificates

The Secretary of State is advised, and the Inland Revenue has confirmed, that:

(a) No transfer of entitlements evidenced by Interim Certificates will qualify for the nil rate of stamp duty on transfers for £30,000 or less laid down by section 55 Finance Act 1963 as amended by section 109 Finance Act 1984.

(b) Ad valorem stamp duty (currently at the rate of one per cent.) will be charged on the consideration for transfers of such entitlements, or in certain circumstances the market value if greater, but in each case ignoring the liability assumed in respect of unpaid instalments.

The Instalment Agreement provides that the Secretary of State will pay any stamp duty on the transfer of shares to the holders of Interim Certificates when the final instalment is paid.

8 Material contracts

The following contracts, not being contracts in the ordinary course of business, have been entered into within the period of two years immediately preceding the publication of this document and are, or may be, material:

(a) The Trust Deed dated 6th August 1984, made between the Company and The Law Debenture Trust Corporation p.l.c. as trustees under which the Loan Stocks are constituted;

(b) The Trustee Side Agreement and the Loan Stock Moratorium Agreement referred to in paragraph 1 above; and

(c) The agreement referred to in paragraph 13 (h) below.

9 Litigation

Neither the Company nor any of its subsidiaries is, or has in the recent past been, engaged in any litigation or arbitration which may have, or has had, a significant effect on the financial position (including results of operations) of British Telecom, and no litigation or claim which may have such an effect is known to the Directors.

10 Subsidiaries and Investments

(a) The following subsidiaries of the Company are currently trading:

	Country and year of incorporation	Share capital issued & fully paid	Percentage of share capital or interest held	Principal activity
British Telecom Cellular Radio Ltd.	England 1982	£2	100 per cent.	Cellular radio system equipment supplier
Telecom Securicor Cellular Radio Limited	England 1983	£2,400,000	51 per cent.	Cellular radio system operator and provider

(b) Since its incorporation, Telecom Securicor Cellular Radio Limited has issued, credited as fully paid, a total of 2,400,000 ordinary shares of £1 each, of which 1,224,000 were issued to British Telecom and 1,176,000 were issued to Securicor Communications Limited.

(c) British Telecom has invested a further £3 million in Intelsat during the period 1st April 1984 to 30th September 1984.

11 Unaudited Balance Sheets at 30th June 1983 and 30th June 1984

Unaudited Balance sheets as at 30th June 1983 and 1984 are set out below:

	At 30th June 1983 £m	At 30th June 1984 £m
Fixed Assets		
Tangible assets	8,290	8,922
Investments	96	125
Total fixed assets	8,386	9,047
Current Assets		
Stocks	118	223
Debtors		
Trade debtors	1,024	1,467
Accrued income	690	643
Prepayments	66	74
Short-term investments	247	218
Cash at bank and in hand	36	53
	2,181	2,678
Creditors: Amounts Falling Due Within One Year		
Short-term borrowings	77	131
Foreign loans	115	28
Lease finance	33	43
Trade creditors	1,035	1,266
Other creditors including taxation and social security	308	332
Accrued expenses	135	104
Deferred income	289	315
	1,992	2,219
Net Current Assets	189	459
Total Assets less Current Liabilities	8,575	9,506
Creditors: Amounts Falling Due After More Than One Year		
HM Government loans	2,944	2,790
Foreign loans	325	299
Lease finance	129	148
	3,398	3,237
Deferred tax	—	115
	5,177	6,154
Reserves	3,927	4,904
Long-Term (Excepted) Liabilities		
Deed of covenant to pension fund trustees	1,250	1,250
	5,177	6,154

12 Working Capital

The Directors consider that, taking account of available facilities, British Telecom has sufficient working capital for its present requirements.

13 Underwriting

(a) An Agreement (the "UK Underwriting Agreement") dated 16th November 1984 between the Secretary of State for Trade and Industry (the "Secretary of State") and Kleinwort, Benson Limited and the United Kingdom underwriters named therein (the "UK Underwriters") provides, *inter alia*, for the underwriting of 2,597,000,000 Ordinary Shares (the "UK Portion") in consideration of a commission payable by the Secretary of State to Kleinwort, Benson Limited on behalf of the UK Underwriters at the rate of 0.375 per cent. of the aggregate value at the Offer for Sale price of the UK Portion; in addition, the Secretary of State has agreed to pay fees to the Brokers to the Offer, and to Kleinwort, Benson Limited both as financial advisers to the Secretary of State and as his agent for the purposes of the Offer for Sale, together in each case with value added tax thereon.

(b) An exchange of letters (the "Bank of England Agreement") dated 16th November 1984 between the Secretary of State and the Governor and Company of the Bank of England (the "Bank") provides, *inter alia*, for the purchase of up to 415,000,000 Ordinary Shares (the "Overseas Portion") by the Bank, in consideration of a commission payable by the Secretary of State to the Bank at the rate of $1\frac{1}{4}$ per cent. of the aggregate value at the Offer for Sale price of the Overseas Portion, in the event that the Overseas Portion is not taken up by the Foreign Offerings referred to in (f) below, subject to the relevant provisions referred to in (g) below. The Bank of England Agreement provides that the Bank will not sell any Ordinary Shares so purchased by the Bank at a price of less than 63p per share prior to payment of the second instalment thereon or at a price of less than 103p per share during the period after the payment of the second instalment thereon and prior to the payment of the final instalment thereon, subject to appropriate adjustment to such prices in the event of a capitalisation issue or issue by way of rights of ordinary share capital by the Company or other reorganisation of such share capital.

(c) The UK Underwriting Agreement and the Bank of England Agreement contain certain warranties and indemnities by the Secretary of State. The UK Underwriting Agreement provides for termination, *inter alia*, in the event of material change in relevant conditions; if it is terminated, the Bank of England Agreement will also terminate.

(d) In respect of the whole of the UK Portion, invitations are being made on 16th November 1984 to institutional investors ("Priority Applicants") and to Swiss Bank Corporation International Limited (as referred to in (e) below), who will each be guaranteed a minimum number of the Ordinary Shares so offered ("Placing Shares"), in aggregate not exceeding 55 per cent. of the Ordinary Shares comprised in the UK Portion; Priority Applicants will also offer to purchase (subject to applications received under the Offer for Sale) up to the balance of the Ordinary Shares comprised in the UK Portion ("Commitment Shares"). Priority Applicants will receive from the Secretary of State a commission of $1\frac{1}{2}$ per cent. of the aggregate value at the Offer for Sale price of their Placing Shares and a commission of $1\frac{1}{4}$ per cent. of the aggregate value at the Offer for Sale price of their Commitment Shares. In the event that the UK Portion is not covered by applications from Priority Applicants, the UK Underwriters will act as Priority Applicants for Commitment Shares. Certain stockbrokers will receive from the Secretary of State a commission of 0.125 per cent. of the aggregate value at the Offer for Sale price on applications from Priority Applicants introduced by them.

(e) By an agreement dated 16th November 1984 between Kleinwort, Benson Limited and Swiss Bank Corporation International Limited ("SBCI"), SBCI has agreed to purchase 49,500,000 Placing Shares and has applied for 40,500,000 Commitment Shares for a commission of $1\frac{1}{4}$ per cent. of the aggregate value at the Offer for Sale price on the shares comprised in its application and a selling concession of $1\frac{1}{4}$ per cent. at the aggregate value of the Offer for Sale price on the shares in respect of which its application is accepted.

(f) It is expected that in the week commencing 26th November 1984, separate underwriting agreements in respect of the Overseas Portion will be entered into by the Secretary of State with (1) Morgan Stanley & Co. Incorporated and a syndicate of underwriters in the United States (the "US Underwriters"), (2) McLeod Young Weir Limited and a syndicate of underwriters in Canada (the "Canadian Underwriters") and (3) The Nomura Securities Co., Ltd. and a syndicate of underwriters in Japan (the "Japanese Underwriters"). These agreements are expected to contain provisions to the following effect: (i) the US, Canadian and Japanese Underwriters will agree to purchase a fixed number of shares which may in total be higher than the 415,000,000 shares provisionally allocated as the Overseas Portion; (ii) the US Underwriters will purchase the shares at a price of between $3\frac{1}{4}$ per cent. and $3\frac{3}{4}$ per cent. less than the offering price of the shares in the United States (which will be the US dollar equivalent of the United Kingdom Offer for Sale price); the Canadian Underwriters will receive commissions of between $3\frac{1}{4}$ per cent. and $3\frac{3}{4}$ per cent. of the aggregate value at the offering price in Canada (which will be the Canadian dollar equivalent of the United Kingdom Offer for Sale price); and the Japanese Underwriters will receive commissions of $2\frac{1}{2}$ per cent. of the aggregate value of the shares purchased at the United Kingdom Offer for Sale price. In addition, overseas underwriters will receive advisory fees and will be reimbursed for certain expenses and disbursements by HM Government.

(g) The UK Underwriting Agreement contains provisions whereby, at the discretion of the Secretary of State, the number of Ordinary Shares which the US Underwriters, the Canadian Underwriters and/or the Japanese Underwriters agree to purchase may exceed the Overseas Portion. In that case, the excess will be treated as applications under the Offer for Sale. The Bank of England Agreement contains provisions whereby, if the number of Ordinary Shares for which applications are made under the Offer for Sale (other than by Priority Applicants in respect of their Commitment Shares) exceeds the UK Portion, such applications will be used to reduce the commitment of the Bank to purchase Ordinary Shares in the event that shares taken up under the Foreign Offerings referred to in (f) above do not comprise all of the Overseas Portion.

(h) In respect of the Offer for Sale and the Foreign Offerings, the Company has entered into an Agreement dated 16th November 1984 with the Secretary of State and the Directors and certain employees of the Company whereby (i) the Directors have given to the Secretary of State a warranty relating to this Offer for Sale and the Directors, subject thereto, and certain employees have received an indemnity from the Secretary of State in relation to certain liabilities under the Offer for Sale and the Foreign Offerings; (ii) the Company has given to the Secretary of State an indemnity in relation to those parts of the offering documents which relate to British Telecom to be used in the Foreign Offerings and has received, subject thereto, an indemnity from the Secretary of State in relation to the Foreign Offerings; and (iii) the Company has undertaken to the Secretary of State to perform certain obligations in connection with the Offer for Sale and the Foreign Offerings.

(i) The Company has been advised that in each of the relevant jurisdictions (the United States of America, Canada and Japan) it potentially has liabilities in respect of material misstatements in or omissions from the registration statements and final prospectuses to be filed and/or distributed in connection with the Foreign Offerings, and that in most cases such liabilities would be strict. The Company has received an indemnity from the Secretary of State relating to such liabilities as described in (h)(ii) above.

14 Miscellaneous

(a) On admission to the Official List, the Ordinary Shares will be "wider-range investments" within the meaning of the Trustee Investments Act 1961.
(b) The expenses of the Offer for Sale to be borne by British Telecom are estimated to amount to £8,400,000 (exclusive of value added tax). The balance of the expenses of and incidental to the Offer for Sale (including underwriting commissions and the preliminary expenses of the Company) will be borne by the Secretary of State.
(c) S. G. Warburg & Co. Ltd. will receive a fee from the Company for its services as financial advisers to the Company, which is included in the expenses in connection with the Offer for Sale as referred to in (b) above.
(d) In addition to the underwriting commissions payable by HM Government to the underwriters described in paragraph 13 above, HM Government will pay commissions to United Kingdom stockbrokers, banks and other financial intermediaries on applications to the extent successful (other than Priority Applications and applications made by employees and pensioners under the special arrangements described above) bearing their stamps and their VAT registration number, if any, as follows:

(i) on any application up to £10,000 submitted through stockbrokers, 2 per cent. of the Offer for Sale price of which $1\frac{5}{8}$ per cent. (in the case of banks) and $1\frac{1}{4}$ per cent. (in the case of other financial intermediaries) will be reallowable;

(ii) on any application up to £10,000 submitted through banks, $1\frac{1}{2}$ per cent. of the Offer for Sale price;

(iii) on any application over £10,000 submitted through stockbrokers, 2 per cent. of the Offer for Sale price on the first £10,000 reallowable as set out above and $\frac{1}{2}$ per cent. on the balance of which $\frac{5}{16}$ per cent. (in the case of banks) and $\frac{1}{4}$ per cent. (in the case of other financial intermediaries) will be reallowable; and

(iv) on any application over £10,000 submitted through banks, $1\frac{1}{2}$ per cent of the Offer for Sale price on the first £10,000 and $\frac{1}{4}$ per cent. on the balance.

These commissions will only be payable (or reallowable) to United Kingdom recognised banks (within the meaning of the Banking Act 1979), the Bank of England and the National Girobank, stockbrokers and certain other financial intermediaries. In addition HM Government has agreed with certain overseas banks that commissions will also be payable to them on the same basis as applications submitted through United Kingdom banks.

The other United Kingdom financial intermediaries eligible for such commissions include:
Solicitors of the Supreme Court, Members of the Institutes of Chartered Accountants, Members of the Chartered Association of Certified Accountants, Licensed Deposit Takers within the meaning of the Banking Act 1979, Licensed Dealers as defined in the Licensed Dealers Rules 1983, Insurance Brokers as defined in the Insurance Brokers Registration Act 1977, Members of the: British Insurance Brokers Association, National Association of Securities Dealers and Investment Managers, Linked Life Assurance Group, Life Offices Association and Life Insurance Association.

Commissions payable by HM Government will be rounded down to the nearest 50p and will be paid together with value added tax thereon. No commission will be payable to any person who would otherwise be entitled to a payment of less than £2.

No commissions will be paid on multiple applications. HM Government reserves the right to audit any commissions that may be payable and has appointed Peat, Marwick, Mitchell & Co. as auditors for this purpose. HM Government further reserves the right to withhold payment of commissions in the event of stockbrokers, banks or other intermediaries failing to satisfy the auditors as to compliance with the foregoing.

(e) Hereditaments occupied by posts, wires, ducts and other apparatus used by British Telecom for the purpose of providing telecommunication services and which are outside buildings are rated in accordance with a formula authorised by a statutory order made from time to time under the Local Government Act 1974 and the General Rate Act 1967 (and equivalent legislation). The 1984 Act introduced the power to apply the procedure to such types of telecommunication apparatus within buildings. In February 1984, the Department of Trade and Industry gave assurances to British Telecom that there was no intention of implementing this power in relation to almost all British Telecom's telecommunication apparatus unless British Telecom were to decide to change its method of operation relating to the location of its apparatus. The effect of the power if it were to be exercised, would depend in part on the outcome of discussions which would have to take place between British Telecom, HM Government and the local authorities. The Company does not consider this would have a material effect on British Telecom's financial position.

(f) The installation on or above ground outside buildings of most of British Telecom's telecommunication apparatus is currently exempt from the requirement under the Town and Country Planning Act 1971 (and equivalent legislation) to obtain planning permission. The 1984 Act contains a power to repeal this exemption. HM Government proposes that the installation of minor telecommunication apparatus under the powers contained in Schedule 2 to the 1984 Act (the Telecommunications Code) should be deemed to be permitted development under a new General Development Order. Until the General Development Order is published, the practical effects of the change are difficult for the Company to predict, but the Company considers that the General Development Order is unlikely to have a material effect on British Telecom's financial position.

(g) HM Government has announced its intention to extend eligibility for Regional Development Grants to certain parts of the service sector. In deciding on new qualifying activities HM Government will seek to avoid payment of grant where this is unlikely to bring about an increase in the overall level of activity in the locality concerned. Value added network services and the provision of cable TV are likely to be qualifying activities in this context. The extension of Regional Development Grants to the service sector could have a minor favourable effect on British Telecom but could be of more benefit to some of its competitors.

(h) Kleinwort, Benson Limited and S. G. Warburg & Co. Ltd. have given and have not withdrawn their written consent to the issue of this document with the inclusion of their letter in the form and context in which it is included. Coopers & Lybrand have given and have not withdrawn their written consent to the issue of this document with the inclusion of their report and letter and the references thereto in the form and context in which each is included. R. Watson & Sons have given and not withdrawn their written consent to the issue of this document with the references to their name in the form and context in which they are included.

(i) The Directors have been advised that the Company is not expected to be a close company, as defined in the Income and Corporation Taxes Act 1970, immediately following the Offer for Sale.

(j) Any person (including any natural person, company, government or political subdivision thereof) which becomes the "beneficial owner" (as defined in the United States Securities Exchange Act of 1934, as amended) of more than 5 per cent. of the ordinary shares becomes subject, under the terms of the Exchange Act, to an obligation to file prescribed reports of beneficial ownership (and reports of changes in such ownership) with the United States Securities and Exchange Commission (the "SEC"), the New York Stock Exchange and the Company on the form prescribed by the SEC. Any person (including any individual, partnership or trustee) or company that becomes the beneficial owner of more than 10 per cent. of the ordinary shares becomes subject, under the terms of the securities legislation in certain provinces of Canada, to an obligation to file prescribed reports of beneficial ownership (and reports of changes in such ownership) with the Quebec, Ontario, Manitoba, Saskatchewan, Alberta and British Columbia securities commissions and with the Toronto Stock Exchange, in a prescribed form.

15 Documents Available for Inspection

Copies of the following documents may be inspected at the offices of Slaughter and May, 35 Basinghall Street, London EC2V 5DB during usual business hours on any weekday (Saturdays excepted) for a period of twenty one days following the date of this Offer for Sale:

(a) the Memorandum and Articles of Association of the Company;

(b) the 1984 Act and the relevant statutory instruments, directions, orders, consents and appointments thereunder;

(c) the licences granted to British Telecom referred to in Part I;

(d) the audited accounts of the Corporation for the two years ended 31st March 1984;

(e) the Accountants' Report together with their statement setting out the adjustments made in arriving at the figures contained in the Report;

(f) the written consents referred to in paragraph 14(h) above;

(g) the Instalment Agreement;

(h) the Trust Deed constituting the Employee Share Ownership Scheme, the rules of the Sharesave Scheme and the rules of the Option Scheme referred to in paragraph 5 above;

(i) the Directors' service agreements referred to in paragraph 3 above;

(j) the contracts referred to in paragraph 8 above;

(k) the mini-prospectus; and

(l) the UK Underwriting Agreement and the Bank of England Agreement.

Part V

Dealing Arrangements

If you are allocated shares under the Offer for Sale, you will be sent a Letter of Acceptance (a temporary document of title) in respect of those shares. It is expected that dealings on The Stock Exchange will commence on the dealing day following the announcement of the basis of allocation, for deferred settlement two dealing days after that on which Letters of Acceptance are posted. **Dealings prior to receipt of Letters of Acceptance will be at your risk and you must recognise that your application may not have been accepted to the extent anticipated or at all.**

The timetable for dealing arrangements and for payment of instalments is as follows:

Letters of Acceptance may be renounced until — 3 pm on 8th March 1985

By 'renouncing' a Letter of Acceptance—which involves the completion of a form ('Form X') on the Letter of Acceptance—you may sell or otherwise dispose of rights to the shares allocated to you free of stamp duty for a limited period. Detailed instructions will be set out in the Letters of Acceptance. Thereafter your rights will only be transferable in registered form and stamp duty will be payable by the person to whom they are transferred.

Your rights will be transferable by delivery of a completed transfer form together with a Letter of Acceptance or a temporary document of title issued to transferees — from 11th March to 3 pm on 31st May 1985

Notices for payment of the second instalment will be posted together with Interim Certificates — on 31st May 1985

Your rights will be transferable by delivery of the Notice for payment, the Interim Certificate and a completed stock transfer form — from 1st June to 3 pm on 24th June 1985

It should be noted that no transfer lodged for registration after 1st June 1985 with a Notice for payment and an Interim Certificate will be accepted for registration unless accompanied by the appropriate payment for the second instalment. This does not affect the special arrangements for Stock Exchange dealings set out below.

Payment of the second instalment will be evidenced by a receipt on your Interim Certificate; it must be paid by — 3 pm on 24th June 1985

The final instalment must be paid by — 3 pm on 9th April 1986

Full details regarding payment of the second and final instalments, together with the dealing and transfer arrangements after 24th June 1985, will be contained in the Notice for payment of the second instalment.

Special arrangements will apply for Stock Exchange dealings as follows:

Dealings in renounced form will cease on 6th March 1985.

Dealings on or after 28th May 1985 will be on the footing that the second instalment will be paid by the seller and will be for deferred settlement on or after 25th June 1985 against delivery of a stock transfer form and the Interim Certificate, duly receipted as noted above.

Special Dealing Arrangements

The Regional Coordinators listed below will effect sales and purchases of entitlements to Ordinary Shares in the Company at the following reduced rates of commission until 31st December 1986:

SALES		PURCHASES	
Value	Commission	Value	Commission
Below £300	£5	Below £300	£5
Up to £424	£7	Up to £606	£10

plus value added tax, contract stamp (if applicable) and, on purchases, stamp duty. Dealings in larger amounts will be at the normal commission rates.

Regional Coordinators

London
Hoare Govett Limited, Heron House, 319-325 High Holborn, London WC1V 7PB. 01-404 0344

Cazenove & Co., 12 Tokenhouse Yard, London EC2R 7AN. 01-588 2828

de Zoete & Bevan, 25 Finsbury Circus, London EC2M 7EE. 01-588 4141

Scrimgeour, Kemp-Gee & Co., 20 Copthall Avenue, London EC2R 7JS. 01-600 7595

Aberdeen
Parsons & Co., 25 Albyn Place, Aberdeen AB1 1YL. (0224) 589345

Belfast
Wm. F. Coates & Co., Northern Bank House, 8-9 Donegall Square North, Belfast BT1 5LX. (0232) 223456

Birmingham
Albert E. Sharp & Co., Edmund House, 12 Newhall Street, Birmingham B3 3ER. 021-233 3003

Smith Keen Cutler, Exchange Buildings, Stephenson Place, Birmingham B2 4NN. 021-643 9977

Bristol
Stock Beech & Co., Bristol & West Building, Broad Quay, Bristol BS1 4DD. (0272) 20051

Cardiff
Lyddon & Co., 113-116 Bute Street, Cardiff CF1 1QS. (0222) 480000

Edinburgh
Wood Mackenzie & Co., Ltd., Erskine House, 68-73 Queen Street, Edinburgh EH2 4NS. 031-225 8525

Bell, Lawrie, Macgregor & Co., P.O. Box 8, Erskine House, 68-73 Queen Street, Edinburgh EH2 4AE. 031-225 2566

Glasgow
Penney Easton & Co., P.O. Box 112, 24 George Square, Glasgow G2 1EB. 041-248 2911

Speirs & Jeffrey, 36 Renfield Street, Glasgow G2 1NA. 041-248 4311

Lincoln
Hill Osborne & Co., Royal Insurance Building, Silver Street, Lincoln LN2 1DV. (0522) 28244

Liverpool
Tilney & Co., 385 Sefton House, Exchange Buildings, Liverpool L2 3RT. 051-236 6000

Manchester
Henry Cooke, Lumsden Ltd., P.O. Box 369, Arkwright House, Parsonage Gardens, Manchester M60 3AH. 061-834 2332

Middlesbrough
Stancliffe Todd & Hodgson, P.O. Box 84, City House, 206-208 Marton Road, Middlesbrough, Cleveland TS4 2JE. (0642) 249211

Newcastle upon Tyne
Wise Speke & Co., Commercial Union House, 39 Pilgrim Street, Newcastle upon Tyne NE1 6RQ. (0632) 611266

Plymouth
Westlake & Co., Princess House, Eastlake Walk, Plymouth PL1 1HG. (0752) 20971

Reading
Heseltine Moss & Co., 30-31 Friar Street, Reading, Berkshire RG1 1AH. (0734) 595511

South East
Quilter Goodison & Co., Garrard House, 31-45 Gresham Street, London EC2V 7LH. 01-600 4177

Summary of Instalment Agreement

Payment of Instalments

Since the shares are to be paid for over a period of 17 months, special provision has been made to enable purchasers to sell freely and without prejudicing the interests of the Secretary of State as seller. Accordingly an agreement dated 16th November 1984 (the "Instalment Agreement") has been entered into between the Company, Lloyds Bank Plc (the "Custodian Bank") and the Secretary of State for Trade and Industry to which every purchaser will be a party. The machinery adopted by the Instalment Agreement provides that shares sold on instalment terms will be registered in the name of and retained by the Custodian Bank until they have been fully paid for. Initially, entitlements will be evidenced by Letters of Acceptance. As explained above, the Custodian Bank will on 31st May 1985 issue to each person, then entered in the register maintained by the Custodian Bank (persons for the time being so registered being referred to below as "Registered Holders") as entitled subject to the Instalment Agreement to Ordinary Shares ("Related Shares"), a Notice of Payment for the second instalment together with an Interim Certificate for his Related Shares. This certificate, however, will only be valid as evidence of rights to Related Shares for transfer purposes after 24th June 1985, if it has been receipted to evidence payment of the second instalment. Upon payment of the final instalment, the Related Shares themselves will be transferred to the Registered Holder free of stamp duty to him.

If any Registered Holder defaults upon the payment of any instalment on any Related Share, then the Secretary of State will be entitled through the agency of the Custodian Bank to cancel the sale of that Related Share and sell it to an alternative purchaser. In that event, such a Registered Holder will be entitled to repayment of the amount of any instalment already paid in respect of the Related Share, after deduction of any loss (including expenses) sustained by the Secretary of State in consequence of the Registered Holder's default. In the case of default on the second instalment, it is expected by the Secretary of State that the sale of Related Shares would normally be on the terms of the Instalment Agreement and accordingly that the new purchaser would be issued with an Interim Certificate crediting the second instalment as duly paid.

The Secretary of State reserves the right, as a condition of accepting payment tendered late and instead of cancelling the sale of Related Shares, to charge to the defaulting holder interest on the sum due for the period of default, calculated on a daily basis at 2 per cent. over the London Inter-Bank Offered Rate for seven day deposits in sterling. Such rate will be determined by the Custodian Bank as described in the Instalment Agreement.

Capitalisation Issues and Non-Cash Dividends

The Instalment Agreement contains special provisions with respect to capitalisation issues. If there is a capitalisation issue of Ordinary Shares ranking *pari passu* in all respects with the existing ordinary share capital of the Company, such shares are excluded from the contract of sale constituted by acceptance of this offer. However, the Instalment Agreement provides that each Registered Holder will be deemed, upon such an issue taking effect, to have agreed to purchase each of such shares on the formula basis described below and the Secretary of State will be deemed to have agreed to reduce the price for each of the existing shares already sold on the same formula basis. The formula prescribes that the price agreed to be paid for each original share is prorated over the original share and the new share(s) applicable thereto and the instalments remaining to be paid after the date of the capitalisation issue will likewise be prorated. In that way, all Registered Holders will be obliged to pay no less and no more for their increased holding than for the original holding and the right of the Secretary of State to receive further instalments in respect of each share will likewise remain unaffected save that such right will be prorated over the increased holding in the manner described. Where the Company makes a capitalisation issue of securities other than Ordinary Shares, or a non-cash distribution, to holders of the Ordinary Shares prior to the payment of the final instalment in respect of the Related Shares, the Custodian Bank will retain such issue or distribution until payment of such final instalment. The Custodian Bank will then transfer the same to the Registered Holder of such Related Shares. Registered Holders at the time when such an issue or non-cash distribution is transferred by the Company to the Custodian Bank may have a tax liability in respect of such issue or distribution which may fall to be satisfied before the Custodian Bank transfers such distribution to the Registered Holders entitled thereto following payment of the final instalment. See "Taxes etc" below.

Other Matters

A copy of the Instalment Agreement is available for inspection as noted in paragraph 15 of Part IV. Subject to the due payment of instalments and to "Capitalisation Issues and Non-Cash Dividends" above, the Instalment Agreement is designed to confer upon purchasers and their successors in title as nearly as practicable all the same rights and privileges, and to impose the same restrictions on rights, as are conferred or imposed on members of the Company by the terms of the Memorandum and Articles of Association of the Company. In particular, Registered Holders will be entitled to participate in cash dividends and rights issues, to vote at meetings and to receive documents in like manner as if they were registered members, but subject to the following special provisions which appear in the Instalment Agreement:

(a) Limitation on holdings: While the Instalment Agreement remains in effect, any disposals required under the provisions of the Articles of Association which limit the size of shareholdings as described in paragraph 2 of Part IV above will in general be of rights evidenced by Interim Certificates, rather than of the underlying shares and the Instalment Agreement provides for this.

(b) Limitations on duties and liability: The Instalment Agreement contains a number of limitations on the liabilities and duties of the three parties above-named to purchasers and their successors in title which are fully set out in the agreement and which include but are not limited to the following. The Company, the Custodian Bank and the Secretary of State agree only to use their reasonable endeavours in good faith to discharge the obligations specifically imposed upon them to purchasers or their successors in title by the Instalment Agreement. They will not be under any obligation or duty or have any liability whatsoever if delayed in or prevented from discharging those obligations or duties by the provision of some law whether present or future and of whatever territory, or by some Act of God, war, or other circumstance beyond their control. In particular, the parties will not be liable for accepting any document taken in good faith to be authentic although the same be forged or not authentic.

(c) Taxes etc: The Custodian Bank will not be liable for any taxes, duties or governmental charges or expenses which may become payable in respect of any Related Shares or rights and obligations evidenced by Interim Certificates, but if the Custodian Bank receives a demand for any such sum then the Custodian Bank has an absolute discretion whether to pay the same and if it decides to pay the same then such part of the sum demanded as is proportionate or referable to the Related Shares shall be payable on request by the Registered Holder or joint Registered Holders thereof to the Custodian Bank in accordance with the procedure set out in the Instalment Agreement. Failure by any Registered Holder to meet any such request may result in the sale of all or part of his entitlement.

(d) Amendment to the Instalment Agreement: The Instalment Agreement may be amended without the consent of the purchasers by agreement between the other parties for the purpose of curing any ambiguity, or of curing, correcting or supplementing any defective provision contained therein or in any manner which those parties may deem necessary or expedient and which does not in their opinion materially prejudice the purchasers. Provision exists for the calling of meetings of Registered Holders to consider any business which is appropriate for Registered Holders to consider, including approval of an alteration to the Instalment Agreement not falling within the foregoing power to amend. A resolution passed at such a meeting binds all holders.

(e) Taxation and compliance with laws and regulations: The Custodian Bank may require Registered Holders from time to time to execute or furnish such documents as may be necessary or appropriate to comply with any fiscal or other laws or regulations relating to the Related Shares or rights and obligations evidenced by Interim Certificates.

The above rights and remedies are in addition to other rights and remedies which the Secretary of State may have and the exercise or a failure to exercise or delay in exercising any of the foregoing rights or remedies or any other right or remedy either in whole or in part will not bar the exercise of any right or remedy (in relation to any default by one or more Registered Holders) against any or all Registered Holders thereafter.

Employees

This Part V does not apply to shares acquired by employees under the Free and Matching Offers described above.

Part VI

A. Bill Voucher and Share Bonus Arrangements

If you buy shares under this Offer for Sale, you may be eligible to receive from HM Government free of charge EITHER bill vouchers for use against British Telecom telephone bills OR a share bonus. These arrangements are special to the Offer for Sale.

Eligibility

To be eligible to apply for bill vouchers or the share bonus, you must apply for shares as an individual investing for yourself alone; or you must be investing jointly with one other individual, solely on behalf of one or both of you. Companies, partnerships, firms, trusts, associations and clubs are not eligible unless they are acting as nominees for which there are special provisions described below.

Bill Vouchers

Each bill voucher will have a face value of £18. The number of vouchers you receive will depend on the number of shares continuously held by you from the acceptance of your application for shares to certain qualifying dates, as shown in the table below. The maximum number of vouchers you can receive is 12.

	Qualifying dates						
	25th June 1985	23rd December 1985	23rd June 1986	23rd December 1986	23rd June 1987	23rd December 1987	Total
Number of shares held	Number of vouchers you receive						
200 to 399	1	—	—	—	—	—	1
400 to 799	2	—	—	—	—	—	2
800 to 1,599	2	2	—	—	—	—	4
1,600 to 2,399	2	2	2	2	—	—	8
2,400 or more	2	2	2	2	2	2	12

(For example, if you buy 800 shares under the Offer for Sale, you will be sent a total of 4 vouchers provided you hold that number of shares until and including 23rd December 1985. If you hold that number of shares only until 22nd December 1985, you will receive only 2 vouchers.)

Vouchers will be posted to you about six weeks after each qualifying date. In the case of joint investors, vouchers will be posted to the first named investor on the Application Form.

Conditions for Use of Vouchers

You will only be able to use one voucher against each telephone bill (which means a British Telecom bill or budget account statement including charges for telephone services). Each voucher will expire ten months after its qualifying date. You may use a voucher when paying a telephone bill by any method currently available (and which continues to be available at the time of payment) except at a bank or by means of a bank giro payment or a National Girobank transfer. If you normally pay by standing order or direct debit, you will have to send the voucher with your telephone bill to your local British Telecom area office.

Vouchers will be issued in your name or, in the case of joint investors, in both names. They can only be used against your telephone bill or that of your husband or wife. If you are investing jointly with one other individual, the vouchers can be used against the bills of either of you or your spouses. When used, names on vouchers will be checked against names on telephone bills. You or your spouse must, if required, be prepared to complete a declaration that the voucher is being used in accordance with these conditions. If you use a voucher against a telephone bill which is for less than £18, a credit will be carried forward except in the case of a final bill for a particular telephone number when the credit will be lost.

Share Bonus

You will be entitled to one extra share for every ten shares continuously held by you from the acceptance of your application for shares to the qualifying date, 30th November 1987. Up to a maximum of 4,000 shares held by you will count for this purpose and therefore the maximum number of extra shares you can receive is 400. You will not receive fractions of shares.

Those shares will be transferred to you as soon as practicable after the qualifying date (together with all rights attaching to those shares from the date of transfer). Any stamp duty on the transfer will be met by HM Government.

Applying for Bill Vouchers or the Share Bonus

If you wish to apply for either bill vouchers or the share bonus, you must complete EITHER Box A OR Box B on the Application Form. If you complete both boxes, you will be deemed to have applied for bill vouchers only. **Only one application for vouchers or the share bonus can be made on your behalf whether alone or jointly with someone else.**

If more than one such application is made on separate application forms, you will not be entitled to bill vouchers or the share bonus on any application whether or not it is accepted.

By applying for bill vouchers or the share bonus, you will be warranting that you are eligible to do so and that, in the case of bill vouchers, you will comply with their conditions of use.

Disposals of Shares and Loss of, and Changes in, Entitlement

Your entitlement to bill vouchers or the share bonus will depend on the minimum number of shares that you hold from the acceptance of your application for shares to relevant qualifying dates. Therefore if you dispose of shares during that period and your shareholding falls below its initial level, your entitlement may be reduced accordingly (whether or not you later acquire more shares). In the case of joint investors, a disposal by either of them will be treated as a disposal by both.

Any entitlement to receive bill vouchers or the share bonus will cease on death (although vouchers already issued will remain valid). In the case of joint investors, the surviving investor will remain eligible for bill vouchers or the share bonus. You will not receive bill vouchers so long as any instalment due on your shares remains unpaid and you will lose all rights to bill vouchers or the share bonus if as a result some part of your entitlement to shares is cancelled or proceedings are commenced to recover the instalment. The number of shares necessary to qualify for bill vouchers or which will qualify for the share bonus will be amended pro rata (ignoring fractions), if there is any capitalisation issue or any consolidation or subdivision of the Company's share capital.

United Kingdom Tax Position

The Inland Revenue has confirmed that the following will be its practice under existing law. Bill vouchers will be free of income tax but will reduce the base cost of your shares (by the value obtained from the vouchers) for capital gains tax purposes. The share bonus will be free of income tax but will be treated for capital gains tax purposes as if acquired at market value on 30th November 1987. However, you will not be liable to capital gains tax unless, in the financial year when you dispose of your shares, the total chargeable gains of that year of you and your spouse exceed the annual exemption limit, at present £5,600. Dealers in securities are covered by different tax arrangements.

Employees and BTSSS Pensioners

If you are an employee of British Telecom, you will not be eligible to apply for bill vouchers or the share bonus in respect of shares you acquire under HM Government's Free Offer and Matching Offer. However, you will be eligible in respect of any shares you buy under the special priority/discount arrangements. If you are a BTSSS pensioner, you will be eligible in respect of shares bought under your priority arrangements.

Applications by Nominees

Nominees may only apply for bill vouchers or the share bonus on behalf of one individual who would himself be eligible to apply. To qualify, the nominee must apply for shares jointly with the individual by entering the nominee's own name in Box 5 on the Application Form and the name of the beneficiary in Box 6. The nominee should sign Box 4 on the Application Form. Box 7 should be signed by the beneficiary or by the nominee on his behalf.

Bill vouchers will be issued in the names of the nominee and the beneficiary but can only be used by the beneficiary or his spouse.

A nominee means an investor who retains no beneficial interest in his shares nor any right to acquire such interest directly or indirectly from the beneficial owner.

Residents of Kingston-upon-Hull, the Channel Islands and Overseas

In view of the conditions for the use of bill vouchers described above, subscribers in Kingston-upon-Hull and the Channel Islands and overseas residents may wish to consider the share bonus. Special arrangements will be made to enable those investing under the overseas offerings to obtain an equivalent to the share bonus.

Definitions

Where the context requires, references to shares in this Part A include references to shares represented by Letters of Acceptance and to entitlements to shares evidenced by Interim Certificates. References to holding shares or Interim Certificates (except in the case of nominees) means being the beneficial owner of those shares as well as being (during the renunciation period) the addressee of the Letter of Acceptance relating to those shares and thereafter being the registered holder thereof in the register of the Custodian Bank or of the Company. Entitlements at qualifying dates will be measured by reference to the relevant register as at 3 pm on that date.

B. Procedure for Application

If you wish to apply for Ordinary Shares, you must complete the Application Form attached at the end of this document in accordance with the "Notes on How to Complete and Deliver the Application Form" set out below.

You should apply only once. Any multiple applications or suspected multiple applications are liable to be rejected or, in some circumstances, aggregated. Photocopies will not be accepted in any circumstances.

The right is reserved to reject, in whole or in part, any application; in particular any application which (alone or together with any other application made or believed to be made by or on behalf of the same applicant or another person associated with him) is for more than 600,000,000 Ordinary Shares will be rejected to the extent it exceeds that number and may also be scaled down thereafter.

If you wish to apply and you are not clear what to do, you should consult a bank manager, stockbroker (including the Regional Coordinators listed in Part V), accountant, solicitor or other professional adviser. Your attention is drawn to the arrangements for payment for the shares by instalments; until the final instalment has been paid, you will so long as you hold entitlements to shares be bound by the terms of and be party to the Instalment Agreement summarised in Part V.

Applications by Employees and BTSSS Pensioners

Special arrangements have been made in relation to employees of British Telecom and BTSSS pensioners.

Non-United Kingdom Applicants

No person receiving a copy of this document and/or an Application Form in any territory other than the United Kingdom, the Channel Islands or the Isle of Man may treat the same as constituting an invitation to him, nor should he in any event use such Application Form, unless in the relevant territory such an invitation could lawfully be made to him without compliance with any unfulfilled registration or other legal requirements. It is the responsibility of any person outside the United Kingdom, the Channel Islands and the Isle of Man receiving a copy of this document and/or an Application Form and wishing to make an application hereunder to satisfy himself as to full observance of the laws of the relevant territory in connection therewith, including the obtaining of any governmental or other consents or the compliance with other necessary formalities, and to pay any transfer or other taxes requiring to be paid in such territory in respect of the Ordinary Shares acquired by him under this Offer for Sale.

No applications will be accepted on the Application Form below from a US or Canadian person. A "US or Canadian person" means any individual who is a national of or resident in the United States or Canada, or their territories or possessions or any corporation, partnership or other entity created or organised in or under the laws of the United States or Canada, or their territories or possessions or any political subdivision thereof and any estate or trust which is subject to United States or Canadian federal income taxation regardless of the source of its income and shall include any United States or Canadian branch of a non-US or a non-Canadian person.

Successful Applications

The basis on which applications have been accepted will be announced as soon as possible after the application list closes; if there has been a heavy demand for shares, you may receive fewer than you applied for. If you are successful in whole or in part, you will be sent a temporary document of title, a Letter of Acceptance, for the Ordinary Shares allocated to you shortly after the announcement. The dealing arrangements are set out in Part V.

Unsuccessful or Partially Successful Applications

If your application is not accepted, all money paid on application will be returned (without interest) and, if your application is accepted in part, the balance of the money paid on application will be returned (without interest). Money will be returned as soon as practicable after the announcement of the basis of allocation. It will be sent by post at the risk of the applicant(s) concerned.

General

Applications hereunder are made on the basis that, without prejudice to their other rights, successful applicants shall not be entitled to set aside their purchase of shares hereunder. See condition (g)(xiv) below.

C. Terms and Conditions

(a) Acceptance of applications will be conditional upon the Ordinary Shares being admitted to the Official List of The Stock Exchange not later than 11th December 1984 (and until then your remittance may be presented for payment and if so it will be kept by a receiving bank in a separate bank account). If this does not happen your money will be returned (without interest).

(b) It is a condition of the Offer for Sale that the provisions relating to termination of the UK Underwriting Agreement referred to in paragraph 13(c) of Part IV are not implemented.

(c) The Instalment Agreement provides that the contract made by acceptance (whether in whole or in part) of any application shall for the purposes of that agreement constitute a separate contract for purchase and sale of each Ordinary Share agreed to be sold; this Section C shall be construed accordingly.

(d) Acceptance of an application by an eligible investor who has elected for the share bonus or the bill vouchers will entitle that investor to the share bonus or bill vouchers (as the case may be) upon the terms, and subject to conditions, set out in Section A of this Part VI.

(e) Save where the context otherwise requires, terms defined in this document bear the same meaning when used herein or in Application Forms.

(f) References herein to rights being effectively renounced mean the renouncee(s) being registered by the receiving banks in relation to the rights concerned.

(g) By completing and delivering an Application Form, you:

(i) offer to purchase the number of Ordinary Shares specified in your Application Form (or such smaller number for which the application is accepted) on the terms of and subject to the conditions set out in this document and the Instalment Agreement (and, in due course, subject to the Memorandum and Articles of Association of the Company) and agree to become a party to and be bound by all relevant provisions of the Instalment Agreement;

(ii) authorise the relevant receiving bank and the Custodian Bank to send a Letter of Acceptance for the number of Ordinary Shares for which your application is accepted and/or a cheque for any money returnable by post at your risk to the address of the person (or the first-named person) named in the Application Form and to procure that your name (and the names of any other joint applicants) is placed on the register of holders of Interim Certificates in respect of such Ordinary Shares the entitlement to which has not been effectively renounced and thereafter to procure that your name (and the names of any other joint applicants) is placed on the Register of Members of the Company in respect of such Ordinary Shares the entitlement to which is evidenced by Interim Certificates the right to which has not been effectively transferred;

(iii) agree that all documents in connection with the share bonus or bill voucher arrangements may be sent by post at your risk to the person (or, in the case of joint applicants, the first-named person) named in the Application Form to his address set out therein or such other address as may from time to time appear in the register of holders of Interim Certificates or the Register of Members of the Company against the name of such person;

(iv) agree that, in consideration of the Secretary of State agreeing that he will not prior to 1st January 1985 sell any of the Ordinary Shares the subject of this Offer for Sale to any person other than by means of one of the

procedures referred to in this Offer for Sale, your application cannot be revoked until 12th December 1984 and that this paragraph shall constitute a collateral contract between you and the Secretary of State which will become binding upon despatch to or receipt by a relevant bank of your application;
(v) agree that completion and delivery of the Application Form constitutes a warranty that your remittance will be honoured on first presentation;
(vi) warrant that no other application has been made on your behalf;
(vii) (if you also duly complete a box to apply for bill vouchers or the share bonus) thereby:
(1) warrant that you are eligible to do so in accordance with the provisions set out in Section A of Part VI;
(2) agree that, if you elect (or are deemed to have elected) for bill vouchers, you will comply with the conditions for use thereof set out in Section A of this Part VI; and
(3) agree that, if you complete both boxes, you will be deemed to have elected for the bill vouchers only;
(viii) declare that you are not a US or Canadian person and you are not applying on behalf of any such person. "US or Canadian person" has the meaning set out in Section B above;
(ix) agree that all applications, acceptances of applications and contracts resulting therefrom under this Offer for Sale shall be governed by and construed in accordance with the laws of England;
(x) warrant that, if you sign the Application Form on behalf of somebody else, you have due authority to do so;
(xi) agree that any Letter of Acceptance and any moneys returnable may be held pending clearance of your payment;
(xii) agree that, in respect of those Ordinary Shares for which your application has been received and is not rejected, acceptance of your application shall be constituted, at the election of the Secretary of State, either (a) by notification to The Stock Exchange of the basis of allocation (in which case such acceptance shall be on that basis) or (b) by notification of acceptance thereof to Lloyds Bank Plc;
(xiii) undertake to pay the second instalment by 3 pm on 24th June 1985 and the final instalment by 3 pm on 9th April 1986 for the Ordinary Shares in respect of which your application is accepted and the right to which has not been effectively renounced or transferred by you prior to the relevant time and date;
(xiv) agree that you will not be entitled to exercise any remedy of rescission for innocent misrepresentation at any time after acceptance of your application; and
(xv) confirm that in making such application you are not relying on any information or representation in relation to British Telecom other than either those contained herein or those contained in the mini-prospectus taken together with this document (the "prospectuses") and accordingly agree that no person responsible for the prospectuses, either of them or any part of them shall have any liability for any such other information or representations.

Copies of the Offer for Sale may be obtained from:

United Kingdom branches of

Allied Irish Banks
Bank of Ireland
Bank of Scotland
Barclays Bank PLC
Clydesdale Bank PLC
Cooperative Bank p.l.c.
Lloyds Bank Plc
Midland Bank plc
National Westminster Bank PLC
Northern Bank
The Royal Bank of Scotland plc
Trustee Savings Banks
Ulster Bank
Williams & Glyn's Bank plc
Yorkshire Bank PLC

Branches of the Post Office

The Brokers to the Offer (listed at the beginning of this document)

The Regional Coordinators (listed in Part V)

The Underwriters

Kleinwort, Benson Limited,
20 Fenchurch Street,
London EC3P 3DB.

Baring Brothers & Co., Limited,
8 Bishopsgate,
London EC2N 4AE.

Robert Fleming & Co. Limited,
8 Crosby Square,
London EC3A 6AN.

Lazard Brothers & Co., Limited,
21 Moorfields,
London EC2P 2HT.

Morgan Grenfell & Co. Limited,
23 Great Winchester Street,
London EC2P 2AX.

S. G. Warburg & Co. Ltd.,
33 King William Street,
London EC4R 9AS.

Charterhouse Japhet plc,
1 Paternoster Row,
London EC4M 7DH.

Hambros Bank Limited,
41 Bishopsgate,
London EC2P 2AA.

Lloyds Bank International Limited,
40-66 Queen Victoria Street,
London EC4P 4EL.

N. M. Rothschild & Sons Limited,
New Court, St. Swithin's Lane,
London EC4P 4DU.

Barclays Merchant Bank Limited,
15/16 Gracechurch Street,
London EC3V 0BA.

County Bank Limited,
11 Old Broad Street,
London EC2N 1BB.

Hill Samuel & Co. Limited,
100 Wood Street,
London EC2P 2AJ.

Samuel Montagu & Co. Limited,
114 Old Broad Street,
London EC2P 2HY.

J. Henry Schroder Wagg & Co. Limited,
120 Cheapside,
London EC2V 6DS.

Dated 16th November 1984

Notes on How to Complete and Deliver the Application Form

Your total investment	**Amount you pay now**	Number of shares you are applying for
£260	**£100**	200
£520	**£200**	400
£1,040	**£400**	800
£1,560	**£600**	1,200
£2,080	**£800**	1,600
£3,120	**£1,200**	2,400
£4,160	**£1,600**	3,200
£5,200	**£2,000**	4,000

Applicants for more than 4,000 shares should apply in multiples of 1,000 shares up to 20,000 shares, in multiples of 10,000 between 20,000 shares and 100,000 shares and in multiples of 50,000 shares thereafter.

1 **Having decided the amount of your total investment and using the table above, put in Box 1 (in figures) the amount you pay now.**

You may only apply for the numbers of shares set out above.

The amount you pay now is 50p per Ordinary Share. The second instalment of 40p is payable on 24th June 1985. The final instalment of 40p is payable on 9th April 1986. A reminder will be sent to investors before the second and final instalments become payable.

2 **Using the table above, put in Box 2 (in figures) the number of Ordinary Shares for which you are applying.**

3 **For bill vouchers, put "YES" in Box A. For the share bonus, put "YES" in Box B. Complete one box only.**

If you wish to apply for bill vouchers or the share bonus, you *must* complete Box A or B. If you complete both boxes, you will receive bill vouchers only. If you do not complete either box, you will not receive bill vouchers or the share bonus. You are advised to read the bill voucher and share bonus arrangements set out above (including the special arrangements for applications by nominees).

4 **Sign the Application Form in Box 4.**

The Application Form may be signed by someone else on your behalf if he is duly authorised to do so (individuals are reminded that, if they are signing for another person, they must enclose their power of attorney). A corporation should sign under the hand of a duly authorised official who should state his representative capacity.

By completing and delivering this Application Form, you declare that you are not a US or Canadian person and you are not applying on behalf of any such person. "US or Canadian person" has for this purpose the meaning set out in Part VI B of the Offer for Sale.

5 **Put your full name and address in BLOCK CAPITALS in Box 5.**

6 **You may apply jointly with other persons.**

You must then arrange for the Application Form to be completed by or on behalf of all the other joint applicants (up to a maximum of three). Their full names and addresses should be put in BLOCK CAPITALS in Box 6. **If you apply jointly with more than one other person, you will not be eligible for bill vouchers or the share bonus.**

7 Box 7 must be signed by or on behalf of the joint applicants.

8 **You must pin your cheque or bankers' draft to your completed Application Form. Your cheque or bankers' draft must be made payable to "BT Offer" for the amount payable on application and be crossed "Not Negotiable".** No receipt will be issued for this payment.

Your cheque or bankers' draft must be drawn in sterling on an account at a branch (which must be in the United Kingdom, the Channel Islands or the Isle of Man) of a bank which is either a member of the London or Scottish Clearing Houses or which has arranged for its cheques and bankers' drafts to be presented for payment through the clearing facilities provided for the members of those Clearing Houses (and must bear the appropriate sorting code number in the top right hand corner).

Applications may be accompanied by a cheque drawn by somebody else.

9 **You must send the completed Application Form by post, or deliver it by hand, so as to arrive not later than 10 am on 28th November 1984. You will find the instructions for the posting or delivery of your Application Form on the back of the Application Form.** If you wish to post your Application Form, please mark your envelope "BT Offer", use first class post and allow at least two days for delivery.

The right is reserved to present all cheques and bankers' drafts for payment on receipt by the receiving bankers.