

Report on directors' remuneration

As recommended by the Greenbury and Hampel reports, the *Remuneration Committee* is made up wholly of independent non-executive directors. It also complies with Section A of the best practice provisions of the Stock Exchange Listing Rules as they relate to executive directors.

The Committee's role is to agree the service contracts, salaries, other benefits, including bonuses and participation in the company's share plans, and other terms and conditions of employment of the executive directors and members of the company's *Group Executive Committee*. It has been chaired since 1 January 1996 by Sir Colin Marshall and its other members during the year were:

Dr Iain Anderson
Sir Ewen Fergusson
Keith Oates

The Committee met seven times during the year ended 31 March 1998. The Chairman and Chief Executive will normally attend meetings to discuss senior executive remuneration recommendations, except their own.

The Committee confirms that full consideration has been given to Section B of the Stock Exchange best practice provisions in framing its remuneration policy. Although the full Board considers itself ultimately responsible for both the framework and the cost of executive remuneration, the Board has delegated prime responsibility for these issues, together with control of executive remuneration packages, to the *Remuneration Committee*.

Remuneration policy

BT's executive remuneration policy is in line with the company's overall practice on pay and benefits, that is to reward employees competitively taking into account performance, market value and competitive pressures in the communications and IT sectors. The Committee does not seek to maintain any strict market position but rather to ensure that pay is set appropriately taking into account pay levels for comparable roles in a range of appropriate 'blue chip' companies both within and outside the telecommunications/hi-tech sectors. When making comparisons, the Committee benchmarks not only with companies in the telecommunications and IT sectors but also the largest companies by market capitalisation, such as the FT-SE 100 and, in particular, those organisations where the complexity of roles and of the business and the extent of international scope are similar. The Committee also

takes account of executive pay trends in the external market and increases in pay for other groups of employees in the company. As BT continues to compete in a global market for executives at this level, the Committee also looks at the global, and particularly, US markets.

Packages

The remuneration package for executive directors comprises:

- **Basic salary**

Salaries are reviewed (although not necessarily increased) annually. Salaries are increased only where the Committee believes that market adjustments are appropriate to reflect performance, increased responsibilities and/or market pressures. Salary adjustments were made during the year for a number of key executives, including Sir Peter Bonfield and Robert Brace. From 1 April 1998, fifteen months after their last increase, Sir Peter Bonfield's salary was increased from £570,000 to £617,500 and Robert Brace's salary increased from £300,000 to £330,000. Bill Cockburn was appointed to the Board on 1 April 1998. His salary is £450,000. However, for the 12 months from 1 March 1998 it has, at his request, been reduced by £120,000 to £330,000. The company will during that period make contributions of £120,000 to an unapproved retirement benefits scheme transferred from Bill Cockburn's previous employer. His bonus and other relevant benefits will continue to be determined on his base salary. Bill Cockburn received a payment of £120,150 in consideration of the loss of potential benefits from his previous employer.

- **Annual bonus**

The annual bonus plan is designed to focus on annual objectives and to reward senior executives appropriately for the results achieved against these objectives. Targets are set at the start of the financial year based on key corporate objectives – such as revenue growth, profitability, quality of service, customer satisfaction and people management. Specific weights are attached to each objective on the basis of the BT Corporate Scorecard. For Sir Peter Bonfield, bonus awards are based wholly, and for Sir Iain Vallance, primarily, on the achievement of group-wide objectives and results. Bill Cockburn's bonus to 31 March 1998 was also calculated on the achievement of group-wide objectives and results. From 1 April 1998, his bonus, in common

with Robert Brace and the other members of the *Group Executive Committee*, will be based on the achievement of a mix of group, divisional and personal objectives. The Committee retains the flexibility to enhance bonus awards where exceptional circumstances make this appropriate.

For Sir Iain Vallance and Sir Peter Bonfield, for 1997/98, the 'on target' bonus was 50% of salary subject to a maximum of 100% of salary. As explained in the *Chairman's statement*, Sir Iain takes up a part-time role later in the year. From that time he will not participate in any annual bonus plan.

Robert Brace's 'on target' bonus for the year was 32.5%, subject exceptionally to a maximum of 100% of salary for this year only. Bill Cockburn's bonus arrangements provide for an 'on target' bonus of 50% of salary subject to a maximum of 75%.

Bonus awards for executive directors for the year under review ranged from 41% to 65% of salary.

- **Long-term remuneration**
**BT Long Term Remuneration Plan/
BT Performance Share Plan**

The BT Long Term Remuneration Plan ('LTRP') was approved by shareholders at the 1995 AGM. It was designed to ensure that BT's remuneration package remains competitive, to encourage personal investment in BT shares, to foster community of interest with shareholders, to encourage key executives to stay with BT and to link reward and long-term corporate performance more effectively. Under the plan, shares are awarded to participants conditionally on the company meeting a pre-determined corporate performance measure and, normally, the participants still being employed by the BT Group at the end of a five-year period. The performance measure is BT's total shareholder return ('TSR') relative to the FT-SE 100. The initial value of the awards granted under the LTRP in 1997 as a percentage of salary ranged from 25% to 100%. Sir Iain Vallance has not participated in the LTRP.

As Bill Cockburn joined the company too late in the year to participate in the 1997 operation of the LTRP, he has been granted an award of shares under the BT Performance Share Plan ('PSP') to the value

of £150,000 at the date of the award.

Under the PSP, approved by shareholders at the 1995 AGM, shares are conditionally awarded to participants on the basis that they will only be entitled to these shares in full at the end of a three-year period (which may be extended up to five years) if the company has met a pre-determined corporate performance measure and the participants are still employed by the BT Group. The performance measure is the same as for the LTRP. The first potential vesting of awards under the PSP will be in 1998/99.

The future

The Remuneration Committee keeps under review remuneration arrangements to ensure that they provide an incentive to executives and align performance and reward with the interests of shareholders.

The Committee's policy is over time to increase the proportion of executives' overall remuneration packages which is performance-linked variable pay.

In furtherance of this policy, and to ensure BT's packages remain competitive, a Deferred Bonus Plan has been introduced. The deferred bonus will equal one-half of the gross annual bonus. It will be compulsorily deferred and applied to acquire BT shares, which will be held in trust for three years. Executives must continue to be employed for the whole of the holding period for the shares to be then transferred. Therefore, in addition to bonuses continuing to be based fully on performance, the value of the deferred bonus will now be aligned with the future fortunes of shareholders. Existing shares will be used for the deferred bonuses and the first deferred award will occur this year.

To increase the linkage with longer-term performance, the LTRP has been modified, and will now be called the Executive Share Plan. In previous years, part of the award was performance-linked only on grant and not also on vesting. This year and in the future all the awards will be subject to performance criteria over a five-year period, which will continue to be TSR. The level of the awards granted will continue to be based on the individual performance of the executives during the preceding year thereby ensuring that both the grant and vesting of awards will be performance-linked. Awards will be between 20% and 100% of salary and

will not exceed the level possible under the previous LTRP arrangement. From and including this year, the optional personal investment and the associated matching grant under the plan will no longer be made available.

To improve the alignment of performance with BT's business cycle, the performance period will now run from 1 April to 31 March in line with the company's financial year, and not from 1 August as in previous years. However, awards will continue to vest on 1 August.

BT Share Option Scheme

The BT Share Option Scheme for senior executives was not renewed after its expiry in January 1995. The last options were granted in December 1994.

Details of options exercised during the year ended 31 March 1998 and unexercised options are shown on page 39.

• Pensions

For executive directors and other senior executives the policy is to provide pension benefits of one thirtieth of final salary for each year of service with a two-thirds surviving spouse's pension. The executive directors and certain other senior executives have undertakings of pension benefits of two-thirds of final salary at normal retirement age with a two-thirds surviving spouse's pension. On death in service a lump sum equal to four times annual salary is payable together with a surviving

spouse's pension of two-thirds of the director's prospective pension. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded.

The primary means of providing pensions for the executive directors and their dependants is through the BT Pension Scheme (BTPS). All the executive directors, except Sir Peter Bonfield, are members of the BTPS. For members of the BTPS the company contributed, on average, 9.5% of salary to the scheme and the individual contributed 6% of salary in the year ended 31 March 1998.

Where an individual will not achieve the target level of pension benefit at normal retirement age because of the earnings cap, the company may make up the shortfall by purchasing additional service in the BTPS and/or through non-approved, unfunded arrangements.

On his retirement as full-time chairman on 31 July 1998 Sir Iain Vallance will be entitled to receive retirement benefits equivalent to two-thirds of his final salary. His surviving spouse's pension is two-thirds of his pension.

Sir Peter Bonfield's pension arrangements are unapproved and unfunded and provide for a pension of two-thirds of his final salary at age 60, inclusive of any retained benefits from his previous employment, and a surviving spouse's pension of two-thirds of his pension. He is entitled to a pension of 52% of salary at age 55. If retirement occurs between age 55 and 60, the percentage of salary to calculate the pension will

	Increase in accrued pension during year or to date of retirement in year (a)		Total accrued pension at year end or at date of retirement, if earlier (b)		Transfer value of increase in accrued benefit (c)	
	1998 £000	1997 £000	1998 £000	1997 £000	1998 £000	1997 £000
Sir Iain Vallance	9	9	332	312	159	98
Sir Peter Bonfield	18	18	41	22	276	184
R P Brace (d)	14	17	98	81	173	129
A W Rudge	10	24	193	179	92	297

(a) The increase in accrued pension during the year excludes any increase for inflation.

(b) The pension entitlement is that which would be paid annually on retirement at normal retirement age based on service to the end of the year or date of retirement if earlier.

(c) The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11 and excludes directors' contributions. The transfer value represents a liability of the company rather than any remuneration due to the individual and cannot be meaningfully aggregated with annual remuneration as it is not money the individual is entitled to receive.

(d) Comparative figures have been restated on a comparable basis.

increase on a uniform basis from 52% at age 55 to two-thirds at age 60. Bill Cockburn is a member of the BTPS and has an unfunded and unapproved arrangement to meet the shortfall resulting from the pensions cap. In addition he has a funded unapproved retirement benefits scheme transferred from his previous employer to which the company is making contributions of £120,000 over the 12 months from 1 March 1998. Mr Cockburn's salary has been reduced, at his request, by £120,000 during this period.

The table on page 35 shows the increase in the accrued benefits to which each director has become entitled during the year and the transfer value of the increase in accrued benefit.

- **Other benefits**

Other benefits include car and driver, personal telecommunications facilities, medical cover for the director and immediate family and financial counselling. In addition to his company car, Sir Iain Vallance has the use of a pool car in Scotland for occasional private use and pays tax accordingly.

Service agreements

It is the company's policy that all the executive directors have service agreements for a period of one year, that they contain provisions for the removal of a director through poor performance and deal with payments to which the director would be entitled if he was removed from office, except for misconduct. The initial three-year term of Sir Peter Bonfield's contract was last year extended, as part of the preparations for the merger with MCI, to 31 December 1999 after which time it can be terminated by either party giving twelve months' notice. Bill Cockburn has an initial two-year contract effective from 1 October 1997 which can be terminated at any time after 30 September 1999 by either party giving 12 months' notice. Sir Iain Vallance's and Robert Brace's contracts can be terminated by the director or BT giving 12 months' notice.

Outside appointments

The Committee believes there are significant benefits to both the company and the individual from executive directors accepting non-executive directorships of companies outside the BT Group. The Committee will consider approving up to two external appointments for which the director may retain the fees.

Non-executive directors' remuneration

The Board has delegated the determination of remuneration for non-executive directors to the Chairman and Chief Executive. They seek external advice on appropriate levels of remuneration. Section A of the best practice provisions of the Stock Exchange Listing Rules says that non-executives' remuneration should be determined by the Board. As the intention is that two-thirds of the BT Board are non-executives who could not vote on their own remuneration, the Board does not consider it appropriate for the whole Board to undertake this role.

The basic fee for non-executive directors, which includes membership of one committee, is £25,000 per year. Additional fees for membership of most other Board committees range from £3,000 to £5,000 per year. Committee chairmen receive an additional fee of £2,000 a year for each committee they chair. Sir Colin Marshall received an inclusive fee of £65,000 last year as Deputy Chairman which increased to £75,000 with effect from 1 April 1998.

Directors' remuneration

The remuneration (excluding pension arrangements) of the directors was as follows:

	Salary and fees		Annual bonus		Deferred bonus		Benefits excluding pension (a)		Total	
	1998 £000	1997 £000	1998 £000	1997 £000	1998 £000	1997 £000	1998 £000	1997 £000	1998 £000	1997 £000
Sir Iain Vallance	500	485	325	185	-	-	37	32	862	702
Sir Peter Bonfield	570	499	325	225	163(c)	-	43	30	1,101	754
R P Brace	300	273	162	110	59(c)	-	23	17	544	400
A W Rudge	208	286	70	116	-	-	11	15	289	417
Sir Colin Marshall	65	65	-	-	-	-	-	-	65	65
J I W Anderson	38(b)	31(b)	-	-	-	-	-	-	38	31
M Argent	52	46	-	-	-	-	1	1	53	47
Sir Ewen Fergusson	38	33	-	-	-	-	-	-	38	33
J K Oates	35	30	-	-	-	-	-	-	35	30
B E Breuel	22	20	-	-	-	-	-	-	22	20
Y M Newbold	8	29	-	-	-	-	-	-	8	29
B C Roberts	-	-	-	-	-	-	-	-	-	-
G H Taylor	-	-	-	-	-	-	-	-	-	-
Rt Hon Lord Tebbit	-	18	-	-	-	-	-	-	-	18
Total remuneration	1,836	1,815	882	636	222	-	115	95	3,055	2,546

(a) Includes such benefits as described on page 36. 1997 figures have been restated.

(b) Payments to non-executive directors include fees paid to their principal employer of £38,000 (1997 – £30,996).

(c) This amount has been awarded, by way of a deferred bonus, for the year ended 31 March 1998. This award will be applied in buying BT shares with a market value no greater than the amount of the award. The executive will receive those shares after three years only if he is still employed by the company.

The directors' long-term remuneration benefits, through the exercise of share options, were as follows:

	1998 £000	1997 £000
Sir Iain Vallance	415	3
R P Brace	-	6
A W Rudge	442	-
M Argent	-	84

The figures in the above table are based on the amount by which the market value of the shares on the date of exercise exceeded the option price. The figures for 1998 include the employee compensation for the special dividend (see note 3 to the financial statements).

Under the terms for his leaving the company, Michael Hepher continued to receive his salary and contractual benefits until his service contract expired on 5 August 1997. The total salary payable during the year ended 31 March 1998 was £149,113 and he received other benefits of £2,401. In the prior year, he received salary of £430,000 and £80,000 in lieu of benefits. Other benefits for the year ended 31 March 1997 were £14,239.

Yve Newbold retired on 30 June 1997, Dr Alan Rudge on 31 October 1997, Gerald Taylor on 9 November 1997, Bert Roberts on 17 March 1998 and Birgit Breuel on 31 March 1998. Gerald Taylor agreed to waive fees of £13,383 (1997 – £8,587) for the year ended 31 March 1998. In the previous financial year, Gerald Taylor joined the Board on 4 November 1996 and Lord Tebbit retired on 2 November 1996. Sir Michael Bett, who retired on 31 January 1996, remains chairman of Cellnet Group Limited, a subsidiary company for which he received fees of £15,000 (1997 – £15,000) during the year ended 31 March 1998. Yve Newbold remains on the Community Affairs Committee for which she received fees of £3,750 after her retirement.

Directors' interests

The interests of directors and their families in the company's shares at 31 March 1998 and 1 April 1997 are shown below:

Beneficial holdings	1998	1997
Sir Iain Vallance	208,366	185,756
Sir Peter Bonfield	9,228^(a)	8,305 ^(a)
R P Brace	30,103^(a)	20,231 ^(a)
Sir Colin Marshall	2,000	2,000
J I W Anderson	4,155	–
M Argent	17,988	17,988
B E Breuel	–	–
Sir Ewen Fergusson	–	–
J K Oates	3,810	3,764

(a) Includes 9,094 shares (1997 – 8,305 shares) purchased and held by Sir Peter Bonfield and 21,841 shares (1997 – 16,710 shares) by Robert Brace in the Long Term Remuneration Plan (see note 28 to the financial statements).

Details of share options held at 1 April 1997, granted and exercised under the share option schemes during the year, and the balance held at 31 March 1998 are as follows:

	Number of shares under option			Option exercise price per share	Market price at date of exercise	Usual date from which exercisable	Usual expiry date	
	1 April 1997	Granted	Exercised					31 March 1998
Sir Iain Vallance	55,189	–	55,189 ^(b)	–	264p	502p	07/09/92	07/09/99
	100,207	–	100,207 ^(b)	–	289p	502p	07/12/93	07/12/00
	57,957	–	–	57,957	333p		09/03/95	09/03/02
	20,770	–	–	20,770	430p		04/03/96	04/03/03
	3,760	–	–	3,760	375p		08/12/97	08/12/04
	237,883	–	155,396	82,487				
Sir Peter Bonfield	6,460	–	–	6,460	267p		14/08/01	14/02/02
R P Brace	136,890	–	–	136,890	263p		06/09/92	06/09/99
	18,680	–	–	18,680	289p		07/12/93	07/12/00
	18,020	–	–	18,020	333p		09/03/95	09/03/02
	24,890	–	–	24,890	430p		04/03/96	04/03/03
	30,180	–	–	30,180	460p		15/11/96	15/11/03
	23,470	–	–	23,470	375p		08/12/97	08/12/04
	2,265	–	–	2,265	320p		14/06/98	14/12/98
	3,876	–	–	3,876	267p		14/08/01	14/02/02
	258,271	–	–	258,271				
A W Rudge ^(c)	60,000	–	60,000 ^(d)	–	264p	517p	07/09/92	07/09/99
	65,622	–	65,622 ^(d)	–	289p	517p	07/12/93	07/12/00
	34,534	–	34,534 ^(d)	–	333p	517p	09/03/95	09/03/02
	10,940	–	–	10,940	430p		04/03/96	04/03/03
	2,745	–	2,745 ^(e)	–	265p	458p	14/06/97	14/12/97
	2,460	–	–	2,460	375p		08/12/97	08/12/04
	2,254	–	–	2,254	306p		14/06/00	14/12/00
	178,555	–	162,901	15,654				

(a) All of the above options were granted for nil consideration.

(b) Options exercised under the BT Share Option Scheme on 9 January 1998.

(c) Dr Rudge retired as a director of the company on 31 October 1997.

(d) Options exercised under the BT Share Option Scheme on 14 January 1998.

(e) Options exercised under the BT Employee Sharesave Scheme, in which all employees of the company are eligible to participate, on 16 June 1997.

Unrealised gains on the above share options at 31 March 1998, based on the market price of the shares at that date, excluding the employee compensation for the special dividend which is discretionary in respect of directors' share options, were as follows:

	Options exercisable			Options not exercisable		
	Number of shares	Unrealised gains		Number of shares	Unrealised gains	
		1998 £000	1997(a) £000		1998 £000	1997(a) £000
Sir Iain Vallance	82,487	240	325	-	-	3
Sir Peter Bonfield	-	-	-	6,460	25	12
R P Brace	252,130	831	303	6,141	22	26
A W Rudge	15,564	39	252	-	-	10

(a) Based on options outstanding at 31 March 1997 and the market price of the shares at that date.

The market price of the shares at 31 March 1998 was 650p (1997 – 445.5p) and the range during the year ended 31 March 1998 was 379.5p to 685p.

Details of the company's ordinary shares provisionally awarded to directors, as participants under the Long Term Remuneration Plan (note 28 to the financial statements), were as follows:

	Total number of award shares(a)			Range of value of award(b)		
	1 April 1997	Awarded	Dividends reinvested	31 March 1998	Minimum £000	Maximum £000
Sir Peter Bonfield	125,137	98,100	17,183	240,420	314	1,563
R P Brace	169,161	65,400	22,348	256,909	301	1,670
A W Rudge	110,045	-	13,983	124,028	161	806

(a) Excluding shares purchased by each director under the plan (see page 38).

(b) Based on the market value of the company's shares at 31 March 1998. The minimum figure represents those shares held at 31 March 1998 which will transfer to each director at the end of year five of the plan (1999 to 2002). The maximum figure represents all shares held at 31 March 1998 which will transfer to each director at the end of year five of the plan (1999 to 2002) provided the corporate performance measure has been fully met. Normally shares will transfer only if the individual is still employed by the group. However, the plan gives discretion to preserve awards of shares after retirement. Under this discretion, Dr Rudge's awards have been preserved until the end of year five of the plan.

At 31 March 1998, Sir Iain Vallance, Sir Peter Bonfield and Robert Brace each had a non-beneficial interest in 21,919 shares (1997 – 62,891) purchased by BT Employee Shares Trustees Limited for allocation to employees under the BT Employee Share Ownership Scheme, and 10,467,987 shares (1997 – 6,206,481) held in trust by Ilford Trustees (Jersey) Limited for allocation to participating employees under the Long Term Remuneration Plan and the Performance Share Plan.

No director had any interest in the debentures of the company or in the share capital or debentures of its subsidiaries.

On appointment to the Board on 1 April 1998, Bill Cockburn had a beneficial interest of 4,181 shares in the company. During the year ended 31 March 1998, he was awarded 32,520 shares under the Performance Share Plan (note 28 to the financial statements). He will only be entitled to these shares in full at the end of a period ending on 31 July 1998 (which may be extended for a further two years), if the company has met a pre-determined corporate performance measure and he is still employed by the BT group.

There have been no other changes in the directors' interests in the share capital or in the debentures of the company and its subsidiaries between 31 March 1998 and 26 May 1998.

Sir Colin Marshall

Deputy Chairman and Chairman of Remuneration Committee

26 MAY 1998