

## Ofcom proposals for the legal separation of Openreach from British Telecommunications plc

Report prepared for Sky UK Limited on the associated pension issues and considerations

### 1 Introduction

**This report has been prepared by Sacker & Partners LLP for Sky UK Limited.**

Sackers is the UK's leading law firm for the pensions and retirement savings industry.

As a specialist practice working exclusively in the pensions industry, everything the firm's specialist lawyers do is geared towards advising clients in relation to pensions. Sackers provides strategic legal advice to the sponsoring employers of workplace pension schemes and corporate investors on all aspects of pensions and retirement savings. Sackers also advises over 500 occupational pension schemes across all industry sectors and across all sizes and structures. The firm's largest pension scheme clients represent 15% of all UK pension scheme assets.

Sackers' specialist pensions, banking and investment lawyers have vast experience, gained over many years, of advising on the whole ambit of the pension issues and solutions covered by this report.

### 2 Executive Summary

- 2.1 On 25 February 2016 Ofcom issued a statement of initial conclusions on its Strategic Review of Digital Communications. In its statement, Ofcom concluded that continuing the status quo was not an option and that it had taken the decision to reform the relationship between the Openreach business and the BT Group in order to give Openreach greater independence and autonomy.
- 2.2 Ofcom has indicated that it would prefer to do this through functional and legal separation, which means making Openreach a wholly-owned subsidiary of the BT Group, with its own purpose, board of directors and governance arrangements.
- 2.3 We have concluded that there is no bar from a pensions perspective to achieving functional and legal separation of Openreach in this way i.e. it is technically possible to manage the legal issues relating to Openreach employees' defined benefit pension liabilities held currently in the BT Pension Scheme.
- 2.4 The most straightforward and least intrusive way to achieve functional and legal separation from a pension perspective would be to permit the newly formed

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Openreach subsidiary to join the BT Pension Scheme as a participating employer. This is the premise supporting options 1 and 2 set out in our report. Under both of those options, the participation of Openreach in BTPS would be restricted to only those Openreach employees who currently participate in BTPS. Under option 1<sup>1</sup> Openreach would assume responsibility for making contributions to cover future service pension costs only with past service liabilities remaining with British Telecommunications plc. Under option 2<sup>2</sup>, in addition to paying future service pension costs, Openreach would take on the contractual responsibility for paying a share of deficit contributions in respect of the past service liabilities of its employees who have pension benefits in the BT Pension Scheme.

- 2.5 Our report identifies other possible options for dealing with BT Pension Scheme liabilities attributable to current and former employees in the Openreach business. For the benefit of those with limited experience of pension matters, it is worth noting that all the options described, whilst technical in nature, are quite ordinary in a UK pension law context. They are all tried and tested methods that have been employed for many years by a variety of companies and trustee boards faced with internal corporate restructurings, the segregation of certain businesses within a group and demergers of subsidiaries.
- 2.6 All the pension options we have identified would be made significantly easier to implement if, on the functional and legal separation of Openreach, the Government were to amend the Crown Guarantee<sup>3</sup> to cover the pension liabilities of Openreach under the BT Pension Scheme.
- 2.7 The Crown Guarantee only applies in the unlikely event of a winding up of BT plc and in that circumstance covers BT plc's obligations to make contributions (including deficit payments) to BT Pension Scheme in respect of all BT plc employees past and present, whether they joined the scheme pre or post privatisation.
- 2.8 It is important to recognise that amending the Crown Guarantee to ensure that the pension liabilities relating to Openreach in the BT Pension Scheme remain covered, would *not* increase the total liabilities which are currently the subject of that guarantee because:
- at present, the Crown Guarantee already covers BT Pension Scheme liabilities for all the employees working in the Openreach business employed by BT plc, for both their past and, notably, their *future* service;
  - on the creation of Openreach as a separate legal entity, those employees would be transferred into Openreach with the likelihood that their pension liabilities, either in whole or in part,<sup>4</sup> will become the responsibility of Openreach and it would be those liabilities which would be the subject of the Crown Guarantee extension.

<sup>1</sup> For further details on option 1 please see section 8.2 below.

<sup>2</sup> For further details on option 2 please see section 8.3 below.

<sup>3</sup> The Crown Guarantee is the name being used to describe a statutory guarantee that was given by the Secretary of State under the Telecommunications Act 1984 to BT plc on privatisation. See section 4, paragraphs 4.11 to 4.13 below.

<sup>4</sup> For example, under option 2 all past *and* future service liabilities would pass to Openreach ; under option 1 only the future service liabilities would pass to Openreach – see section 8 below for details.

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### 3 Scope and objectives of this report

3.1 On 25 February 2016, Ofcom issued a statement of initial conclusions on its Strategic Review of Digital Communications. In its statement, Ofcom concluded that continuing the status quo was not an option and that it had taken the decision to reform the relationship between Openreach and the BT Group, in order to give Openreach greater independence and autonomy.

3.2 Ofcom stated that there were two options to achieve this:

1. Structural separation; or
2. Functional and legal separation.

Ofcom has indicated that it would prefer to consider functional and legal separation, but that *“if functional separation cannot be strengthened then it reserves the right to take forward structural separation”*<sup>5</sup>.

3.3 In this report, we have taken:

- **Structural separation** of Openreach from the BT Group to mean the splitting of the vertically-integrated Openreach operations into a separate legal entity, with no significant common ownership between BT and Openreach and restrictions to prevent re-entry of either entity into the other’s market; and
- **Functional and legal separation** of Openreach from the BT Group to mean the establishment of the vertically-integrated Openreach operations into a separate legal entity within the BT Group, with Openreach remaining under BT Group ownership, being a wholly owned subsidiary of BT plc.

3.4 The scope and objectives of this report are to identify what would need to be done from a pensions perspective to achieve functional and legal separation and to consider the potential effects/consequences that might arise. The report considers the pension issues and possible effects on employees’ pension promise that would be associated with achieving a functional and legal separation of the Openreach business.

3.5 When considering the possible options to address functional and legal separation, we have sought to apply a proportionality test i.e. to indicate the least disruptive pension option for achieving the outcome of the Openreach division becoming a wholly-owned subsidiary of BT plc.

3.6 Three obstacles from a pensions perspective have been raised concerning the viability of achieving a functional and legal separation:

- 3.6.1 the pension benefits of those employees engaged in the Openreach business who remain entitled to defined benefit pensions under BT Pension Scheme;

<sup>5</sup> Ofcom: Making Communications work for everyone: initial conclusions from the Strategic Review of Digital Communications dated 25 February 2016, see paragraphs 1.42 to 1.49 on pages 8 and 9.

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3.6.2 the existence of the “Crown Guarantee” which relates to BT plc’s defined benefit pension liabilities; and

3.6.3 the impact that creating Openreach as a wholly-owned subsidiary would have on the financial employer covenant afforded to BT Pension Scheme.

3.7 In this report:

- in section 4, in order to inform the debate on the above three issues, we provide a brief history of the BT Pension Scheme and explain the extent of the Crown Guarantee;
- in section 5 we consider what is meant by the “employer covenant” and summarise BT’s current funding arrangements for the BT Pension Scheme;
- in section 6 we explain the legal impact that a transfer of staff to a newly created Openreach subsidiary would have on pensions benefits;
- in section 7 we discuss the possible amendment of the Crown Guarantee to Openreach; and
- in section 8 we detail four possible options for dealing with pensions on a functional and legal separation of the Openreach business and consider the advantages and disadvantages of each, having regard to the issues raised under section 3.6 above.

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## 4 BT Pension Scheme (BTPS)

- 4.1 The BT Pension Scheme is the largest private sector occupational pension scheme in the UK. It provides “defined benefit” pensions which are pensions calculated using a member’s pensionable service and a pre-determined fraction of salary. As at 30 June 2015, BT Pension Scheme Trustee Limited, the sole Trustee of the BT Pension Scheme, reported that net assets were £43.084 billion<sup>6</sup> compared with liabilities of £53 billion<sup>7</sup>.

### History pre-privatisation

- 4.2 Before 1969, those engaged in the telecommunications business now conducted by BT were employed by the Post Office. In that role those employees were entitled to a Civil Service defined benefit pension. In 1969 the Post Office was separated out from the Civil Service, becoming a statutory corporation. It was also given the statutory power to set up a trust-based defined benefit pension scheme, which it did on 24 September 1969, being the Post Office Staff Superannuation Scheme (“**POSSS**”). POSSS provided equivalent pension benefits to those promised to telecommunications business employees by the Civil Service.
- 4.3 In 1981, the Post Office’s telecommunications business was hived off to a new statutory corporation, the British Telecommunications Corporation (the “**Corporation**”) by the British Telecommunications Act 1981. Those employees employed in the telecommunications business who had been in Post Office employment were transferred to employment with the new Corporation with effect from 1 October 1981. Despite being employed by the Corporation, they continued to build up pension benefits in the POSSS.
- 4.4 On 2 March 1983 the Corporation entered into a Trust Deed (with Rules attached), which established The British Telecommunications Staff Superannuation Scheme (“**BTPS**”) with effect from 31 March 1983<sup>8</sup> <sup>9</sup>. The BTPS Rules provided pension and death benefits that mirrored those promised under the POSSS rules.
- 4.5 Corporation employees who were members of the POSSS then joined BTPS for future service pension and death benefits with effect from 31 March 1983. The assets and liabilities relating to the accrued pension benefits in the POSSS for Corporation employees were then transferred into BTPS. The effect of the asset transfer from the POSSS to the BTPS was that the Corporation assumed all responsibility for the continued funding of the pension benefits that had built up for employees in the POSSS prior to joining BTPS.

<sup>6</sup> Source: Trustee newsletter for active members dated February 2016 issued by BT Pension Scheme Trustees Limited.

<sup>7</sup> Source: Financial Times, 17 June 2016

<sup>8</sup> Source: British Telecommunications Staff Superannuation Scheme Trust Deed dated 2 March 1983 and made between British Telecommunications and Sir Douglas Spottiswoode Morpeth TD FCA, Malcolm Argent, Peter David Bairstow, John Stephen Sadler, Iain David Thomas Vallance, Norman Stagg OBE, Kenneth Rowland Thomas, Edward Alban Webb OBE, Arthur Harvey Willitt MBE.

<sup>9</sup> The name of The British Telecommunications Staff Superannuation Scheme was changed to the BT Pension Scheme with effect from 1 January 1993. Source: appendix 1 of the Rules for Section A Members, recital (B) of the pro-forma deed of adherence.

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### **Pensions on privatisation**

- 4.6 Section 60 of the Telecommunications Act 1984 provided the legal mechanism which enabled all the "*property, rights and liabilities*" to which the Corporation "*was entitled or subject*" immediately before privatisation to be transferred to the newly formed British Telecommunications plc ("**BT plc**") with effect from 6 August 1984 (the date of privatisation). Employees of the Corporation were also transferred to employment with BT on that date.
- 4.7 Immediately before privatisation, BTPS had only one participating employer, being the Corporation. The effect of the Telecommunications Act 1984 on pension and benefits under BTPS was that from the date of privatisation (6 August 1984) the role of the Corporation as both sponsoring company and the employer under the BTPS Trust Deed and Rules was switched to BT plc.
- 4.8 Provisions in the Telecommunications Act<sup>10</sup> also ensured that BT plc 'stood in the shoes' of the Corporation, so that in effect although it was the Corporation that set up BTPS and imposed funding obligations on itself under the Trust Deed and Rules, following privatisation, BT plc and not the Corporation was treated as having originally set up BTPS.
- 4.9 This meant that on privatisation, BT plc assumed all the past service pension liabilities of all existing members (active members, deferred members and pensioners) in BTPS and also assumed legal responsibility for the continued future defined benefit pension provision of all its newly transferred employees.
- 4.10 To reflect this, the BTPS Trust Deed and Rules were amended to record the fact that employment with BT plc comprised an employee's service from 1 October 1969 to 30 September 1981 with the Post Office, service from 1 October 1981 to 6 August 1984 with the Corporation and service from 7 August 1984 onwards with either BT plc or another participating company in the BTPS.

### **Crown Guarantee**

- 4.11 The 'Crown Guarantee' is the name being used to describe a statutory guarantee that was given by the Secretary of State under Section 68 of the Telecommunications Act 1984 to BT plc on the privatisation of the Corporation.
- 4.12 Section 68 only applies in the unlikely event that either a resolution is passed under the Insolvency Act 1986 for the voluntary winding-up of BT plc or a Court makes an order for the winding up of BT plc. In those circumstances, the Secretary of State becomes liable on the commencement of the winding up to discharge any outstanding liability of BT plc for the payment of pensions which was vested in BT plc on privatisation under Section 60 of the Telecommunications Act 1984 (see 4.6 above).

<sup>10</sup> Section 109(4) and paragraphs 36 and 37 of Schedule 5 to the Telecommunications Act 1984. See Appendix 3 for the full provisions.

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- 4.13 There has been some legal uncertainty as to what pension liabilities Section 68 actually covers. A 2014 Court of Appeal judgment<sup>11</sup> concerning the extent of the Crown Guarantee in respect of BT plc's pension liabilities has now confirmed that:
- the Crown Guarantee is only relevant on a winding up of BT plc. Should that occur, it only relates to the obligations on BT plc to make pension contributions to BTPS, including deficit contributions agreed under a funding agreement between the BTPS Trustee and BT plc<sup>12</sup>, for all its employees and former employees whether they joined BTPS either pre or post privatisation;
  - the provisions in the 1983 Trust Deed<sup>13</sup> and subsequent BTPS Rules do *not* create a new obligation on BT plc on scheme termination to restore the solvency of the fund to full buy-out level i.e. so as to enable members' pension benefits to be secured by the purchase of annuities from an insurance company;
  - that being the case, the Crown Guarantee does not include an obligation on the termination of BTPS to restore the solvency of the pension fund to full buy-out level; and
  - the Crown Guarantee does not cover the pension liabilities of other BT Group companies which have, since privatisation, started participating in BTPS (although those liabilities only equate to approximately 5% of the total liabilities of BTPS). What this means is that the *entire* scheme is not covered by the Crown Guarantee.

#### **Current structure and membership**

- 4.14 Members belong to one of the following three sections depending on the date on which they are treated as having joined BTPS:
- Section A is for members who are treated as having joined before 1 December 1971;
  - Section B is for members who are treated as having joined between 1 December 1971 and 31 March 1986; and
  - Section C is for members who joined between 1 April 1986 and 31 March 2001.

Although the BTPS Rules are split into these benefit sections, the assets and liabilities relating to the benefits provided under each section are not *legally segregated* (i.e. the assets of each section are not ring-fenced). Instead, BTPS is one single trust fund out of which all members' benefits are paid. All the participating employers and their employees pay contributions into the trust, with the assets being invested collectively by the BTPS Trustee.

<sup>11</sup> Secretary of State for Culture, Media and Sport v BT Pension Scheme Trustees Limited and British Telecommunications PLC [2014] EWCA Civ 958 (Court of Appeal, Civil Division)

<sup>12</sup> See section 5, paragraphs 5.10-5.13 below.

<sup>13</sup> The Court considered key provisions in the 1983 Trust Deed. See Appendix 4 below.

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- 4.15 The BTPS Rules are unusual in that they do not have provisions which enable the scheme to be terminated and wound up, otherwise than on the expiry of the perpetuity period<sup>14</sup> for the trust. The existence of the Crown Guarantee and the effect of the 2014 Court of Appeal judgment<sup>15</sup> also create further legal complexities in relation to BTPS which do not apply to other private sector schemes, notably whether and to what extent the employer debt legislation<sup>16</sup> applies to BTPS<sup>17</sup> and BTPS' membership of the Pension Protection Fund and what would happen in practice on an insolvency of the BT Group. A discussion on those legal complexities is beyond the scope of this report as they do not directly affect the conclusion reached that functional and legal separation is technically possible from a pensions perspective.
- 4.16 BTPS was closed to new members with effect from 31 March 2001. From 1 April 2001 all new employees have not been permitted to join. Their pension benefits have been provided instead from various other defined contribution schemes sponsored by BT plc since that date, the current scheme being the BT Retirement Saving Scheme ("**BTRSS**"), a contract-based scheme with Standard Life.
- 4.17 As at 30 June 2015<sup>18</sup>, BTPS had 37,065 active members, 199,333 pensioners (163,397 retired former employees, 33,783 widows/widowers, 2,153 children) and 71,785 deferred members. The BT Group plc Annual Report 2016 contains approximate membership figures as at 31 March 2016 of 35,000 active members, 69,000 deferred members and 197,500 pensioners, giving an approximate total membership of 301,500.
- 4.18 However, it is not clear how many of those current and former employees are or were employed in the Openreach business. The 2015 Annual Report for BT Group plc states that 32,700 current employees out of total workforce of 88,500 (i.e. 37%) were engaged in the Openreach business as at 31 March 2015. Of those 32,700, the report<sup>19</sup> states that 2,500 were recently hired engineers (so would not be members of BTPS). The 2016 Annual Report for the BT Group plc reveals that there are approximately 31,500 current Group employees ("over 30%") who work in the Openreach business.

<sup>14</sup> Clause 19 of the 1983 Trust Deed provided for the perpetuity period to last until the death of the last survivor of the lineal descendants living on 1 April 1983 of the late King George VI and for a period of 21 years after that and such further period if any as may be lawful. Tax-approved pension schemes tend to benefit from the rule against perpetuities being disapplied (S.I.1990/1143).

<sup>15</sup> Secretary of State for Culture, Media and Sport v BT Pension Scheme Trustees Limited and British Telecommunications PLC [2014] EWCA Civ 958 (Court of Appeal, Civil Division)

<sup>16</sup> Section 75 and 75A of the Pensions Act 1995 and the Occupational Pension Schemes (Employer Debt) Regulations 2005 which trigger "section 75 debts" when an employer leaves an open multi-employer scheme, leaving other defined benefit employers with active members still participating or on the insolvency of the employer or on the scheme winding up with a deficit on a buy-out basis.

<sup>17</sup> Ordinarily schemes with a guarantee from a public authority are not subject to the employer debt legislation but as the 2014 Court of Appeal judgment has confirmed that there are some employers in this scheme that are not covered by the Crown Guarantee, the position is, as far as we are aware, untested and so remains uncharted territory. The views of the BTPS Trustees and their advisers will be paramount should this issue have any bearing on discussions relating to any of the options. Even if, on a 'worst case' scenario, the consensus was that the employer debt legislation applied to all the employers in BTPS on account of the fact that the Crown Guarantee only partially covers the liabilities, no section 75 debts would be triggered on a functional and legal restructuring, particularly as we believe that the Openreach employees are currently employed by BT plc.

<sup>18</sup> Source: BTPS Trustee Newsletter 2016 dated February 2016.

<sup>19</sup> See page 10 of the BT Group plc Annual Report & Form 20-F 2015



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## 5 Employer covenant and BT plc's funding agreement for BTPS

- 5.1 It has been suggested that the employer covenant afforded to BTPS by BT plc may be a bar to the functional and legal separation of the Openreach business. To understand the concern requires some analysis about what is meant by "employer covenant".
- 5.2 The Pensions Regulator defines the employer covenant as "*the extent of the employer's legal obligation and financial ability to support the scheme both now and in the future*"<sup>20</sup>. The Pensions Regulator expects trustees to understand the employer covenant from three principal aspects:
- *Legal*: looking at the nature and enforceability of the employer's obligations to support the defined benefit scheme;
  - *Scheme-related*: the funding needs of the scheme, now and in the future; and
  - *Financial*: the ability of the employer to contribute cash when required.
- 5.3 The employer covenant underwrites the risks to a defined benefit scheme and the trustees' understanding of its strength underpins their approach to investment risk and scheme funding. The crucial point to appreciate is that there is a direct link between the trustees' view of the strength of the employer covenant supporting their scheme and the length of any deficit contribution funding plan for the scheme:
- If the covenant is strong but cash for further investment is needed in the employer's business, then trustees may be prepared to take a longer-term view about the time required for the scheme to achieve full funding.
  - Conversely, if the deficit is sizeable and the trustees consider the employer covenant to be strong, they may wish to see the pension deficit paid off more quickly on the basis that the employer is able to afford to do so.
- 5.4 For these reasons, negotiations between trustees and employers will differ from scheme to scheme depending on:
- the liabilities of the scheme in question and the trustees' desired level of prudence when choosing the actuarial assumptions used to calculate those liabilities;
  - the trustees' attitude to risk when setting investment strategy;
  - the covenant of the employers able to support the scheme; and
  - the economic circumstances surrounding the employer's business.
- 5.5 Whether the financial covenant of BT plc would, in itself, be a bar to functional and legal separation would depend on the view of the BTPS Trustee, assisted by its

<sup>20</sup> Source: The Pensions Regulator's Code of Practice no. 3 entitled "Funding defined benefits" July 2014.

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employer covenant advisers, on the employer covenant afforded by BT plc currently i.e. including the Openreach business, taking into account the size of the BTPS deficit attributable to BT plc's own pension liabilities *compared with* the employer covenant afforded by BT plc post functional and legal separation taking into account its share of pension liabilities. The fact that BT plc is the parent company of Openreach should mean, that from an employer covenant perspective, the overall position is neutral as no value will have left the overall group because of functional and legal separation. This is why, from a pensions perspective, functional and legal separation is preferable to structural separation.

- 5.6 The financial overview on page 58 of the BT Group's Annual Report 2016 gives an insight into how, from an employer covenant perspective, Openreach would be viewed relative to BT plc:

*"Around 60% of Openreach's revenue is generated from other BT lines of business so its contribution to external group revenue is the smallest, at 11%. Total Openreach revenue is equivalent to 27% of group revenue. It is the group's largest EBITDA contributor, generating 40% of the total, reflecting the return it earns on its extensive network assets. But as a capital-intensive business, Openreach incurs costs relating to capital expenditure and depreciation, which are not reflected in this EBITDA contribution."*

- 5.7 What proportion of BT plc's current pension liabilities will continue to be attributable to BT plc and what proportion will be attributed to the new Openreach subsidiary on functional and legal separation is, therefore, a key consideration that needs to be addressed and a decision taken about what that allocation would be. When making this decision, consideration would need to be given as to how any proposed allocation would affect the relative covenant strength of BT plc when compared to that of a legally separated Openreach. Such an analysis would need to be undertaken by an employer covenant assessor who had access to actuarial information from the BTPS scheme actuary and financial information from BT. In our view the decision should be taken with input and, if appropriate, support from the BTPS Trustee board.
- 5.8 In our experience, generally when faced with group re-organisations and the division of pension schemes as a result of corporate restructuring, trustees are keen to actively engage with the employer in order to establish what the likely impact would be of the proposals on the scheme and to explain and inform the debate on any perceived difficulties. If the proposals would have a materially detrimental effect on the security of members' benefits and changes to the proposals could not be made to alleviate that effect, then the Pensions Regulator expects trustees to seek additional protections for members. For this reason, the aim of trustee involvement would be to work towards finding a solution that has the least impact on the security of members' pension benefits.
- 5.9 The Crown Guarantee is clearly of value to the scheme in relation to BT plc's own pension liabilities as it protects the majority of BTPS members' benefits in the event of a winding up of BT plc. The question though is how much weight does the BTPS Trustee place upon it when considering BT plc's financial covenant and negotiating

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deficit funding contributions from BT plc? Unfortunately, that information is not in the public domain but the BTPS Trustee has told BTPS members that<sup>21</sup>:

*“the Crown Guarantee is only applicable on the winding up of BT and its existence is not taken into account in assessing the funding position of the scheme from time to time or agreeing any recovery plan (deficit contribution funding plan) that might be needed to address any shortfall in the scheme.”*

What this means in practice is that the cash contributions required from BT plc to fund the deficit ignore the position on the winding up of BT plc.

**January 2015 BT/BTPS funding agreement<sup>22</sup>**

5.10 The funding of BTPS is subject to a legal agreement which is negotiated between BT plc and the BTPS Trustee at the conclusion of each triennial valuation. The most recent triennial funding valuation was undertaken as at 30 June 2014, with the current deficit contribution plan signed by BT plc and the BTPS Trustee in January 2015.

5.11 As at 30 June 2014, the market value of assets was £40.2bn and the funding deficit was £7bn. A deficit contribution plan was agreed to remove the £7bn deficit over a 16 year period to 2030. BT plc was required to make deficit payments of £875m in March 2015, £625m in April 2015 and £250m in March 2016, all of which have been paid. BT plc’s remaining deficit reduction payments are as follows:

Year to 31 March	2017	2018	2019	2020	2021	2022	2023
Deficit contribution (£m)	250	688	699	711	724	670	670

Year to 31 March	2024	2025	2026	2027	2028	2029	2030
Deficit contribution (£m)	670	495	495	495	495	495	289

<sup>21</sup> In the Trustee Report and Accounts 2015, Chairman’s statement by Paul Spencer CBE, 16 December 2015.

<sup>22</sup> Source for the information contained in this section: page 107 and note 20 (pages 205-206) of the: BT Group plc Annual Report and Form 20-F 2016, dated 4 May 2016.

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5.12 The funding agreement with the BTPS Trustee went further than detailing the payment of agreed deficit contributions. It also gave the following protections to the BTPS Trustee some of which will be of relevance to a functional and legal separation of Openreach:

- **Shareholder distributions:** in the event that shareholder distributions exceed an agreed threshold, BT plc will provide matching payments to BTPS. The threshold allows for 15% per year dividend per share growth plus £300m per year of share buybacks on a cumulative basis. BT will consult with the BTPS Trustee if it considers share buybacks in excess of £300m per year or making a special dividend. These provisions apply from 29 January 2015 until 31 March 2019, or until the finalisation of the next formal actuarial valuation if earlier.
- **Material corporate events:** in the event that BT generates net cash proceeds greater than £1bn from disposals (net of acquisitions) in any 12-month period ending 30 June, BT plc will make additional contributions to BTPS equal to one third of those net cash proceeds. BT plc will also consult with the BTPS Trustee if:
  - it considers making acquisitions with a total cost of more than £1bn in any 12-month period; or
  - it considers making disposals of more than £1bn; or
  - it considers making a Class 1 transaction (acquisition or disposal) which will have a material impact on BTPS; or
  - it becomes aware it is likely to be subject to a takeover offer.

BT plc is required to advise the BTPS Trustee should there be other material corporate events which would materially impact BT plc's covenant to BTPS. These provisions apply from 29 January 2015 until 31 March 2019, or until the finalisation of the next formal actuarial valuation if earlier.

- **Negative pledge:** A negative pledge that future creditors will not be granted superior security to BTPS in excess of a £1.5bn threshold, to cover both BT plc and BT Group plc. This provision applies until the deficit reduces to below £2bn at any subsequent funding valuation.

5.13 In addition to the above deficit payments, from 1 April 2015, the employer contribution rate for future accrual of pensions for current employees is between 7.5% and 10% of pensionable salaries.

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## 6 Functional and legal separation – TUPE and pensions

- 6.1 In order to achieve functional and legal separation of the Openreach business, the assets and liabilities of the Openreach business would need to be transferred into a newly formed subsidiary company (or companies, depending on the structure of the functional and legal separation).
- 6.2 We would expect this transfer to constitute a “relevant transfer” for the purposes of Regulation 3(1) of the Transfer of Undertaking (Protection of Employment) Regulations 2006 (“**TUPE**”). Further details are set out in Appendix 1.
- 6.3 Notwithstanding the strict operation of TUPE in relation to pensions, in section 8 of this report we have assumed that to achieve functional and legal separation the new Openreach subsidiary (or subsidiaries) would enter into a legally binding contractual agreement with BT plc to continue to provide mirror image BTPS benefits for all TUPE transferred employees who were actively participating in BTPS immediately prior to the transfer. This would enable contractual arrangements to protect the continued provision of defined benefit arrangements, where statute would not do so.

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## 7 Extending the Crown Guarantee to the Openreach subsidiary

7.1 In the Government's response to Ofcom's strategic review<sup>23</sup>, the following two statements were made:

*"The Government believes Ofcom should be firmly focused on taking whatever action is needed to correct the competition problems identified, and to promote the growth of the digital economy, however radical a change that might be."*

*"The Government urges Ofcom to confirm a clear and speedy timetable for decision-making on the necessary changes to resolve the issues identified".*

7.2 One change which, although not a radical change of itself, would greatly assist to resolve any issues around the security of members' existing benefits relates to the Crown Guarantee.

7.3 If the Government agreed to amend the Crown Guarantee to ensure that the pension liabilities in the BTPS that relate to Openreach remain covered, this would remove one of the BTPS Trustee's key concerns about the effect that a functional and legal separation would have on the security of existing members' benefits. This in turn would assist in achieving the desired outcome for a functional and legal separation, whilst meeting the aim to promote the growth of the digital economy.

7.4 Extending the Crown Guarantee in this way would not increase the liabilities which are currently the subject of that guarantee because:

- at present, the Crown Guarantee covers BTPS pension liabilities for all the employees working in the Openreach business employed by BT plc, for both their past and, notably, their *future* service;
- on the creation of Openreach as a separate legal entity, those employees would be transferred into Openreach, with their pension liabilities, either in whole or in part, likely to become the responsibility of Openreach. Under options 1, 2 or 3 in section 8 below, those liabilities would remain within the umbrella of the BTPS.

7.5 Conversely, without the Government offering an extension of the Crown Guarantee to Openreach, the Government would obtain a potential windfall from the functional and legal separation. This is because the transfer of staff into Openreach would have the effect of reducing the pension liabilities covered by the Crown Guarantee. By offering to extend coverage to Openreach, the Government would therefore be maintaining the status quo, rather than increasing its potential liability under the Crown Guarantee.

<sup>23</sup> Source: Department for Culture, Media & Sport: Government response to the Ofcom Strategic Review of Digital Communications and Business Connectivity Market reviews.  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/511596/Government\\_response\\_to\\_the\\_Ofcom\\_Digital\\_Communications\\_and\\_Business\\_Connectivity\\_Market\\_reviews.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/511596/Government_response_to_the_Ofcom_Digital_Communications_and_Business_Connectivity_Market_reviews.pdf)

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## 8 Possible options for the treatment of BTPS pension liabilities on functional and legal separation

8.1 There are a number of possible options for the treatment of BTPS past and future pension liabilities relating to employees who would be directly affected by the functional and legal separation of the Openreach business.

### 8.2 **Option 1 – Openreach participates in BTPS (future service costs only)**

8.2.1 The new Openreach subsidiary (“**Openreach**”) joins BTPS as a participating employer.

8.2.2 Together with BT plc and the BTPS Trustee it signs the standard BTPS short-form deed of adherence appended to the BTPS Rules and so becomes responsible for the costs of *future* pension provision for those of its current employees who were active members of BTPS immediately before the TUPE transfer. For the remainder of this report, those employees are referred to as “**Openreach BTPS Employees**”.

8.2.3 Openreach pays the current employer contribution rate for future pension provision (between 7.5% to 10% of pensionable salaries depending on employees’ category of membership). It could also, potentially, pay an additional amount as a contribution towards the expenses of running the scheme as those are expressed, under the Rules to be met from the general assets of BTPS.

#### 8.2.4 **Advantages:**

- As the current stated intention of Ofcom is to achieve functional and legal separation with the minimum amount of intrusion and upheaval, and as Openreach would be a wholly owned subsidiary of BT plc (the sponsoring employer of BTPS) it is the most straightforward solution of all the possible pension options.
- This is the simplest solution for Openreach BTPS Employees’ future pension provision. There would be no change to their pension benefits, which would continue unaffected by the change of employer.
- There would be no need to obtain the employees’ consents or require them to sign any forms.
- No formal 60 day statutory pension consultation would be required.
- It is the quickest and least complex of all the options.
- The BTPS Trustee would be able to have regard to both BT plc and the Openreach assets and cash flows when considering the employer covenant afforded to BTPS from both BT plc and Openreach.

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- If there was a refusal on the part of Government to extend the Crown Guarantee as described in section 7 above, the existing Crown Guarantee would continue to apply to the accrued pension liabilities attributable to Openreach BTPS Employees (from 1969 to the date of the TUPE transfer).
- There would be no immediate need to reopen the January 2015 deficit funding agreement unless BT plc considered the current level of contributions was unaffordable.

#### 8.2.5 **Disadvantages:**

- If the Crown Guarantee is not extended to Openreach, it would no longer apply to the pension liabilities attributable to Openreach BTPS Employees after the TUPE transfer. This may be offset though to some extent by Openreach starting with a clean sheet in relation to pensions i.e. the assets transferred into the business would be available to cover any future pension liabilities, should the current future contribution rate of 7.5% to 10% prove in the future to have been insufficient.
- BT plc may want Openreach to take on the legal responsibility for more of the **past** service pension liabilities attributable to the Openreach business, which otherwise would remain the responsibilities of BT plc. However, if the Government was not minded to extend the Crown Guarantee as discussed in section 7 above, then the impact of losing the Crown Guarantee would need to be weighed up against this when considering the security of members' benefits.
- It is possible that depending on the pension liabilities and the relative size of Openreach that, the BTPS Trustee would prefer to explore option 2 below, particularly if the Crown Guarantee is extended to Openreach.

#### 8.3 **Option 2 – Openreach participates in BTPS (past and future service costs)**

- 8.3.1 As with option 1, Openreach joins BTPS as a new participating employer.
- 8.3.2 It signs up to a deed with the BTPS Trustee and BT plc which incorporates the standard deed of adherence terms.
- 8.3.3 The deed then goes further and records Openreach's agreement to pay a proportion of BT plc's deficit payments under the existing funding agreement that are calculated by the BTPS scheme actuary as being attributable to its Openreach BTPS Employees.
- 8.3.4 In summary, Openreach would be contractually responsible for funding both the future service *and past service costs* of pension provision under BTPS for all its Openreach BTPS Employees.



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### 8.3.5 Advantages

- As the current stated intention of Ofcom is to achieve functional and legal separation with the minimum amount of intrusion and upheaval, and as Openreach would be a wholly owned subsidiary of BT plc, being the sponsoring employer of BTPS, it is one of the neatest solutions. If the Crown Guarantee is extended to cover Openreach, then option 2 becomes possibly the most attractive option.
- There would be no change to Openreach BTPS employees' future pension provision: their pension benefits would continue unaffected by the change of employer.
- There would be no need to obtain the employees' consents or require them to sign any forms.
- No formal 60 day statutory pension consultation would be required.
- The BTPS Trustee would be able to have regard to both BT plc and the Openreach assets and cash flows when considering the employer covenant afforded to BTPS from both BT plc and Openreach.

### 8.3.6 Disadvantages:

- If the Crown Guarantee is not extended to Openreach, it would no longer apply to the accrued pension liabilities attributable to Openreach BTPS Employees (from 1969 to the date of the TUPE transfer and beyond).
- This option requires negotiation of the deed of participation in respect of the assumption of responsibility for payment of that part of the deficit contributions attributable to the Openreach BTPS Employees. For this reason, we would expect this option to take longer to implement than option 1.
- BT plc may want Openreach to take on the legal responsibility for more of the past service pension liabilities attributable to the Openreach business (see options 3 or 4 below). However, if relevant, the impact of losing the Crown Guarantee and the covenant of Openreach would need to be weighed up against this when considering the security of members' benefits.

## 8.4 Option 3 – BTPS is split into two segregated sections under one trust: the BT section and the Openreach section.

- 8.4.1 Currently, as explained under section 4.14 above, although BTPS is a scheme with different benefit structures for members who joined at different times all the benefits are being paid out of the single trust fund. This option introduces the idea that BTPS could be split into two parts, with Openreach being the main sponsoring employer of its own segregated section and BT the main sponsoring employer of the other.

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- 8.4.2 The BTPS Trustee, as the sole Trustee, would have responsibility for both segregated sections. The two segregated sections would each have its own separate funding agreement with the BTPS Trustee to cover future pension costs, the expenses of running the section and, where necessary, contributions to cover any funding deficit in the segregated section.
- 8.4.3 This option involves BT plc and the BTPS Trustee agreeing to amend the BTPS Trust Deed and Rules to introduce the new section, which would be, largely<sup>24</sup>, a mirror-image of the existing BTPS benefits. The Openreach section would then need to be registered with HMRC as it would be treated for pension purposes i.e. funding, audit and investment purposes as a separate “scheme” to the BT section (which itself would still be treated as its own “scheme”).
- 8.4.4 Openreach would ask all Openreach BTPS Employees to sign a form to join the Openreach section for **future** service benefits from the TUPE transfer date. One option would then be for all the past service liabilities to remain behind in the BT section, with Openreach only taking on responsibility for future service costs (as for option 1, albeit in a segregate section).
- 8.4.5 An alternative option would be for BT plc, the BTPS Trustee and Openreach to enter into a transfer deed to agree that transferred into the Openreach section are the assets and liabilities relating to *either*:
- (a) the past service benefits for *current* Openreach BTPS Employees<sup>25</sup> (as per option 2 above).
- To achieve this, current employees could be asked to give their *consent*, requiring each individual member to return a form to the BTPS Trustee. This is quite common and was the chosen approach used on the demerger of Cellnet (mmO2) from BT in 2001.
- or*
- (b) the past service benefits for current and former employees (including early leavers and pensioners) attributable to the Openreach business *assuming they are identifiable from employment records*.
- To achieve this, current Openreach BTPS Employees could be asked to give their *consent* (as for (a) above) and former employees could be transferred *without their consent*, using the statutory route of the BPTS actuary providing an actuarial certificate. If current employees refused to give their consent, they

<sup>24</sup> Consideration would need to be given about a number of technical drafting issues, including whether a standard termination provision enabling triggering of the section being wound up should be added on the sectionalisation of BTPS. In addition consideration would need to be given to other balance of power issues i.e. what could Openreach as the “lead” employer in that section do and what could BT plc still do as Principal Employer of BTPS. In practice, as long as Openreach is a wholly owned subsidiary, this will not be a real issue.

<sup>25</sup> Openreach BTPS Employees defined in section 8.2.2 above.

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too could still have their liabilities transferred using the actuarial certificate route.

- It is likely that this would require considerable negotiation between the actuaries of each of BT plc, Openreach and the BTPS scheme actuary. Whether this option would be viable would depend on the view of the employer covenant in the Openreach section and the size of the liabilities. To achieve it, it is likely that the Crown Guarantee would need to be extended to the Openreach section or additional mitigation required.

8.4.6 Being legally segregated in this way means there cannot be any cross-subsidy between the two sections. So if one section is in surplus and the other in deficit, the assets of one cannot be used for the benefit of the other.

8.4.7 Whatever the option chosen under 8.4.5 above, actuaries use a range of methods and assumptions for deciding how to calculate the liabilities to transfer and these would be the subject of negotiation between BT plc, Openreach and the BTPS Trustee. For example:

- a past service reserve basis (calculated based on accrued rights to the date of the TUPE transfer with an allowance for projected future salary increases) was used on the demerger of Cellnet (mmO2) from BT in 2001. If this basis were chosen, it would be common to use the actuarial methods and assumptions adopted by the BTPS scheme actuary at the last formal actuarial valuation; or
- a 'share of fund' basis is another method which is frequently used in situations where the scheme has a sizeable deficit. This would mean that the transfer amount would take account of the fact that BTPS was underfunded, so the assets transferred into the Openreach section would not fully fund the benefits to be provided. Again, it is likely that the actuarial methods and assumptions adopted by the BTPS scheme actuary would be those chosen for the last formal actuarial valuation.

#### 8.4.8 **Advantages**

- Restructuring BTPS to have two segregated sections under the trust retains the BTPS Trustee as the trustee of members' benefits, with all the knowledge as to the benefit structure, past practice in connection with the provision of benefits and administration. It also has the added advantage of economies of scale.
- The structure keeps members in the same "umbrella trust", with the same infrastructure and branding for member communications and investment structures that can be difficult and expensive to un-wind stay in place.
- It enables the pension liabilities of Openreach to be legally segregated from BT plc.

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- It provides a pensions 'half way house' between functional and legal separation and structural separation. It would also make the latter more straightforward if it were ever contemplated in the future.

### Disadvantages

- It is more complex than options 1 or 2 as it is, in effect, setting up a quasi new Openreach scheme as a section of BTPS.
- It would take considerably more time to implement than options 1 and 2, as there would need to be a lead in time to register the new section of BTPS scheme with HMRC.
- The drafting of the new documentation and the actuarial, legal and covenant advice needed for the BTPS Trustee to agree to this approach is likely to lead to further delay and cost.
- There may be technical issues around transferring some of the past service liabilities, e.g. for those with previously contracted-out benefits.
- Post segregation issues such as future BTPS decision-making: there is a need to agree what powers are held by BT plc, Openreach and the BTPS Trustee. BT plc and Openreach will have an ongoing relationship under the proposed method for functional and legal separation so this is unlikely to be an issue whilst Openreach is a wholly-owned subsidiary.
- It would require **more than one** Openreach company to participate in the section in order for it to be treated as being truly segregated. Depending on the structure of the Openreach business post functional and legal separation this may or may not create further complexity.
- It requires member engagement for providing consent to join the new Openreach section for future service. Assuming that the intention is to seek to get past service liabilities also transferred, it would require current employees to consent to a transfer of those past service liabilities into the Openreach section.
- Unless the Crown Guarantee is extended to cover the pension liabilities of Openreach in the Openreach section, the guarantee would be lost for members of the Openreach section and further mitigation may be required by the BTPS Trustee. The fact that the Openreach section is still within the BTPS trust, makes this a more attractive option than option 4 below for extending the Crown Guarantee.
- If the pension promise for *former* employees attributable to the Openreach business is being transferred *without their consent* using an actuarial certificate, this could lead to protracted negotiations between BT plc, Openreach and the BTPS Trustee.

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## 8.5 Option 4 – Openreach sets up its own mirror-image scheme

- 8.5.1 The final option, and included here for completeness, is for Openreach to set up its own trust-based occupational pension scheme which mirrors the benefits which Openreach BTPS Employees were being promised immediately before the TUPE transfer date. Openreach then invites all Openreach BTPS Employees to join from the TUPE transfer date.
- 8.5.2 The costs involved in setting up a new pension scheme and resolving all covenant and legal issues would be in addition to scheme funding costs.
- 8.5.3 In all other respects, this option is the same as for option 3 with one notable difference: if there is any possibility that the Government could be persuaded to extend the Crown Guarantee for Openreach BTPS Employees, then any one of options 1 to 3 above would appear to be more attractive, as they all maintain Openreach BTPS Employees' pension benefits under the umbrella of the BTPS trust.

## 8.6 Alternatives to a cash injection

- 8.6.1 With any of the options for pensions detailed in this section 8, the BTPS Trustee will instruct its employer covenant advisers to look into the employer covenant afforded to the BTPS Trustee by BT plc both before and after functional and legal separation and also the covenant of Openreach when compared to its pension liabilities.
- 8.6.2 If there is any perceived weakening, then the BTPS Trustee may seek additional funding although it is not the case that additional cash is the only solution. We are seeing an increase in contingent assets<sup>26</sup> and asset backed funding structures<sup>27</sup> which allow companies to provide extra security for trustees without the need for cash. However, as BT plc would have a 100% shareholding in Openreach, it is difficult to see how the employer covenant would be affected in a material way as no value is leaving the overall group.

### Sacker & Partners LLP 1 July 2016

#### The use of this report

This report has been provided to assist Sky UK Limited and is only appropriate for the purposes of facilitating and assisting with discussions with Ofcom on the proposals for the functional and legal separation of Openreach from BT plc. It is not intended, nor should it be used, to assist with any other action or decision and we accept no liability to any third party in respect of the content of this report.

<sup>26</sup> In simple terms a contingent asset is an asset which remains in the employer's control unless and until a pre-agreed "trigger" event occurs at which point the asset is transferred to the pension scheme.

<sup>27</sup> Asset backed funding structures typically involve the establishment of a Scottish Limited partnership ("SLP") into which the employer transfers assets, such as property. The trustee becomes a limited partner in the SLP and receives payments from it. If certain trigger events occur, the trustee can access the underlying assets. These structures are used as a funding solution and to provide additional security to trustees in the form of a ring-fenced pool of assets. Well-known companies that have taken advantage of these types of structures are Marks and Spencer, John Lewis, Diageo and TUI. The first two put property into an SLP, Diageo put in whiskey and TUI the intellectual property of part of its brand.

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## APPENDIX 1

### Functional and legal separation - TUPE and pensions

- 1 We would expect the transfer of the business to the new Openreach subsidiary to constitute a “relevant transfer” for the purposes of Regulation 3(1) of the Transfer of Undertaking (Protection of Employment) Regulations 2006 (“**TUPE**”).
- 2 As a consequence, at the time when the assets and liabilities are transferred, those employees who are wholly or mainly working in the business would be transferred automatically by operation of TUPE from employment with BT plc<sup>28</sup> to employment with the new Openreach subsidiary (or subsidiaries).
- 3 Under TUPE, the BT employment contracts would also be mapped across, so that employees automatically transfer to the new Openreach subsidiary (or other appropriate Openreach subsidiary) on their existing employment terms, including the terms of any collective agreements. The only exception to the replication of contract terms under TUPE relates to pension benefits provided from trust-based occupational pension schemes, such as the BTPS.
- 4 One consequence of the transfer is that TUPE does not protect the future service pension promise for any employee who is actively participating in BTPS immediately before the transfer of employment. In theory, the new Openreach subsidiary would be free to provide, for future service of those employees, only defined contribution pensions from a stakeholder or trust-based occupational scheme. The only requirement under pensions legislation is for the employer to match the contributions that employees pay, up to a cap of 6% of salary. Contributions made are also subject to the minimum required under auto-enrolment pension legislation<sup>29</sup>.
- 5 For all current employees in the Openreach business who are members of the BT Retirement Savings Scheme (**BTRSS**), the defined contribution contract-based scheme with Standard Life, TUPE will protect the rates of payment of employer and employee contributions payable to BTRSS. This means that all those existing contribution rates would be mapped across unchanged. Where current employees were in legacy BT defined contribution schemes, their right to retain those more beneficial rates would continue unchanged, with the same restrictions applying. See below for details on defined contribution pension rates for current BT Group employees.

<sup>28</sup> We have assumed for the purposes of this report that the employees who currently participate in BTPS will be transferring from BT plc.

<sup>29</sup> Part 1 of the Pensions Act 2008.

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## APPENDIX 2

### Details of current defined contribution pension contributions under the BT Retirement Savings Scheme

#### Contribution rates since 1 April 2010

- 1 For members who joined from 1 April 2009:
  - Minimum member contribution is 5%.
  - Members pay 5% and receive an employer contribution of 8%.
  - Members who pay 6% receive an employer contribution of 8.5%.
  - Members who pay 7% and above receive an employer contribution of 9%.
- 2 For those who were ex-BT Retirement Plan members ("**BTRP**") (set up when Section C of the BTPS was closed to new members in 2001) or ex Syntegra Ltd Flexible Pension Plan ("**SLFPP**") members, they retain the right to pay a minimum pension contribution of 4% in return for an employer contribution of 6%.
- 3 Ex-BTRP and SLFPP members who were entitled to higher employer contributions in those previously sponsored BT plc defined contributions schemes retain those higher levels of employer contributions provided that they maintain their own level of contribution which attracted those rates.

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## APPENDIX 3

### Crown guarantee

In this Appendix we have set out the relevant provisions in the Telecommunications Act 1984 (as amended) which relate to the Crown Guarantee for pensions liabilities.

In summary, a Crown guarantee was created under Section 68 of the Act making the Secretary of State Secretary of State for Culture Media and Sport liable on the commencement of a winding up of BT to "*discharge any outstanding liabilities*" which had vested in BT by virtue of section 60. At a later date, Section 68 was amended so that the discharge related to "*any outstanding pension liabilities*".

### Section 60 of the Telecommunications Act 1984 (as amended)

#### **60 Vesting of property etc. of British Telecommunications in a company nominated by the Secretary of State**

(1) On such day as the Secretary of State may by order appoint for the purposes of this Part (in this Act referred to as "the transfer date"), all the property, rights and liabilities (other than the excepted liabilities) to which British Telecommunications was entitled or subject immediately before that date shall (subject to the following provisions of this section) become by virtue of this section property, rights and liabilities of a company nominated for the purposes of this section by the Secretary of State (in this Act referred to as "the successor company").

(2) In this Act "the excepted liabilities" means the liabilities which subsist by virtue of a deed of covenant dated 22nd November 1978 and made between the Post Office and the then trustees of the Post Office Staff Superannuation Scheme.

(3) The Secretary of State may, after consulting British Telecommunications, by order nominate for the purposes of this section any company formed and registered under the Companies Act 1985 or the enactments thereby replaced; but on the transfer date the company in question must be a company limited by shares which is wholly owned by the Crown.

(4) References in this Act to property, rights and liabilities of British Telecommunications are references to all such property, rights and liabilities, whether or not capable of being transferred or assigned by British Telecommunications.

(5) It is hereby declared for the avoidance of doubt that—

(a) any reference in this Act to property of British Telecommunications is a reference to property of British Telecommunications whether situated in the United Kingdom or elsewhere; and



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(b) any such reference to rights or liabilities of British Telecommunications is a reference to rights to which British Telecommunications is entitled, or (as the case may be) liabilities to which British Telecommunications is subject, whether under the law of the United Kingdom or of any part of the United Kingdom or under the law of any country or territory outside the United Kingdom.

(6) In the House of Commons Disqualification Act 1975 in Part III of Schedule 1 (other disqualifying offices) there shall be inserted (at the appropriate place in alphabetical order) the following entry—

“Director of the successor company within the meaning of Part V of the Telecommunications Act 1984, being a director nominated or appointed by a Minister of the Crown or by a person acting on behalf of the Crown”.....

### Section 68 of the Telecommunications Act 1984 (as amended)

#### **68 Liability of Secretary of State in respect of liabilities vesting in successor company**

(1) This section applies where—

(a) a resolution has been passed, in accordance with *the Insolvency Act 1986*<sup>30</sup>, for the voluntary winding up of the successor company, otherwise than merely for the purpose of reconstruction or amalgamation with another company; or

(b) without any such resolution having been passed beforehand, an order has been made for the winding up of the successor company by the court under that Act.

(2) The Secretary of State shall become liable on the commencement of the winding up to discharge any outstanding liability of the successor company *for the payment of pensions*<sup>31</sup> which vested in that company by virtue of section 60 above.

(3) Any sums required by the Secretary of State for discharging any liability imposed on him by this section shall be paid out of money provided by Parliament.

(4) Where the Secretary of State makes a payment to any person in discharge of what appears to him to be a liability imposed on him by this section, he shall thereupon become a creditor of the successor company to the extent of the amount paid, his claim being treated for the purposes of the winding up as a claim in respect of the original liability.

(5) Any sums received by the Secretary of State in respect of any claim made by virtue of subsection (4) above in the winding up of the successor company shall be paid into the Consolidated Fund.

<sup>30</sup> The reference to “the Insolvency Act 1986” was substituted for the previous reference to the Companies Act 1948.

<sup>31</sup> The words “for the payment of pensions” were inserted by the Communications Act 2003. The explanatory note to the Communications Bill explained that it was thought, by then, that the only outstanding liability of BT for which the Secretary of State was considered responsible under the Crown Guarantee was in respect of the payment of pensions.

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- (6) The reference in subsection (2) above to the commencement of the winding up is a reference—
- (a) in a case within subsection (1)(a) above, to the passing of the resolution; and
  - (b) in a case within subsection (1)(b) above, to the making of the order.

### Schedule 5 (General transitional provisions and savings)

**36(1)** Except as otherwise provided by the foregoing provisions of this Part of this Schedule (whether expressly or by necessary implication), any agreement made, transaction effected or other thing done by, to or in relation to British Telecommunications which is in force or effective immediately before the transfer date shall have effect as from that date as if made, effected or done by, to or in relation to the successor company, in all respects as if the successor company were the same person, in law, as British Telecommunications, and accordingly references to British Telecommunications

- (a) in any agreement (whether or not in writing) and in any deed, bond or instrument;

.....

- (c) in any other document whatsoever (other than an enactment) relating to or affecting any property, right or liability of British Telecommunications which vests by virtue of section 60 of this Act in the successor company,

shall be taken as from the transfer date as referring to the successor company.....

**37(1)** It is hereby declared for the avoidance of doubt that

- (a) the effect of section 60 of this Act in relation to any contract of employment with British Telecommunications in force immediately before the transfer date is merely to modify the contract (as from that date) by substituting the successor company as the employer (and not to terminate the contract or vary it in any other way); and

- (b) that section is effective to vest the rights and liabilities of British Telecommunications under any agreement or arrangement for the payment of pensions, allowances or gratuities in the successor company along with all other rights and liabilities of British Telecommunications...

and accordingly for the purposes of any such agreement or arrangement (as it has effect by virtue of paragraph 36 above in relation to employment with the successor company or with a wholly owned subsidiary of that company) any period of employment with British Telecommunications shall count as employment with the successor company or (as the case may be) with a wholly owned subsidiary of that company.

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## APPENDIX 4

### 2 March 1983 Trust Deed

#### Provisions which relate to the application of the Crown Guarantee

##### **Clause 10 (Contributions by the Corporation)**

10. The Corporation shall contribute to the Fund by monthly instalments:

(a) such contributions as are certified by the Actuary as needed to meet the cost of benefits under the Schedule 1 Rules, excluding a member's contributions towards the cost of family and dependants' benefits;

(b) such sums as may be due under Rule 12 of the General Rules;

(c) such further contributions as may from time to time be required to repair any deficiency reported by the Actuary.

##### **Clause 12 (actuarial valuations)**

12. (1) On or before [31 March 1988] and thereafter at the end of such periods not exceeding 5 years as the Trustees shall from time to time determine the Actuary shall make an actuarial valuation of the assets and liabilities of the Fund and shall make a report upon the financial position thereof making therein any recommendations he thinks fit to the Trustees who shall forthwith transmit to the Corporation and to such organisation or organisations as are mentioned in Clause 3(2) a copy of such report and any recommendations they may wish to make in regard thereto.

(2) Where on any such valuation the Actuary certifies that a deficiency or a disposable surplus in the Fund is disclosed the Corporation shall within 3 months after receiving the valuation and report and the Trustees' recommendations (if any) make arrangements which in the opinion of the Corporation are expedient for making good the deficiency or as the case may require for dealing with the surplus.

(3) Subject to the provisions of sub-clause (4) if a deficiency is certified in the Fund any arrangements made shall provide for an annual deficiency contribution of such amount as may be certified by the Actuary to be required to make good the deficiency over such period not exceeding 40 years from the date of the valuation as the Corporation may determine.

(4) The Corporation may instead of arrangements in accordance with sub-clause (3) or in substitution at any time for any such arrangements previously made make arrangements consisting of:-

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(a) an undertaking by the Corporation by deed to make to the Trustees payments of such equal or unequal amounts as the Corporation may determine and specify in the deed payable in the case of arrangements pursuant to sub-clause (2) at such time or times in every year during such period not exceeding 40 years from the date of the valuation as the Corporation may determine and so specify or in the case of substitutionary arrangements at such time or times in every year during a period co-terminous with the outstanding term of the arrangements replaced as the Corporation may determine and so specify; and (unless the Actuary certifies that in his opinion no further provision is required);

(b) provision for an annual deficiency contribution of such amount as may be certified by the Actuary to be required in his opinion to make good over such period not exceeding 40 years from the date of the valuation or (in the case of substitutionary arrangements) from the date of the last valuation as the Corporation may determine that part of the total deficiency disclosed on the valuation or (in the case of substitutionary arrangements) on the last valuation which remains after taking account of the provision made by the said deed and (in the case of substitutionary arrangements) the total amount paid by way of deficiency contribution since the date of the deed or (if earlier) the beginning of the month in which payments under the deed are deemed to be first due.

#### **Clause 20 (Termination)**

20. (1) If the Scheme terminates an actuarial investigation shall be made and the Fund shall be realised and subject to the payment of all costs charges and expenses and the Trustees' liabilities to creditors properly payable thereout the monies then in hand together with such sums as may be due from the Corporation to restore the solvency of the Fund shall be applied under the advice of the Actuary, where appropriate, so far as they permit to the purposes and with the priorities indicated in the following sub-clauses.

(2) The words and expressions used in this clause shall have the same meanings as in the Social Security Pensions Act 1975 as amended from time to time.

(3) On a winding up of the Scheme, any liabilities of the Scheme in respect of:-

(a) guaranteed minimum pensions and accrued rights to guaranteed minimum pensions;

(b) any such benefits as are excluded by Section 33(5) of the Social Security Pensions Act 1975 from earners' guaranteed minimum pensions;

(c) pensions and other benefits in respect of which entitlement to payment has already arisen; and

(d) state scheme premiums; shall be accorded priority over other liabilities under the Scheme.

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(4) If the assets of the Scheme are not sufficient to meet in full the liabilities specified in sub-clause (3) above, the assets shall be applied to meet those liabilities in the order of priority in which those liabilities are specified in sub-clause (3).

(5) If after the liabilities specified in sub-clause (3) have been met there are assets in hand then such assets together with any sums due from the Corporation to restore the solvency of the Fund shall be applied under the advice of the Actuary to the following purposes (if and to the extent that those purposes have not been satisfied under sub-clause (3) above), and with the priorities indicated, namely:-

first in the purchase from the Government or from any insurance company to which the Insurance Companies Acts 1974 and 1981 apply of non-commutable non-assignable annuities payable under the same conditions as payments receivable under the Rules for those persons who immediately before the winding up were entitled whether immediately or in reversion to pensions out of the Fund such annuities to be of amounts equal to the pensions to which those persons are then entitled;

secondly in the purchase in like manner of non-assignable (and except in so far as the Trustees may with the consent of the Commissioners of Inland Revenue determine non-commutable) deferred annuities for members and others who might at some future date become entitled to the benefits out of the Fund regard being had to their respective prospects of becoming so entitled had the Fund continued to exist the amount of their service reckonable for such benefits and the amount of such benefits at the date of termination of the Scheme;

thirdly any moneys which remain after the first two purposes set out in this sub-clause (5) have been satisfied shall be returned to the Corporation.