

FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended: September 30, 1997

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 1-4471

XEROX CORPORATION  
(Exact Name of Registrant as  
specified in its charter)

New York 16-0468020

(State or other jurisdiction (IRS Employer Identification No.)  
of incorporation or organization)

P.O. Box 1600  
Stamford, Connecticut 06904-1600  
(Address of principal executive offices)  
(Zip Code)

(203) 968-3000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at October 31, 1997
Common Stock	325,888,334 shares

This document consists of 33 pages.

Forward-Looking Statements

From time to time the Registrant and its representatives may provide information, whether orally or in writing, including certain statements in this Form 10-Q under "Management's Discussion and Analysis of Results of Operations and Financial Condition", which are deemed to be "forward-looking" within the meaning of the Private Securities Litigation Reform Act of 1995 ("Litigation Reform Act"). These forward-looking statements and other information relating to the Company are based on the beliefs of management as well as assumptions made by and information currently available to management.

The words "anticipate", "believe", "estimate", "expect", "intends", and similar expressions, as they relate to the Company or the Company's management, are intended to identify forward-looking statements. Such statements reflect the current views of the Registrant with respect to future events and are subject to certain risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described herein as anticipated, believed, estimated

or expected. The Registrant does not intend to update these forward-looking statements.

In accordance with the provisions of the Litigation Reform Act we are making investors aware that such "forward-looking" statements, because they relate to future events, are by their very nature subject to many important factors which could cause actual results to differ materially from those contained in the "forward-looking" statements. Such factors include but are not limited to the following:

**Competition** - the Registrant operates in an environment of significant competition, driven by rapid technological advances and the demands of customers to become more efficient. There are a number of companies worldwide with significant financial resources which compete with the Registrant to provide document processing products and services in each of the markets served by the Registrant, some of whom operate on a global basis. The Registrant's success in its future performance is largely dependent upon its ability to compete successfully in its currently-served markets and to expand into additional market segments.

**Transition to Digital** - presently black and white light lens copiers represent over half the Registrant's revenues. This segment of the general office is mature with anticipated declining industry revenues as the market transitions to digital technology. Some of the Registrant's new digital products replace or compete with the Registrant's current light lens equipment. Changes in the mix of products from light lens to digital, and the pace of that change as well as competitive developments could cause actual results to vary from those expected.

**Pricing** - the Registrant's ability to succeed is dependent upon its ability to obtain adequate pricing for its products and services which provide a reasonable return to shareholders. Depending on competitive market factors, future prices the Registrant can obtain for its products and services may vary from historical levels.

**Financing Business** - a significant portion of the Registrant's profits arise from the financing of its customers' purchase of the Registrant's equipment. Presently the Registrant finances approximately 80% of such equipment purchases in the U.S. and 75% in Western Europe. The Registrant's ability to provide such financing at competitive rates and realize profitable spreads is highly dependent upon its own costs of borrowing which, in turn, depend upon its credit ratings. Significant changes in such ratings could reduce the profitability of such financing business and/or make the Registrant's financing less attractive to customers thus reducing the volume of financing business done. The Registrant's present credit ratings permit ready access to the credit markets and there is no assurance that these credit ratings can be maintained and/or ready access to the credit markets can be assured.

**Productivity** - the Registrant's ability to sustain and improve its profit margins is largely dependent on its ability to maintain an efficient, cost-effective operation. Productivity improvements through process reengineering, design efficiency and supplier cost improvements are required to offset labor and materials cost inflation and competitive price pressures.

**International Operations** - the Registrant derives approximately half its revenue from operations outside of the United States. In addition, the Registrant manufactures many of its products and/or their components outside the United States. The Registrant's future revenue, cost and profit results could be adversely affected by a number of factors, including changes in foreign currency exchange rates, changes in economic conditions from country to country, changes in a country's political conditions, trade protection measures, licensing requirements and local tax issues.

**New Products/Research and Development** -the process of developing new high technology products and solutions is inherently complex and uncertain. It requires accurate anticipation of customers' changing needs and emerging technological trends. The Registrant must then make long-term investments and commit significant resources before knowing whether these investments will

eventually result in products that achieve customer acceptance and revenues required to provide anticipated returns from these investments.

Disengagement From Insurance Business - during the process of disengaging from the insurance segment, the Registrant will continue to be subject to all the business risks and rewards of such businesses. Although Registrant believes that the proceeds received from the disposition of the remaining insurance businesses will be consistent with the net carrying value of these businesses, until such remaining insurance companies are actually sold, no assurances can be given as to the ultimate impact the remaining insurance companies will have on the Registrant's total results from operations or whether the proceeds of sales will equal such carrying value. The insurance business is subject to cyclical competitive conditions, judicial decisions affecting insurers' liabilities, and by volatile and unpredictable developments, including changes in the propensity of courts to grant large awards, fluctuations in interest rates and other changes in the investment environment (which affect market prices of insurance companies' investments, the income from those investments and inflationary pressures that may tend to affect the size of losses). In addition, the operating results of the remaining insurance companies have been historically influenced by exposure to uncollectible reinsurance, which had been greater than for most other insurers.

Xerox Corporation  
Form 10-Q  
September 30, 1997

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For additional information about The Document Company Xerox,  
please visit our World-wide Web site at [www.xerox.com](http://www.xerox.com) and select  
"Investor Information."

## PART I - FINANCIAL INFORMATION

Item I	Xerox Corporation Consolidated Statements of Income			
	Three months ended		Nine months ended	
	September 30,		September 30,	
(In millions, except per-share data)	1997	1996	1997	1996
<b>Revenues</b>				
Sales	\$ 2,346	\$ 2,165	\$ 6,611	\$ 6,267
Service and rentals	1,787	1,740	5,394	5,280
Finance income	243	253	749	756
Total Revenues	4,376	4,158	12,754	12,303
<b>Costs and Expenses</b>				
Cost of sales	1,281	1,214	3,635	3,496
Cost of service and rentals	929	890	2,740	2,671
Equipment financing interest	128	131	386	386
Research and development expenses	273	261	816	779
Selling, administrative and general expenses	1,284	1,256	3,752	3,691
Gain on affiliates' sales of stock, net	-	(11)	-	(11)
Other, net	31	34	50	65
Total Costs and Expenses	3,926	3,775	11,379	11,077
<b>Income before Income Taxes, Equity Income and Minorities' Interests</b>				
	450	383	1,375	1,226
Income taxes	153	138	478	441
Equity in net income of unconsolidated affiliates	37	30	105	92
Minorities' interests in earnings of subsidiaries	14	25	75	97
Income from Continuing Operations	320	250	927	780
Discontinued Operations	-	-	-	-
Net Income	\$ 320	\$ 250	\$ 927	\$ 780
<b>Primary Earnings per Share</b>				
Continuing Operations	\$ 0.92	\$ 0.71	\$ 2.70	\$ 2.24
Discontinued Operations	-	-	-	-
Primary Earnings per Share	\$ 0.92	\$ 0.71	\$ 2.70	\$ 2.24
<b>Fully Diluted Earnings per Share</b>				
Continuing Operations	\$ 0.88	\$ 0.68	\$ 2.57	\$ 2.14
Discontinued Operations	-	-	-	-
Fully Diluted Earnings per Share	\$ 0.88	\$ 0.68	\$ 2.57	\$ 2.14

See accompanying notes.

Xerox Corporation  
Consolidated Balance Sheets

	September 30,	December 31,
(In millions, except share data in thousands)	1997	1996

## Assets

Cash	\$ 62	\$ 104
Accounts receivable, net	2,129	2,022
Finance receivables, net	4,282	4,386
Inventories	3,092	2,676
Deferred taxes and other current assets	952	964
Total Current Assets	10,517	10,152
Finance receivables due after one year, net	7,096	6,986
Land, buildings and equipment, net	2,287	2,256
Investments in affiliates, at equity	1,434	1,282
Goodwill	1,345	623
Other assets	1,266	1,121
Investment in discontinued operations	3,303	4,398
Total Assets	\$ 27,248	\$ 26,818

## Liabilities and Equity

Short-term debt and current portion of long-term debt	\$ 3,807	\$ 3,536
Accounts payable	476	577
Accrued compensation and benefit costs	717	761
Unearned income	201	208
Other current liabilities	2,103	2,122
Total Current Liabilities	7,304	7,204
Long-term debt	9,015	8,424
Postretirement medical benefits	1,079	1,050
Deferred taxes and other liabilities	2,266	2,429
Discontinued operations liabilities - policyholders' deposits and other	1,850	2,274
Deferred ESOP benefits	(494)	(494)
Minorities' interests in equity of subsidiaries	125	843
Company obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely subordinated debentures of the Company	637	-
Preferred stock	709	721
Common shareholders' equity	4,757	4,367
Total Liabilities and Equity	\$ 27,248	\$ 26,818
Shares of common stock issued	325,902	325,902
Shares of common stock outstanding	325,584	323,681

See accompanying notes.

Xerox Corporation

## Consolidated Statements of Cash Flows

Nine months ended September 30 (in millions)	1997	1996
Cash Flows from Operating Activities		
Income from Continuing Operations	\$ 927	\$ 780
Adjustments required to reconcile income to cash flows from operating activities:		
Depreciation and amortization	517	528
Provisions for doubtful accounts	176	164
Provision for postretirement medical benefits, net of payments	30	30
Minorities' interests in earnings of subsidiaries	75	97
Undistributed equity in income of affiliated companies	(101)	(91)
Increase in inventories	(723)	(747)
Increase in finance receivables	(513)	(379)
Increase in accounts receivable	(166)	(242)
Decrease in accounts payable and accrued compensation and benefit costs	(126)	(223)
Net change in current and deferred income taxes	108	194
Other, net	(183)	(434)
Total	21	(323)
Cash Flows from Investing Activities		
Cost of additions to land, buildings and equipment	(311)	(340)
Proceeds from sales of land, buildings and equipment	25	30
Purchase of additional interest in Xerox Limited	(812)	-
Net change in payables to Discontinued Operations	(168)	(26)

Total	(1,266)	(336)
Cash Flows from Financing Activities		
Net change in debt	249	1,314
Dividends on common and preferred stock	(356)	(330)
Proceeds from sale of common stock	130	85
Repurchase of common and preferred stock	(116)	(257)
Dividends to minority shareholders	(5)	(1)
Net proceeds from issuance of mandatorily redeemable preferred stock	637	-
Total	539	811
Effect of Exchange Rate Changes on Cash	(7)	(2)
Cash Provided (Used) by Continuing Operations	(713)	150
Cash Provided (Used) by Discontinued Operations	671	(150)
Decrease in Cash	(42)	-
Cash at Beginning of Period	104	136
Cash at End of Period	\$ 62	\$ 136

See accompanying notes.

Xerox Corporation  
Notes to Consolidated Financial Statements

1. The consolidated financial statements presented herein have been prepared by Xerox Corporation ("the Company") in accordance with the accounting policies described in its 1996 Annual Report to Shareholders and should be read in conjunction with the notes thereto.

Effective 1997, Fuji Xerox changed its reporting period from a fiscal year ending October 20 to a fiscal year ending December 20. The results of operations during the period between the end of the 1996 fiscal year and the beginning of the new fiscal year (the stub period) amounted to a gain of \$8 million. The gain was credited to retained earnings.

Effective July 1, 1997, we changed the functional currency for our Brazilian operation from the U.S. dollar to the Brazilian Real as we believe that the Brazilian economy is no longer considered hyperinflationary. The effect of this change is immaterial to both the Company's results of operations and financial position in the third quarter.

In the opinion of management, all adjustments (consisting only of normal recurring adjustments) which are necessary for a fair statement of operating results for the interim periods presented have been made. Interim financial data presented herein are unaudited.

References herein to "we" or "our" refer to Xerox and consolidated subsidiaries unless the context specifically requires otherwise.

2. Inventories consist of (in millions):

	September 30, 1997	December 31, 1996
Finished products	\$ 1,787	\$ 1,570
Work in process	125	80
Raw materials and supplies	446	322
Equipment on operating leases, net	734	704
Total	\$ 3,092	\$ 2,676

3. In June, 1997, we acquired the remaining 20 percent of Xerox Limited (formerly Rank Xerox Limited) from The Rank Group Plc (Rank) in a transaction valued at 940 million pounds sterling, or approximately \$1.5 billion. As a result of this transaction, we now own 100 percent of Xerox Limited. The transaction was funded entirely by debt consisting of 500 million pounds sterling of third party debt and 440 million pounds sterling of notes payable issued to Rank, which will be paid in deferred installments, half within one year and the other half at the end of two years. An

additional payment of up to 60 million pounds sterling would be made in 2000 based upon achievement of certain significant Xerox Limited earnings growth targets by 1999. The purchase price was allocated such that goodwill increased by \$737 million, minority interest in equity of subsidiaries was reduced by approximately \$720 million, with the balance of \$70 million applied to other assets and liabilities, primarily investment in affiliates, at equity.

4. In January 1997, a trust sponsored and wholly owned by the Company issued 650,000 shares of 8% Capital Securities (the Preferred Securities) with an aggregate liquidation amount of \$650 million to the public for net proceeds, after discount and fees, of \$637 million. The trust also issued 20,103 shares of common securities to the Company. The proceeds from these offerings were invested by the trust in \$650 million aggregate principal amount of the Company's newly-issued 8% Junior Subordinated Debentures due 2027 (the Debentures). The Debentures represent all of the assets of the trust. The proceeds from the issuance of the Debentures were used by the Company for general corporate purposes. The Debentures and related income statement effects are eliminated in the Company's consolidated financial statements.

The Preferred Securities accrue and pay cash distributions semi-annually at a rate of 8% per annum of the stated liquidation amount of \$1,000 per Preferred Security. The Company has guaranteed, on a subordinated basis, distributions and other payments due on the Preferred Securities (the Guarantee). The Guarantee, when taken together with the Company's obligations under the Debentures and in the indenture pursuant to which the Debentures were issued and the Company's obligations under the Amended and Restated Declaration of Trust governing the trust, provides a full and unconditional guarantee of amounts due on the Preferred Securities.

The Preferred Securities are mandatorily redeemable upon the maturity of the Debentures on February 1, 2027, or earlier to the extent of any redemption by the Company of any Debentures. The redemption price on February 1, 2027 will be \$1,000 per share plus accrued and unpaid distributions to the date fixed for redemption.

5. Common shareholders' equity consists of (in millions):

	September 30, 1997	December 31, 1996
Common stock	\$ 327	\$ 327
Additional paid-in-capital	1,354	1,353
Retained earnings	3,656	3,090
Net unrealized gain (loss) on investment securities	5	(1)
Translation adjustments	(506)	(241)
Treasury stock	(79)	(161)
Total	\$ 4,757	\$ 4,367

6. Interest expense totaled \$450 million and \$446 million for the nine months ended September 30, 1997 and 1996, respectively.

7. In 1996, the Board of Directors authorized the Company to repurchase up to \$1 billion of Xerox common stock. The stock would be purchased from time to time on the open market depending on market conditions. Through September 30, 1997, 8.5 million shares had been repurchased for \$422 million, some of which had been reissued to satisfy the exercise of stock options. In the second quarter of 1997, the repurchase program was suspended in connection with the acquisition of the remaining interest in Xerox Limited, as described above.

8. Summarized operating results of Insurance follow (in millions):

Three months ended		Nine months ended	
September 30, 1997	1996	September 30, 1997	1996

Revenues				
Insurance premiums earned	\$ 285	\$ 433	\$1,090	\$1,287
Investment and other income	90	112	313	325
Total Revenues	375	545	1,403	1,612
Costs and Expenses				
Insurance losses and loss expenses	252	349	1,173	1,054
Insurance acquisition costs and other operating expenses	100	178	377	461
Interest expense	40	50	138	153
Administrative and general expenses	45	10	17	19
Total Costs and Expenses	437	587	1,705	1,687
Realized Capital Gains	2	-	9	2
Income (Loss) Before Income Taxes	(60)	(42)	(293)	(73)
Income Tax Benefits	14	16	79	31
Income (Loss) From Insurance *	\$ (46)	\$ (26)	\$ (214)	\$ (42)

\* The above operating results exclude the gains and losses related to sales of the Insurance subsidiaries. All results, including the sale-related impacts, were charged to reserves established for this purpose and, therefore, did not impact our earnings.

The net assets at September 30, 1997 and December 31, 1996 of the Insurance businesses included in our consolidated balance sheets as discontinued operations are as follows (in millions):

	September 30, 1997	December 31, 1996
Insurance Assets		
Investments	\$ 5,850	\$ 7,889
Reinsurance recoverable	1,974	2,458
Premiums and other receivables	646	1,082
Deferred taxes and other assets	806	1,201
Total Insurance Assets	\$ 9,276	\$12,630
Insurance Liabilities		
Unpaid losses and loss expenses	\$ 6,453	\$ 8,572
Unearned income	565	812
Notes payable	200	215
Other liabilities	882	1,185
Total Insurance Liabilities	\$ 8,100	\$10,784
Investment in Insurance, net	\$ 1,176	\$ 1,846

## 9. Litigation

### Continuing Operations

On March 10, 1994, a lawsuit was filed in the United States District Court for the District of Kansas by two independent service organizations (ISOs) in Kansas City and St. Louis and their parent company. Plaintiffs claim damages predominately resulting from the Company's alleged refusal to sell parts for high volume copiers and printers to plaintiffs prior to 1994. The Company's policies and practices with respect to the sale of parts to ISOs were at issue in an antitrust class action in Texas, which was settled by the Company during 1994. Claims for individual lost profits of ISOs who were not named parties, such as the plaintiffs in the Kansas action, were not included in that class action. In their complaint plaintiffs allege monetary damages in the form of lost profits in excess of \$10 million (to be trebled) and injunctive relief. In a report prepared, pursuant to Rule 26(a)2)B) of the Federal Rules of Civil Procedure, an accountant retained by plaintiffs as an expert has indicated that he plans to testify at trial that, allegedly as a result of Xerox' conduct, plaintiffs have lost profits of approximately \$75 million. The Company has asserted counterclaims against the plaintiffs alleging patent and copyright infringement, misappropriation of Xerox trade secrets and conversion. On December 11, 1995, the District Court issued a preliminary injunction against the parent company for copyright infringement. On April 8, 1997, the District Court granted partial summary judgment in favor of the Company on plaintiffs' antitrust claims, ruling that the Company's unilateral refusal to sell or license its patented parts cannot give rise to antitrust liability. The Court's ruling did not preclude a finding of antitrust liability based upon other allegations of exclusionary conduct, including the refusal to sell unpatented parts. The District Court also granted summary judgment in favor of the Company on its patent infringement claim, leaving open with

respect to patent infringement only the issues of willfulness and the amount of damages, and granted partial summary judgment in favor of the Company with respect to some of its claims of copyright infringement. On July 17, 1997 the District Court, pursuant to 28 U.S.C. Section 1292(b), certified its April 8, 1997 Order for interlocutory appeal to the United States Court of Appeals for the Federal Circuit and stayed trial of the matter pending remand.

On January 3, 1996, an action was commenced by Barneyscan Corporation against Registrant, Pixelcraft, Inc., a wholly owned subsidiary of Registrant, and three individuals, seeking damages "in excess of \$10 million" for breach of contract and fraud, punitive damages, attorneys' fees and an accounting. Plaintiff claimed it was entitled to royalties on certain machines and software sold by Pixelcraft between July 1, 1992 and June 30, 1996. In August 1997, in an amended letter to a court-appointed mediator, plaintiff expanded its damage claim by alleging that it was also entitled to royalties in excess of \$400 million for use of Barneyscan technology in conjunction with Xerox color copiers and printers during that time period. Pixelcraft admits that Barneyscan is entitled to royalties of approximately \$750,000 from Pixelcraft alone, minus certain offsets, and no more. Registrant (I) denies any liability to plaintiff, (ii) denies the use of Barneyscan technology as alleged by plaintiff, and (iii) asserts that the royalty calculation used by plaintiff is inconsistent with the facts in numerous respects. Defendants intend to vigorously defend the action. There is no trial date.

#### Discontinued Operations

Farm & Home Savings Association, now part of Mercantile Bank, (Farm & Home) and certain Talegen Holdings, Inc. insurance companies (Insurance Companies) entered into an agreement (Indemnification Agreement) under which the Insurance Companies are required to defend and indemnify Farm & Home from certain actual and punitive damage claims being made against Farm & Home relating to the Brio superfund site (Brio). A number of lawsuits were filed against Farm & Home in the District Courts of Harris County, Texas, by several hundred plaintiffs, former residents of, or students attending school within, a residential subdivision known as Southbend, seeking both actual and punitive damages allegedly relating to injuries arising out of the hazardous substances at Brio. The Insurance Companies have been defending these cases under a reservation of rights because it is unclear whether certain of the claims fall under the coverage of either the policies or the Indemnification Agreement. On August 29, 1997 the trial court granted motions for summary judgment filed on behalf of Farm & Home dismissing the claims of approximately 640 plaintiffs, finding that Farm & Home owed no duty to the plaintiffs as a matter of law. As a result of that ruling, the parties consummated a previously agreed settlement, under which all but approximately 50 of the pending bodily injury claims have been settled, and no appeal will be taken from the trial court's ruling. The final group of 50 plaintiffs have also agreed to a settlement which is to be submitted for court approval in November 1997. After all of the properties within Southbend were acquired by the Insurance Companies, all of the structures were demolished. Ownership of the land has been transferred to an unrelated third party, which has agreed to indemnify the Insurance Companies for any liability arising after the conveyance.

#### Item II Xerox Corporation Management's Discussion and Analysis of Results of Operations and Financial Condition

##### Document Processing

##### Summary

Income from continuing operations increased 28 percent to \$320 million in the 1997 third quarter from \$250 million in the 1996 third quarter. For the first nine months, income from continuing operations increased 19 percent to \$927 million.

Revenues of \$4.4 billion in the quarter represented 9 percent growth on a pre-currency basis. After the adverse effect of

currency, revenue growth was 5 percent. The pre-currency revenue growth was driven by 21 percent growth in equipment sales (excluding OEM sales) and 31 percent growth in document outsourcing. For the first nine months, revenues of \$12.8 billion represented 6 percent growth on a pre-currency basis or 4 percent after the adverse effect of currency.

Fully diluted earnings per share increased 29 percent to \$0.88 in the third quarter. For the first nine months of 1997, fully diluted earnings per share increased 20 percent to \$2.57.

#### Pre-Currency Growth

To understand the trends in the business, we believe that it is helpful to adjust revenue and expense growth (except for ratios) to exclude the impact of changes in the translation of foreign currencies into U.S. dollars. We refer to this adjusted growth as "pre-currency growth."

A substantial portion of our consolidated revenues is derived from operations outside of the United States where the U.S. dollar is not the functional currency, primarily in Europe. When compared with the average of the major European currencies on a revenue weighted basis, the U.S. dollar was approximately 11 percent stronger in the 1997 third quarter than in the 1996 third quarter; only the pound sterling was stronger. As a result, currency translation had an unfavorable impact of approximately 4 percentage points on total revenues in the 1997 third quarter.

Revenues denominated in currencies where the local currency is the functional currency are not hedged for purposes of translation into U.S. dollars.

#### Revenues

For the major product categories, the pre-currency revenue growth rates are as follows:

	1996					1997		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3
Total Revenues	4%	6%	5%	8%	6%	5%	6%	9%
Digital Products	19	21	23	26	23	18	24	26
Light Lens Copiers	-	-	(4)	-	(1)	(2)	(3)	1

Digital product revenues grew 26 percent in the 1997 third quarter following 24 percent growth in the second quarter and 18 percent growth in the first quarter. These revenues represent 35 percent of total revenues in the 1997 third quarter compared with 30 percent in the 1996 third quarter. Color copying and printing grew 48 percent with continued excellent growth in the DocuColor 40, the Company's 40 page-per-minute color document production system. Orders and installations of the new black and white Document Centre digital copiers introduced in April continue to exceed our expectations, and these copiers were supply constrained in the third quarter. Production publishing grew 19 percent in the 1997 third quarter compared with 9 percent growth in the 1997 second quarter, primarily as a result of excellent customer demand for the new 180 page-per-minute DocuTech Production Publisher. Computer printing grew 4 percent in the 1997 third quarter following two quarters of unusually strong growth.

Despite continuing pricing pressures, black-and-white light lens copier revenues grew 1 percent in the 1997 third quarter compared with a weak 1996 third quarter, and follows declines of 3 percent in the second quarter and 2 percent in the first quarter. These revenues were 51 percent of total revenues in the 1997 third quarter compared with 55 percent in the 1996 third quarter.

Geographically, the pre-currency revenue growth rates are as follows:

	1996					1997		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3
Total Revenues	4%	6%	5%	8%	6%	5%	6%	9%

United States	5	6	5	9	6	6	3	7
Xerox Limited	(2)	2	2	2	1	3	6	11
Other Areas	11	10	6	14	10	3	11	11

Memo: Fuji Xerox      13   15   11   11   12      11   4   4

Revenues from the U.S. sales and service operations grew 11 percent in the third quarter driven by excellent digital equipment sales and strong black and white light lens copier sales. Lower OEM sales in the 1997 third quarter compared with a year ago reduced total U.S. revenue growth to 7 percent.

Xerox Limited (formerly Rank Xerox Limited) and related companies manufacture and market Xerox products principally in Europe. Overall, the European economies remain soft. However, Holland and Italy had strong revenue growth in the third quarter and growth in France and Germany was good. The U.K. had modest growth.

Other Areas include operations principally in Latin America, Canada and China. Brazil had strong revenue growth in the 1997 third quarter reflecting excellent growth in equipment sales and document outsourcing. Revenue growth was also excellent in Mexico, but smaller Latin American countries such as Chile and Venezuela continue to be impacted by difficult economic conditions. Revenues in Canada and China were essentially flat in the third quarter.

Fuji Xerox Co., Ltd., an unconsolidated entity, jointly owned by Xerox Limited and Fuji Photo Film Company Limited, develops, manufactures and distributes document processing products in Japan, Australia, New Zealand, and other areas of the Pacific Rim. The 1997 third quarter reflects modest growth in Japan, due to difficult economic conditions, and excellent growth in Fuji Xerox' other Asian territories.

The pre-currency growth rates by type of revenue are as follows:

	1996					1997		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3 <sup>-</sup>
Total Revenues	4%	6%	5%	8%	6%	5%	6%	9%
Sales	3	6	7	12	7	5	6	12
Equipment(1)	7	9	6	14	10	10	11	21
Supplies	1	8	11	11	8	1	2	2
Paper	(2)	(7)	(12)	(7)	(7)	(9)	(1)	8
Service/Rentals/								
Outsourcing/Other	5	4	4	4	4	4	5	6
Service	1	(2)	(3)	(1)	(1)	(2)	1	2
Rentals	2	2	1	(4)	-	(11)	(8)	(10)
Doc. Outsourcing(2)	48	51	51	41	47	41	36	31
Finance Income	1	-	4	1	1	2	5	-

Memo:

Revenues Excluding Equipment Sales	3	4	2	3	3	2	3	5
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(1) Excluding OEM

(2) Excludes equipment in outsourcing contracts that are accounted for as sales.

Equipment sales in the 1997 third quarter grew 21 percent reflecting excellent growth in digital products, particularly color copying and printing, the recently introduced Document Centre black and white digital copiers, and production publishing.

Supplies sales: The decline in growth in the first three quarters of 1997 from the 1996 third and fourth quarters is due principally to a reduction in sales of OEM printer cartridges following the buildup of inventory for new products at OEM customers.

Paper sales: Our strategy is to charge a spread over mill wholesale prices to cover our costs and value added as a

distributor. Good revenue growth in the 1997 third quarter reflects volume increases partially offset by moderating industry-wide domestic price declines.

Combined service, rental, document outsourcing and other revenue growth improved to 6 percent in the 1997 third quarter. The 31 percent growth in document outsourcing (excluding equipment in outsourcing contracts accounted for as sales) continued to divert revenues from service, rentals, finance income and supplies. Service revenues grew 2 percent as the impact of higher machine populations resulting from recent higher equipment sales was partially offset by competitive price pressures. Rental revenues continued to decline, due primarily to Latin American customers' preference for purchase or document outsourcing rather than rental.

Document Outsourcing revenues are included in Equipment Sales as well as in Service/Rental/Document Outsourcing/Other. Where document outsourcing contracts include revenue accounted for as equipment sales, this revenue is included as Equipment Sales on the income statement. All other document outsourcing revenue, including service, equipment rental, supplies, paper, and labor, are included in Service/Rentals/Outsourcing/Other on the income statement. Growth in total document outsourcing revenue is higher than the growth included in Service/Rentals/Outsourcing/Other, reflecting an increase in the proportion of equipment in outsourcing contracts accounted for as sales.

Finance income: Our strategy for financing equipment sales in the industrialized economies is to charge a spread over our cost of borrowing and to lock in that spread by match funding the finance receivables with borrowings of similar maturities. Good growth in the financing of equipment sales in the U.S. and Latin America has been partially offset by lower average interest rates.

#### Gross Profit and Expenses

The gross margins by revenue stream were as follows:

	1996					1997		
	Q1	Q2	Q3	Q4	FY	Q1	Q2	Q3 <sup>-</sup>
Total Gross Margin	46.0%	47.9%	46.2%	47.1%	46.9%	46.5%	47.8%	46.6%
Sales	42.9	45.7	43.9	45.4	44.6	43.2	46.2	45.4
Service/Rent/DocOut	49.0	50.4	48.8	49.3	49.4	49.9	49.7	48.0
Financing	49.0	49.5	48.3	51.0	49.5	48.9	49.2	47.3

The total gross margin increased by 0.4 percentage points in the 1997 third quarter from the 1996 third quarter.

The sales gross margin improved by 1.5 percentage points from the 1996 third quarter principally due to product mix and productivity, partially offset by competitive pricing pressures. The service, rentals and document outsourcing gross margin declined by 0.8 percentage points from the 1996 third quarter due primarily to continued pricing pressures and adverse currency partially offset by productivity.

Research and development (R&D) expense increased 4 percent in the 1997 third quarter as we continue to invest in technological development to maintain our premier position in the rapidly changing document processing market. Xerox R&D is strategically coordinated with that of Fuji Xerox which invested \$537 million in R&D in the 1996 full year, for a combined total of \$1.6 billion.

Selling, administrative and general expenses (SAG) increased 5 percent in the 1997 third quarter. SAG was 29.4 percent of revenue in the 1997 third quarter, a decrease of 0.8 percentage points from the 1996 third quarter, primarily due to productivity initiatives and expense controls.

Worldwide employment increased by 1,000 in the 1997 third quarter to 90,100, primarily as a result of the net hiring of 500 employees for the company's fast-growing document outsourcing business, 200 for increased sales coverage, and 200 for volume related manufacturing.

The \$3 million decrease in other expenses, net, from the 1996 third quarter was due to the non-recurrence of several one-time charges in 1996 partially offset by increased non-financing interest expense associated with our June 1997 acquisition of the Rank Group's remaining interest in Xerox Limited. Also, we reduced debt with the proceeds from \$650 million of mandatorily redeemable preferred stock issued through a trust in January 1997. This partially offset the increase in non-financing interest expense because the after-tax impact of the dividend on these securities is included in the income statement in Minorities' Interests in the Earnings of Subsidiaries.

Income Taxes, Equity in Net Income of Unconsolidated Affiliates and Minorities' Interests in the Earnings of Subsidiaries

Income before income taxes increased 18 percent to \$450 million in the 1997 third quarter from \$383 million in the 1996 third quarter.

The effective tax rate was 34.2 percent in the 1997 third quarter compared with 36.0 percent in the 1996 third quarter. The effective tax rate for the 1997 first nine months is 34.8 percent and we expect the 1997 full-year tax rate to be in line with the first nine months.

Equity in the net income of unconsolidated affiliates is principally the Xerox Limited share of Fuji Xerox income. Total equity in net income increased in the 1997 third quarter as the underlying growth in Fuji Xerox was partially offset by the adverse impact of currency translation.

Minorities' interests reduction in the 1997 third quarter was due to our acquisition of the remaining interest in Xerox Limited, effective in June, partially offset by the after tax impact of the dividend on the mandatorily redeemable preferred stock discussed above.

Effective July 1, 1997, we changed the functional currency for our Brazilian operation from the U.S. dollar to the Brazilian Real because we believe the Brazilian economy is no longer considered hyperinflationary. The effect of this change on our reported results is immaterial to both the Company's results of operations and financial position in the 1997 third quarter.

In June 1997, the Company completed the acquisition of The Rank Group's remaining 20 percent financial interest in Xerox Limited and related companies for 940 million pounds sterling, or approximately \$1.5 billion. The transaction was funded entirely by debt consisting of 500 million pounds sterling of third party debt and 440 million pounds sterling of notes payable issued to The Rank Group.

In February 1996, the board of directors authorized the repurchase of up to \$1 billion of Xerox common stock. Through the 1997 second quarter, the company had repurchased 8.5 million shares for \$422 million. As a result of the Xerox Limited transaction, the repurchase program was suspended during the second quarter as use of the company's financial resources to fund the \$1.5 billion acquisition of The Rank Group's remaining interest in Xerox Limited produces greater value for Xerox shareholders.

Effective 1997, Fuji Xerox changed its reporting period from a fiscal year ending October 20 to a fiscal year ending December 20. The results of operations during the period between the end of the 1996 fiscal year and the beginning of the new fiscal year (the stub period) amounted to a gain of \$8 million. The gain was credited directly to retained earnings.

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 128 "Earnings Per Share." Commencing with our fourth quarter reporting, SFAS No. 128 will require us to present basic and diluted earnings per share (EPS) on the face of the income statement. The computation of basic EPS replaces primary EPS. If we had implemented SFAS No. 128 during the third quarter, we would have reported basic EPS of \$0.94 and \$2.74 for the quarter and year to date, respectively, and diluted EPS of \$0.89 and \$2.58 for the quarter and year to date, respectively.

In June 1997, the FASB issued SFAS No. 130, "Reporting Comprehensive Income" and No. 131, "Disclosures about Segments of an Enterprise and Related Information." Commencing in 1998, SFAS No. 130 will require companies to report comprehensive income and SFAS No. 131 will require companies to report segment performance as it is used internally to evaluate segment performance. These statements merely add additional disclosure requirements.

#### Discontinued Operations

The net investment in the discontinued financial services businesses which includes Insurance, Other Financial Services and Third-Party Financing and Real Estate totaled \$1,453 million at September 30, 1997 compared with \$2,124 million at December 31, 1996. The decrease primarily reflects the sales of Coregis Group, Inc. (Coregis) and Industrial Indemnity Holdings, Inc. (II), somewhat offset by scheduled funding of reinsurance coverage to the Talegen Holdings, Inc. (Talegen) companies and The Resolution Group, Inc. (TRG) by Ridge Reinsurance Limited (Ridge Re) and interest for the period on the assigned debt. A discussion of the discontinued businesses follows.

#### Insurance

In 1995, we recorded a \$1,546 million after-tax charge in connection with agreements to sell all of our "Remaining" insurance companies, which included Coregis, Crum & Forster Holdings, Inc. (CFI), II, Westchester Specialty Group, Inc. (WSG), TRG and three insurance-related service companies.

On September 11, 1996, those transactions were terminated. No additional charges are considered necessary as a result of the termination. In September 1996, the Board of Directors of Xerox formally approved a plan of disposal under which we have retained investment bankers to assist us in the simultaneous disposition of each of the Remaining insurance and service companies.

During 1997, we made significant progress in the disposition of these companies, including the completion of the sales of three of the five Remaining insurance companies as well as the announced sale agreement for a fourth, and the completed disposition of one service company. We expect to make an announcement related to the disposition of the one remaining insurance company, CFI, within the coming months. Specifically, during 1997 the following has occurred:

- - In the first quarter, we sold certain assets of Apprise Corp., one of Talegen's insurance-related service companies. The financial terms of this transaction were not material.
- - In the second quarter, we completed the sale of Coregis for \$375 million in cash and the assumption of \$75 million in debt.
- - In the third quarter, we completed the sale of II for \$365 million in cash, plus the assumption of \$79 million in debt.
- - On September 18, 1997, we announced an agreement to sell WSG for \$333 million in cash, less transaction related costs estimated to be \$60 million. This transaction is subject to customary closing conditions and regulatory approvals and is expected to close before the end of January 1998.
- - On October 15, 1997 we completed the sale of TRG for \$150 million in cash and \$462 million in performance-based instruments to an investor group led by the Chief Executive Officer of TRG.

The selling prices of the disposed companies were consistent with the estimated values of the units when we discontinued the insurance operations in 1995. During the disposal process, we will continue to be subject to all business risks and rewards of the remaining units. Until the remaining units are actually sold, no assurances can be given as to the ultimate impact on our total results from operations or whether the proceeds of sales will equal their carrying value.

Xerox Financial Services, Inc. (XFSI) continues to provide aggregate excess of loss reinsurance coverage to the current and former Talegen/TRG units through Ridge Reinsurance Limited (Ridge Re), a wholly owned subsidiary. As of October 1997, XFSI is

obligated to pay five remaining annual premium installments of \$45 million, plus finance charges for coverage totaling \$1,109 million (which is net of 15 percent coinsurance). At September 30, 1997, Ridge Re had recognized approximately \$632 million of the available coverage.

The net investment in Insurance at September 30, 1997 totaled \$1,176 million compared with a balance of \$1,846 million at December 31, 1996. The decrease primarily reflects the sales of Coregis and II, somewhat offset by contractual payments to Ridge Re for annual premium installments and associated finance charges and interest on the assigned insurance debt.

#### Property and Casualty Operating Trends

The industry's profitability can be significantly affected by cyclical competitive conditions, judicial decisions affecting insurers' liabilities, and by volatile and unpredictable developments, including changes in the propensity of courts to grant large awards, fluctuations in interest rates and other changes in the investment environment (which affect market prices of insurance companies' investments, the income from those investments and inflationary pressures that may tend to affect the size of losses). WSG and CFI's operating results have historically been influenced by these industry trends, as well as by their exposure to uncollectible reinsurance, which had been greater than most other insurers.

#### Other Financial Services

The net investment in Other Financial Services (OFS) at September 30, 1997 was \$124 million compared with \$101 million at December 31, 1996. The increase in the investment primarily reflects the effect of a transfer from Insurance which had no effect on the total net investment in the discontinued financial services businesses.

On June 1, 1995, XFSI completed the sale of Xerox Financial Services Life Insurance Company and related companies (Xerox Life). In connection with the transaction, OakRe Life Insurance Company (OakRe), a wholly-owned XFSI subsidiary, assumed responsibility, via Coinsurance Agreements, for existing Single Premium Deferred Annuity (SPDA) policies issued by Xerox Life. The Coinsurance Agreements include a provision for the assumption (at their election) by the purchaser's companies, of all of the SPDA policies at the end of their current rate reset periods. A Novation Agreement with an affiliate of the new owner provides for the assumption of the liability under the Coinsurance Agreements for any SPDA policies not so assumed. Other policies (of Immediate, Whole Life, and Variable annuities as well as a minor amount of SPDAs) were sold and are now the responsibility of the purchaser's companies.

As a result of the Coinsurance Agreements, at September 30, 1997, OakRe retained approximately \$1.7 billion of investment portfolio assets (transferred from Xerox Life) and liabilities related to the reinsured SPDA policies. Interest rates on these policies are fixed and were established upon issuance of the respective policies. Substantially all of these policies will reach their rate reset periods through the year 2000 and will be assumed under the Agreements as described above. Xerox Life's portfolio was designed to recognize that policy renewals extended liability "maturities," thereby permitting investments with average duration somewhat beyond the rate reset periods. OakRe's practice is to selectively improve this match over time as market conditions allow.

In connection with the aforementioned sale, XFSI established a \$500 million letter of credit and line of credit with a group of banks to support OakRe's coinsurance obligations. The term of this letter of credit is five years and it is unused and available at September 30, 1997. Upon a drawing under the letter of credit, XFSI has the option to cover the drawing in cash or to draw upon the credit line.

#### Third-Party Financing and Real Estate

Third-Party Financing and Real Estate assets at September 30, 1997 totaled \$337 million, a \$113 million reduction from the December 31, 1996 level due primarily to the continued run-off and sales of third-party assets. The proceeds were used to

reduce assigned debt to \$134 million at September 30, 1997, a \$89 million decrease from the year-end 1996 level.

#### Capital Resources and Liquidity

Total debt, including ESOP and discontinued operations debt not shown separately in our consolidated balance sheets, was \$13,206 million at September 30, 1997 or \$758 million more than at December 31, 1996. The changes in consolidated indebtedness since year-end and versus the first nine months of 1996 are summarized as follows:

(In millions)	1997	1996
Total Debt as of January 1	\$12,448	\$11,794
Non-Financing Businesses		
Document Processing operations	173	553
Discontinued Businesses	(506)	132
Total Non-Financing	(333)	685
Financing Businesses	(106)	(15)
Total Operations	(439)	670
Shareholder dividends	356	330
Acquisition of Additional Interest in RX	1,534	-
Mandatorily redeemable preferred stock	(637)	-
Equity redemption and other changes	(56)	165
Total Debt as of September 30	\$13,206	\$12,959

The following table summarizes the changes in total equity during the first nine months of 1997 and 1996:

(In millions)	1997	1996
Total equity as of January 1	\$5,931	\$5,396
Income from Continuing Operations	927	780
Shareholder dividends paid	(356)	(330)
Proceeds from Sale of Common Stock	130	85
Repurchase of common and preferred stock	(116)	(257)
Purchase of Minority Interest	(723)	-
Net proceeds from issuance of mandatorily redeemable preferred stock	637	-
All other, net	(202)	(15)
Balance as of September 30	\$6,228	\$5,659

#### Non-Financing Operations

Operational cash flows are highly seasonal. Due primarily to profit sharing payments and inventory build up, historically our operations have used cash in the first half and generated cash later in the year.

The following table summarizes Document Processing non-financing operations cash generation and borrowing for the nine months ended September 30, 1997 and 1996:

(In millions)	Cash Generated/(Borrowed)	
	Nine Months Ended September 30	
	1997	1996
Document Processing		
Non-Financing:		
Income	\$ 763	\$ 663
Depreciation and amortization	517	528
Capital expenditures, net	(286)	(310)
Working capital/other	(1,167)	(1,434)
Total	\$ (173)	\$ (553)

Nine-month cash usage of \$173 million was \$380 million less than in the first nine months of 1996 due primarily to higher net income, and lower restructuring payments.

#### Financing Businesses

Financing businesses debt was reduced by \$106 million and \$15 million during the first nine months of 1997 and 1996, respectively. This larger decline in 1997 reflects currency translation effects related to the strength of the U.S. dollar compared with the major European currencies largely offset by volume growth.

We have entered into certain financial instruments to manage interest rate and foreign currency exposures. These instruments are held solely for hedging purposes and include interest rate swap agreements, forward exchange contracts and foreign currency swap agreements. We do not enter into derivative instrument transactions for trading purposes and we employ long-standing policies prescribing that derivative instruments only be used to achieve a set of very limited objectives.

Currency derivatives are primarily arranged in conjunction with underlying transactions that give rise to foreign currency-denominated payables and receivables; for example, an option to buy foreign currency to settle the importation of goods from suppliers, or a forward exchange contract to fix the U.S. dollar value of a foreign currency-denominated loan. In addition, when cost-effective, currency derivatives may be used to hedge balance sheet exposures.

Revenues denominated in currencies where the local currency is the functional currency are not hedged.

With regard to interest rate hedging, virtually all customer financing assets earn fixed rates of interest. We "lock in" an interest rate spread by arranging fixed-rate liabilities with similar maturities as the underlying assets. Additionally, customer financing assets in one currency are consistently funded with liabilities in the same currency. We refer to the effect of these conservative practices as "match funding" customer financing assets. This practice effectively eliminates both the risk of a major compression in interest margins if interest rates increase and the opportunity for margin expansion if interest rates decline.

More specifically, pay fixed-rate and receive variable-rate swaps are typically used in place of more expensive fixed-rate debt. Pay variable-rate and receive variable-rate swaps are used to transform variable-rate medium-term debt into commercial paper or LIBOR obligations. Additionally, pay variable-rate and receive fixed-rate swaps are used from time to time to transform longer-term fixed-rate debt into commercial paper or LIBOR-rate obligations. The transactions performed within each of these three categories enable cost-effective management of interest rate exposures. The potential risk attendant to this strategy is non-performance of a swap counterparty. We address this risk by arranging swaps exclusively with a diverse group of strong-credit counterparties, regularly monitoring their credit ratings, determining the replacement cost, if any, of existing transactions, and internally capping related exposures.

Our currency and interest rate hedging is typically unaffected by changes in market conditions as forward contracts, options and swaps are normally held to maturity consistent with our objective to lock in currency rates and interest rate spreads on the underlying transactions.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings

The information set forth under Note 9 contained in the "Notes to Consolidated Financial Statements" on pages 13-15 of this Quarterly Report, on Form 10-Q, is incorporated by reference in answer to this item.

### Item 2. Changes in Securities

During the quarter ended September 30, 1997, Registrant issued the following securities in transactions which were not registered under the Securities Act of 1933, as amended (the Act):

- (a) Securities Sold: on July 1, 1997, Registrant issued 1,393 shares of Common stock, par value \$1 per share.
- (b) No underwriters participated. The shares were issued to each of the non-employee Directors of Registrant: B.R. Inman, A.A. Johnson, V.E. Jordan, Jr., Y. Kobayashi, H. Kopper, R.S. Larsen, J.D. Macomber, G.J. Mitchell,

N.J. Nicholas, Jr., J.E. Pepper, M.R. Seger and T.C. Theobald.

- (c) The shares were issued at a deemed purchase price of \$78.875 per share (aggregate price \$109,125), based upon the market value on the date of issuance, in payment of the quarterly Directors' fees pursuant to Registrant's Restricted Stock Plan for Directors.
- (d) Exemption from registration under the Act was claimed based upon Section 4(2) as a sale by an issuer not involving a public offering.

Item 6. Exhibits and Reports on Form 8-K

- (a) Exhibit 3(a)(1) Restated Certificate of Incorporation of Registrant filed by the Department of State of the State of New York on October 29, 1996. Incorporated by reference to Exhibit 3(a)(1) to Registrant's Quarterly Report on Form 10-Q for the Quarter Ended September 30, 1996.

Exhibit 3(b) By-Laws of Registrant, as amended through June 11, 1997 (in electronic form only).

Exhibit 10(e) 1997 Restatement of Registrant's Unfunded Retirement Income Guarantee Plan (in electronic form only).

Exhibit 10(f) 1997 Restatement of Registrant's Unfunded Supplemental Retirement Plan (in electronic form only).

Exhibit 10(k) Registrant's Deferred Compensation Plan For Directors, 1997 Amendment and Restatement (in electronic form only).

Exhibit 10(l) Registrant's Deferred Compensation Plan For Executives, 1997 Amendment and Restatement (in electronic form only).

Exhibit 11 Computation of Net Income per Common Share.

Exhibit 12 Computation of Ratio of Earnings to Fixed Charges.

Exhibit 27 Financial Data Schedule (in electronic form only).

- (b) A current report on Form 8-K dated June 30, 1997, August 1, 1997 and September 18, 1997 reporting Item 5 "Other Events" was filed during the quarter for which this Quarterly Report is filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

XEROX CORPORATION  
(Registrant)

Date: November 12, 1997

\_\_\_\_\_  
By Philip D. Fishbach  
Vice President and Controller  
(Principal Accounting Officer)

Exhibit 11  
Xerox Corporation

Computation of Net Income Per Common Share  
(Dollars in millions, except per-share data; shares in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	1997	1996	1997	1996
<b>I. Primary Net Income Per Common Share</b>				
Income from continuing operations	\$ 320	\$ 250	\$ 927	\$ 780
Accrued dividends on ESOP preferred stock, net	(11)	(11)	(33)	(32)
Accrued dividends on redeemable preferred stock	-	-	-	(1)
Adjusted income from continuing operations	309	239	894	747
Discontinued operations	-	-	-	-
Adjusted net income	\$ 309	\$ 239	\$ 894	\$ 747
Average common shares outstanding during the period	325,237	324,524	324,430	324,578
Common shares issuable with respect to common stock equivalents for stock options, incentive and exchangeable shares	6,520	9,049	6,520	9,049
Adjusted average shares outstanding for the period	331,757	333,573	330,950	333,627
Primary earnings per share:				
Continuing operations	\$ 0.92	\$ 0.71	\$ 2.70	\$ 2.24
Discontinued operations	-	-	-	-
Primary earnings per share	\$ 0.92	\$ 0.71	\$ 2.70	\$ 2.24
<b>II. Fully Diluted Net Income Per Common Share</b>				
Income from continuing operations	\$ 320	\$ 250	\$ 927	\$ 780
Accrued dividends on redeemable preferred stock	-	-	-	(1)
ESOP expense adjustment, net of tax	-	-	-	(1)
Interest on convertible debt, net of tax	1	-	2	1
Adjusted income from continuing operations	321	250	929	779
Discontinued operations	-	-	-	-
Adjusted net income	\$ 321	\$ 250	\$ 929	\$ 779
Average common shares outstanding during the period	325,237	324,524	324,430	324,578
Stock options, incentive and exchangeable shares	6,760	9,050	6,760	9,050
Convertible debt	2,644	2,644	2,644	2,644
ESOP preferred stock	27,418	28,063	27,418	28,063
Adjusted average shares outstanding for the period	362,059	364,281	361,252	364,335
Fully diluted earnings per share:				
Continuing operations	\$ 0.88	\$ 0.68	\$ 2.57	\$ 2.14
Discontinued operations	-	-	-	-
Fully diluted earnings per share	\$ 0.88	\$ 0.68	\$ 2.57	\$ 2.14

## Xerox Corporation

## Computation of Ratio of Earnings to Fixed Charges

(In millions)	Nine months ended September 30,			Year ended December 31,			
	1997	1996	1996	1995	1994	1993*	1992
Fixed charges:							
Interest expense	\$ 450	\$ 446	\$ 592	\$ 603	\$ 520	\$ 540	\$ 627
Rental expense	92	110	140	142	170	180	187
Preferred stock dividend of subsidiary	37	-	-	-	-	-	-
Total fixed charges before capitalized interest	579	556	732	745	690	720	814
Capitalized interest	-	-	-	-	2	5	17
Total fixed charges	\$ 579	\$ 556	\$ 732	\$ 745	\$ 692	\$ 725	\$ 831
Earnings available for fixed charges:							
Earnings**	\$ 1,480	\$ 1,318	\$ 2,067	\$ 1,980	\$ 1,602	\$ (193)	\$ 1,183
Less undistributed income in minority owned companies	(101)	(91)	(84)	(90)	(54)	(51)	(52)
Add fixed charges before capitalized interest and preferred stock dividend of subsidiary	542	556	732	745	690	720	814
Total earnings available for fixed charges	\$ 1,921	\$ 1,783	\$ 2,715	\$ 2,635	\$ 2,238	\$ 476	\$ 1,945
Ratio of earnings to fixed charges (1) (2)	3.32	3.21	3.71	3.54	3.23	0.66	2.34

(1) The ratio of earnings to fixed charges has been computed based on the Company's continuing operations by dividing total earnings available for fixed charges, excluding capitalized interest, by total fixed charges. Fixed charges consist of interest, including capitalized interest, one-third of rent expense as representative of the interest portion of rentals, and preferred stock dividend requirements of subsidiaries. Debt has been assigned to discontinued operations based on historical levels assigned to the businesses when they were continuing operations, adjusted for subsequent paydowns. Discontinued operations consist of the Company's Insurance and Other Financial Services businesses and its real-estate development and third-party financing businesses.

(2) The Company's ratio of earnings to fixed charges includes the effect of the Company's finance subsidiaries, which primarily finance Xerox equipment. Financing businesses are more highly leveraged and, therefore, tend to operate at lower earnings to fixed charges ratio levels than do non-financial businesses.

\* 1993 earnings were inadequate to cover fixed charges. The coverage deficiency was \$249 million.

\*\* Sum of "Income before Income Taxes, Equity Income and Minorities' Interests" and "Equity in Net Income of Unconsolidated Affiliates."

BY-LAWS

of

XEROX CORPORATION

June 11, 1997

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ARTICLE I

MEETINGS OF STOCKHOLDERS

SECTION 1. ANNUAL MEETINGS: A meeting of shareholders entitled to vote shall be held for the election of Directors and the transaction of other business in May of each year on any day (except a Saturday, Sunday, or holiday) in that month as determined by the Board of Directors.

SECTION 2. SPECIAL MEETINGS: Special Meetings of the shareholders may be called at any time by the Chairman of the Board, the President or the Board of Directors.

SECTION 3. PLACE OF MEETINGS: Meetings of shareholders shall be held at the principal office of the Company or at such other place, within or without the State of New York, as may be fixed by the Board of Directors.

SECTION 4. NOTICE OF MEETINGS:

(a) Notice of each meeting of shareholders shall be in writing and shall state the place, date and hour of the meeting. Notice of a Special Meeting shall state the purpose or purposes for which it is being called and shall also indicate that it is being issued by or at the direction of the person or persons calling the meeting. If, at any meeting, action is proposed to be taken which would, if taken, entitle shareholders, fulfilling the requirements of Section 623 of the Business Corporation Law to receive payment for their shares, the notice of such meeting shall include a statement of that purpose and to that effect.

(b) A copy of the notice of any meeting shall be given, personally or by mail, not less than ten nor more than fifty days before the date of the meeting, to each shareholder entitled to vote at such meeting. If mailed, such notice is given when deposited in the United States mail, with postage thereon prepaid, directed to the shareholder at his address as it appears on the record of shareholders, or, if he shall have filed with the Secretary a written request that notices to him be mailed to some other address, then directed to him at such other address.

(c) Notice of meeting need not be given to any shareholder who submits a signed waiver of notice, in person or by proxy, whether before or after the meeting. The attendance of any shareholder at a meeting, in person or by proxy, without protesting prior to the conclusion of the meeting the lack of notice of such meeting, shall constitute a waiver of notice by him.

SECTION 5. QUORUM AND ADJOURNED MEETINGS:

(a) At any Annual or Special Meeting the holders of a majority of the shares of stock entitled to vote thereat, present in person or by proxy, shall constitute a quorum for the transaction of any business, provided that when a specified item of business is required to be voted on by a class or series, voting as a class, the holders of a majority of the shares of stock of such class or series shall constitute a quorum for the transaction of such specified item of business. When a quorum is once present to organize a meeting, it is not broken by the subsequent withdrawal of any shareholders.

(b) Despite the absence of a quorum, the shareholders present may adjourn the meeting to another time and place, and it shall not be necessary to give any notice of the adjourned meeting if the time and place to which the meeting is adjourned are announced at the meeting at which the adjournment is taken. At the adjourned meeting any business may be transacted that might have been transacted on the original date of the meeting. If after the adjournment, however, the Board of Directors fixes a new record date for the adjourned meeting, a notice of the adjourned meeting shall be given to each shareholder on the new record date entitled to notice under Section 4 of this Article I of the By-Laws.

SECTION 6. ORGANIZATION: At every meeting of the shareholders, the Chairman of the Board, or in his absence, the President, or in his absence, an Executive Vice President designated by the Chairman of the Board, or in the absence of such officers, a person selected by the meeting, shall act as chairman of the meeting. The Secretary or, in his absence, an Assistant Secretary shall act as secretary of the meeting, and in the absence of both the Secretary and an Assistant Secretary, a person selected by the meeting shall act as secretary of the meeting.

SECTION 7. VOTING:

(a) Whenever any corporate action, other than the election of Directors, is to be taken by vote of the shareholders, it shall, except as otherwise required by law or by the Certificate of Incorporation be authorized by a majority of the votes cast at a meeting of shareholders by the holders of shares entitled to vote thereon.

(b) Directors shall, except as otherwise required by law, be elected by a plurality of the votes cast at a meeting of shareholders by holders of shares entitled to vote in the election; provided, however, a nomination shall be accepted, and votes cast for a nominee shall be counted by the inspectors of election, only if the Secretary of the Company has received at least twenty-four hours prior to the meeting a statement over the signature of the nominee that he consents to being a nominee and, if elected, intends to serve as a Director.

SECTION 8. QUALIFICATION OF VOTERS:

(a) Every shareholder of record of Common Stock and Series B Convertible Preferred Stock of the Company shall be entitled at every meeting of such shareholders to one vote for every share of Common Stock and Series B Convertible Preferred Stock, respectively, standing in his name on the record of shareholders.

(b) Shares of stock belonging to the Company and shares held by another domestic or foreign corporation of any type or kind, if a majority of the shares entitled to vote in the election of directors of such other corporation is held by the Company, shall not be shares entitled to vote or to be counted in determining the total number of outstanding shares.

(c) Shares held by an administrator, executor, guardian, conservator, committee, or other fiduciary, except a trustee, may be voted by him, either in person or by proxy, without transfer of such shares into his name. Shares held by a trustee may be voted by him, either in person or by proxy, only after the shares have been transferred into his name as trustee or into the name of his nominee.

(d) Shares standing in the name of another domestic or foreign corporation of any type or kind may be voted by such officer, agent or proxy as the By-Laws of such corporation may provide, or in the absence of such provision, as the Board of Directors of such corporation may provide.

SECTION 9. PROXIES:

(a) Every shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting may authorize another person or persons to act for him by proxy.

(b) Every proxy must be signed by the shareholder or his attorney-in-fact. No proxy shall be valid after the expiration of eleven months from the date thereof unless otherwise provided in the proxy. Every proxy shall be revocable at the pleasure of the shareholder executing it, except as otherwise provided by law.

(c) The authority of the holder of a proxy to act shall not be revoked by the incompetence or death of the shareholder who executed the proxy unless, before the authority is exercised, written notice of an adjudication of such incompetence or of such death is received by the Secretary or an Assistant Secretary.

SECTION 10. INSPECTORS OF ELECTION:

(a) The Board of Directors, in advance of any shareholders' meeting, may appoint one or more inspectors to act at the meeting or any adjournment thereof. If inspectors are not so appointed, the person presiding at a shareholders' meeting may, and on the request of any shareholder entitled to vote thereat, shall, appoint one or more inspectors. In case any person appointed fails to appear or act, the vacancy may be filled by appointment made by the Board of Directors in advance of the meeting or at the meeting by the person presiding thereat. Each inspector, before entering upon the

discharge of his duties, shall take and sign an oath faithfully to execute the duties of inspector at such meeting with strict impartiality and according to the best of his ability.

(b) The inspectors shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots or consents, hear and determine all challenges and questions arising in connection with the right to vote, count and tabulate all votes, ballots or consents, determine the result, and do such acts as are proper to conduct the election or vote with fairness to all shareholders. On request of the person presiding at the meeting or any shareholder entitled to vote thereat, the inspectors shall make a report in writing of any challenge, question or matter determined by them and execute a certificate of any fact found by them. Any report or certificate made by them shall be prima facie evidence of the facts stated and of the vote as certified by them.

SECTION 11. LIST OF SHAREHOLDERS AT MEETINGS: A list of share-holders as of the record date, certified by the Secretary or by the transfer agent, shall be produced at any meeting of shareholders upon the request thereat or prior thereto of any shareholder. If the right to vote at any meeting is challenged, the inspectors of election, or person presiding thereat shall require such list of shareholders to be produced as evidence of the right of the persons challenged to vote at such meeting, and all persons who appear from such list to be shareholders entitled to vote thereat may vote at such meeting.

## ARTICLE II

### BOARD OF DIRECTORS

SECTION 1. POWER OF BOARD AND QUALIFICATION OF DIRECTORS: The business of the Company shall be managed under the direction of the Board of Directors, each of whom shall be at least eighteen years of age.

SECTION 2. NUMBER, TERM OF OFFICE AND CLASSIFICATION:

(a) The Board of Directors shall consist of not less than five nor more than twenty-one members. The number of Directors shall be determined from time to time by resolution of a majority of the entire Board of Directors then in office, provided that no decrease in the number of Directors shall shorten the term of any incumbent Director. At each Annual Meeting of shareholders Directors shall be elected to hold office until the next annual meeting.

(b) If and whenever six full quarter-yearly dividends (whether or not consecutive) payable on the Cumulative Preferred Stock of any series shall be in arrears, in whole or in part, the number of Directors then constituting the Board of Directors shall be increased by two and the holders of the Cumulative Preferred Stock, voting separately as a class, regardless of series, shall be entitled to elect the two additional Directors at any annual meeting of shareholders or special meeting held in place thereof, or at a special meeting of the holders of the Cumulative Preferred Stock called as hereinafter provided. Whenever all arrears in dividends on the Cumulative Preferred Stock then outstanding shall have been paid and dividends thereon for the current quarter-yearly dividend period shall have been paid or declared and set apart for payment, then the right of the holders of the Cumulative Preferred Stock to elect such additional two Directors shall cease (but subject always to the same provisions for the vesting of such voting rights in the case of any similar future arrearages in dividends), and the terms of office of all persons elected as Directors by the holders of the Cumulative Preferred Stock shall forthwith terminate and the number of the Board of Directors shall be reduced accordingly. At any time after such voting power shall have been so vested in the Cumulative Preferred Stock, the Secretary of the Company may, and upon the written request of any holder of the Cumulative Preferred Stock (addressed to the Secretary at the principal office of the Company) shall, call a special meeting of the holders of the Cumulative Preferred Stock for the election of the two Directors to be elected by them as herein provided, such call to be made by notice similar to that provided in the By-Laws for a special meeting of the shareholders or as required by law. If any such special meeting required to be called as above provided shall not be called by the Secretary within twenty days after receipt of any such request, then any holder of Cumulative Preferred Stock may call such meeting, upon the notice above provided, and for that purpose shall have access to the stock books of the Company. The Directors elected at any such special meeting shall hold office until the next annual meeting of the shareholders or special meeting held in place thereof. In case any vacancy shall occur among the Directors elected by the holders of the Cumulative Preferred Stock, a successor shall be elected to serve until the next annual meeting of the shareholders or special meeting held in place thereof by the then remaining Director elected by the holders of the Cumulative Preferred Stock or the successor of such remaining

Director.

(c) All Directors shall have equal voting power.

SECTION 3. ORGANIZATION: At each meeting of the Board of Directors, the Chairman of the Board, or in his absence, the President, or in his absence, a chairman chosen by a majority of the Directors present shall preside. The Secretary shall act as secretary of the Board of Directors. In the event the Secretary shall be absent from any meeting of the Board of Directors, the meeting shall select its secretary.

SECTION 4. RESIGNATIONS: Any Director of the Company may resign at any time by giving written notice to the Chairman of the Board, the President or to the Secretary of the Company. Such resignation shall take effect at the time specified therein or, if no time be specified, then on delivery.

SECTION 5. VACANCIES: Newly created directorships resulting from an increase in the number of Directors and vacancies occurring in the Board of Directors for any reason may be filled by vote of a majority of the Directors then in office, although less than a quorum exists. A Director elected to fill a vacancy shall hold office until the next annual meeting.

SECTION 6. PLACE OF MEETING: The Board of Directors may hold its meetings at such place or places within or without the State of New York as the Board of Directors may from time to time by resolution determine.

SECTION 7. FIRST MEETING: On the day of each annual election of Directors, the Board of Directors shall meet for the purpose of organization and the transaction of other business. Notice of such meeting need not be given. Such first meeting may be held at any other time which shall be specified in a notice given as hereinafter provided for special meetings of the Board of Directors.

SECTION 8. REGULAR MEETINGS: Regular meetings of the Board of Directors may be held at such times as may be fixed from time to time by resolution of the Board of Directors without notice.

SECTION 9. SPECIAL MEETINGS: Special meetings of the Board of Directors shall be held whenever called by the Chairman of the Board, the President, or by any two of the Directors. Oral, telegraphic or written notice shall be given, sent or mailed not less than one day before the meeting and shall state, in addition to the purposes, the date, place and hour of such meeting.

SECTION 10. WAIVERS OF NOTICE: Notice of a meeting need not be given to any Director who submits a signed waiver of notice whether before or after the meeting, or who attends the meeting without protesting, prior thereto or at its commencement, the lack of notice to him.

SECTION 11. QUORUM AND MANNER OF ACTING:

(a) If the number of Directors is twelve or more, seven Directors shall constitute a quorum for the transaction of business or any specified item of business. If the number of Directors is less than twelve, a majority of the entire Board of Directors shall constitute a quorum.

(b) A majority of the Directors present, whether or not a quorum is present, may adjourn any meeting to another time and place without notice to any Director.

SECTION 12. WRITTEN CONSENTS: Any action required or permitted to be taken by the Board of Directors or any committee thereof may be taken without a meeting if all members of the Board or the committee consent in writing to the adoption of a resolution authorizing the action. The resolution and the written consents thereto by the members of the Board or committee shall be filed with the minutes of the proceedings of the Board or committee.

SECTION 13. PARTICIPATION AT MEETINGS BY TELEPHONE: Any one or more members of the Board of Directors or any committee thereof may participate in a meeting of such Board or committee by means of a conference telephone or similar communications equipment allowing all persons participating in the meeting to hear each other at the same time. Participation by such means shall constitute presence in person at a meeting.

SECTION 14. COMPENSATION: The Board of Directors shall have authority to fix the compensation of Directors for services in any capacity.

SECTION 15. INTERESTED DIRECTORS:

(a) No contract or other transaction between the Company and one or more of its Directors, or between the Company and any other corporation, firm,

association or other entity in which one or more of its Directors are directors or officers, or are financially interested, shall be either void or voidable for this reason alone or by reason alone that such Director or Directors are present at the meeting of the Board of Directors, or of a committee thereof, which approves such contract or transaction, or that his or their votes are counted for such purpose, provided that the parties to the contract or transaction establish affirmatively that it was fair and reasonable as to the Company at the time it was approved by the Board, a committee, or the shareholders.

(b) Any such contract or transaction may not be avoided by the Company for the reasons set forth in (a) if

(1) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the Board or committee, and the Board or committee approves such contract or transaction by a vote sufficient for such purpose without counting the vote of such interested Director or, if the votes of the disinterested Directors are insufficient for such purpose, by unanimous vote of the disinterested Directors (although common or interested Directors may be counted in determining the presence of a quorum at a meeting of the Board or of a committee which approves such contract or transactions), or

(2) the material facts as to such Director's interest in such contract or transaction and as to any such common directorship, officership or financial interest are disclosed in good faith or known to the shareholders entitled to vote thereon, and such contract or transaction is approved by vote of such shareholders.

SECTION 16. LOANS TO DIRECTORS: A loan shall not be made by the Company to any Director unless it is authorized by vote of the shareholders (the shares of the Director who would be the borrower shall not be shares entitled to vote); except that for purposes of loans made to any Directors under the Restricted Stock Purchase Plan, adopted by the shareholders of the Company on May 15, 1969, such adoption shall constitute full and complete authorization for any such loan made thereunder.

### ARTICLE III

#### EXECUTIVE COMMITTEE

SECTION 1. HOW CONSTITUTED AND POWERS: There shall be an Executive Committee, consisting of not less than three nor more than nine Directors, including the Chairman of the Board and the Chairman of the Executive Committee, elected by a majority of the entire Board of Directors, who shall serve at the pleasure of the Board. The Executive Committee shall have all the authority of the Board, except it shall have no authority as to the following matters:

(a) The submission to shareholders of any action that needs shareholders' authorization.

(b) The filling of vacancies in the Board or in any committee.

(c) The fixing of compensation of the Directors for serving on the Board or on any committee.

(d) The amendment or repeal of the By-Laws, or the adoption of new By-Laws.

(e) The amendment or repeal of any resolution of the Board which, by its terms, shall not be so amendable or repealable.

(f) The declaration of dividends.

SECTION 2. MEETINGS: Meetings of the Executive Committee, of which no notice shall be necessary, shall be held on such days and at such place as shall be fixed, either by the Chairman of the Board, the Chairman of the Executive Committee, or by a vote of the majority of the whole Committee.

SECTION 3. QUORUM AND MANNER OF ACTING: Unless otherwise provided by resolution of the Board of Directors, a majority of the Executive Committee shall constitute a quorum for the transaction of business and the act of a majority of all of the members of the Committee, whether present or not, shall be the act of the Executive Committee. The members of the Executive Committee shall act only as a Committee. The procedure of the Committee and its manner of acting shall be subject at all times to the directions of the Board of Directors.

SECTION 4. ADDITIONAL COMMITTEES: The Board of Directors by resolution adopted by a majority of the entire Board may designate from among its members additional committees, each of which shall consist of three or more Directors and shall have such authority as provided in the resolution designating the committee, except such authority shall not exceed the authority conferred on the Executive Committee by Section 1 of this Article.

SECTION 5. ALTERNATE MEMBERS: The Board of Directors may designate one or more eligible Directors as alternate members of the Executive Committee, or of any other committee of the Board, who may replace any absent member or members at any meeting of any such committee.

#### ARTICLE IV

##### OFFICERS

SECTION 1. NUMBER: The officers of the Company shall be a Chairman of the Board, a President, a Chairman of the Executive Committee, one or more Vice Presidents, a Treasurer, a Secretary, a Controller, and such other officers as the Board of Directors may in its discretion elect. Any two or more offices may be held by the same person, except the offices of Chairman of the Board and Secretary, and President and Secretary.

SECTION 2. TERM OF OFFICES AND QUALIFICATIONS: Those officers whose titles are specifically mentioned in Section 1 of this Article IV shall be chosen by the Board of Directors on the day of the Annual Meeting. Unless a shorter term is provided in the resolution of the Board electing such officer, the term of office of such officer shall extend to and expire at the meeting of the Board held on the day of the next Annual Meeting. The Chairman of the Board, the President and the Chairman of the Executive Committee shall be chosen from among the Directors.

SECTION 3. ADDITIONAL OFFICERS: Additional officers other than those whose titles are specifically mentioned in Section 1 of this Article IV shall be elected for such period, have such authority and perform such duties, either in an administrative or subordinate capacity, as the Board of Directors may from time to time determine.

SECTION 4. REMOVAL OF OFFICERS: Any officer may be removed by the Board of Directors with or without cause, at any time. Removal of an officer without cause shall be without prejudice to his contract rights, if any, but his election as an officer shall not of itself create contract rights.

SECTION 5. RESIGNATION: Any officer may resign at any time by giving written notice to the Board of Directors, or to the Chairman of the Board, or to the Secretary. Any such resignation shall take effect at the time specified therein, or if no time be specified, then upon delivery.

SECTION 6. VACANCIES: A vacancy in any office shall be filled by the Board of Directors.

SECTION 7. CHAIRMAN OF THE BOARD: The Chairman of the Board shall preside at all meetings of the shareholders at which he is present, unless at such meetings the shareholders shall appoint a chairman other than the Chairman of the Board. The Chairman of the Board shall preside at all meetings of the Directors at which he is present. The Chairman of the Board shall act as the Chief Executive Officer of the Company and it shall be his duty to supervise generally the management of the business of the Company with responsibility direct to the Board and subject to the control of the Board. The Chairman of the Board shall have such powers and perform such other duties as may be assigned to him by the Board.

SECTION 8. PRESIDENT: The President shall have such powers and perform such duties as may be assigned to him by the Board and the Chairman of the Board. The President shall, in the absence of the Chairman of the Board, preside at all meetings of the shareholders and Directors at which he is present. In the absence or inability to act of the Chairman of the Board, or if the Office of Chairman of the Board be vacant, the President, subject to the right of the Board from time to time to extend or confine such powers and duties or to assign them to others, shall perform all the duties and may exercise all the powers of the Chairman of the Board.

SECTION 9. CHAIRMAN OF THE EXECUTIVE COMMITTEE: The Chairman of the Executive Committee shall have such powers and perform such duties as may be assigned to him by the Board. The Chairman of the Executive Committee shall preside at meetings of the Executive Committee of the Board of Directors.

SECTION 10. THE VICE PRESIDENTS: Each Vice President shall have such powers and shall perform such duties as may be assigned to him by the Board of Directors, the Chairman of the Board or the President.

SECTION 11. THE TREASURER: The Treasurer shall, if required by the Board of Directors, give a bond for the faithful discharge of his duties, in such sum and with such sureties as the Board of Directors shall require. He shall have charge and custody of, and be responsible for, all funds and securities of the Company, and deposit all such funds in the name of and to the credit of the Company in such banks, trust companies, or other depositories as shall be selected by the Board of Directors. The Treasurer may sign certificates for stock of the Company authorized by the Board of Directors. He shall also perform all other duties customarily incident to the office of Treasurer and such other duties as from time to time may be assigned to him by the Board of Directors.

SECTION 12. THE CONTROLLER: The Controller shall keep and maintain the books of account for internal and external reporting purposes. He shall also perform all other duties customarily incident to the office of Controller and such other duties as may be assigned to him from time to time by the Board of Directors.

SECTION 13. THE SECRETARY: It shall be the duty of the Secretary to act as secretary of all meetings of the Board of Directors, and of the shareholders, and to keep the minutes of all such meetings at which he shall so act in a proper book or books to be provided for that purpose; he shall see that all notices required to be given by the Company are duly given and served; he may sign and execute in the name of the Company certificates for the stock of the Company, deeds, mortgages, bonds, contracts or other instruments authorized by the Board of Directors; he shall prepare, or cause to be prepared, for use at meetings of shareholders the list of shareholders as of the record date referred to in Article I, Section 11 of these By-Laws and shall certify, or cause the transfer agent to certify, such list; he shall keep a current list of the Company's Directors and officers and their residence addresses; he shall be custodian of the seal of the Company and shall affix the seal, or cause it to be affixed, to all agreements, documents and other papers requiring the same. The Secretary shall have custody of the Minute Book containing the minutes of all meetings of shareholders, Directors, the Executive Committee, and any other committees which may keep minutes, and of all other contracts and documents which are not in the custody of the Treasurer or the Controller of the Company, or in the custody of some other person authorized by the Board of Directors to have such custody.

SECTION 14. APPOINTED OFFICERS: The Board of Directors may delegate to any officer or committee the power to appoint and to remove any subordinate officer, agent or employee.

SECTION 15. ASSIGNMENT AND TRANSFER OF STOCKS, BONDS, AND OTHER SECURITIES: The Chairman of the Board, the Treasurer, the Secretary, any Assistant Secretary, any Assistant Treasurer, and each of them, shall have power to assign, or to endorse for transfer, under the corporate seal, and to deliver, any stock, bonds, subscription rights, or other securities, or any beneficial interest therein, held or owned by the Company.

#### ARTICLE V

##### CONTRACTS, CHECKS, DRAFTS AND BANK ACCOUNTS

SECTION 1. EXECUTION OF CONTRACTS: The Board of Directors, except as in these By-Laws otherwise provided, may authorize any officer or officers, agent, or agents, in the name of and on behalf of the Company to enter into any contract or execute and deliver any instrument, and such authority may be general or confined to specific instances; but, unless so authorized by the Board of Directors, or expressly authorized by these By-Laws, no officer, agent or employee shall have any power or authority to bind the Company by any contract or engagement or to pledge its credit or to render it liable pecuniarily in any amount for any purpose.

SECTION 2. LOANS: No loans shall be contracted on behalf of the Company, and no negotiable paper shall be issued in its name unless specifically authorized by the Board of Directors.

SECTION 3. CHECKS, DRAFTS, ETC.: All checks, drafts, and other orders for the payment of money out of the funds of the Company, and all notes or other evidences of indebtedness of the Company, shall be signed on behalf of the Company in such manner as shall from time to time be determined by resolution of the Board of Directors.

SECTION 4. DEPOSITS: All funds of the Company not otherwise employed shall be deposited from time to time to the credit of the Company in such banks, trust companies or other depositories as the Board of Directors may select.

## STOCKS AND DIVIDENDS

SECTION 1. CERTIFICATES OF STOCK: Certificates for stock of the Company shall be in such form as shall be approved by the Board of Directors. The certificates of stock shall be numbered in order of their issue, shall be signed by the Chairman of the Board, the President or a Vice President, and the Secretary or an Assistant Secretary, or the Treasurer or an Assistant Treasurer. The signature of the officers upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent or registered by a registrar other than the Company itself or its employee. In case any officer who has signed or whose facsimile signature has been placed upon a certificate shall have ceased to be such officer before such certificate is issued, it may be issued by the Company with the same effect as if he were an officer at the date of issue.

SECTION 2. TRANSFER OF STOCK: Transfers of stock of the Company shall be made only on the books of the Company by the holder thereof, or by his duly authorized attorney, on surrender of the certificate or certificates for such stock, properly endorsed. Every certificate surrendered to the Company shall be marked "Canceled", with the date of cancellation, and no new certificate shall be issued in exchange therefor until the old certificate has been surrendered and canceled. A person in whose name stock of the Company stands on the books of the Company shall be deemed the owner thereof as regards the Company; provided that, whenever any transfer of stock shall be made for collateral security, and not absolutely, such fact, if known to the Secretary of the Company, or to its transfer agent shall be so expressed in the entry of the transfer. No transfer of stock shall be valid as against the Company, or its shareholders for any purpose, until it shall have been entered in the stock records of the Company as specified in these By-Laws by an entry showing from and to whom transferred.

SECTION 3. TRANSFER AND REGISTRY AGENTS: The Company may, from time to time, maintain one or more transfer offices or agencies and/or registry offices at such place or places as may be determined from time to time by the Board of Directors; and the Board of Directors may, from time to time, define the duties of such transfer agents and registrars and make such rules and regulations as it may deem expedient, not inconsistent with these By-Laws, concerning the issue, transfer and registration of certificates for stock of the Company.

SECTION 4. LOST, DESTROYED AND MUTILATED CERTIFICATES: The holder of any stock of the Company shall immediately notify the Company of any loss, destruction or mutilation of the certificate therefor. The Company may issue a new certificate in place of the lost or destroyed certificate, but as a condition to such issue, the holder of such certificate must make satisfactory proof of the loss or destruction thereof, and must give to the Company a bond of indemnity in form and amount and with one or more sureties satisfactory to the Treasurer, the Secretary or any Assistant Treasurer or Assistant Secretary. Such bond of indemnity shall also name as obligee each of the transfer agents and registrars for the stock the certificate for which has been lost or destroyed.

SECTION 5. RECORD DATES FOR CERTAIN PURPOSES: The Board of Directors of the Company shall fix a day and hour not more than fifty days preceding the date of any meeting of shareholders, or the date for payment of any cash or stock dividend, or the date for the allotment of any rights of subscription, or the date when any change or conversion or exchange of capital stock shall go into effect, as a record date for the determination of the shareholders entitled to notice of, and to vote at, any such meeting and any adjournment thereof, or entitled to receive payment of any such dividend, or entitled to receive any such allotment of rights of subscription, or entitled to exercise rights in respect of any such change, conversion or exchange of capital stock, and in such case, such shareholders and only such shareholders as shall be shareholders of record on the day and hour so fixed shall be entitled to such notice of, and to vote at, such meeting or any adjournment thereof, or to receive payment of such dividend, or to receive such allotment of rights of subscription, or to exercise rights in connection with such change or conversion or exchange of capital stock, as the case may be, notwithstanding any transfer of any stock on the books of the Company after such day and hour fixed as aforesaid.

SECTION 6. DIVIDENDS AND SURPLUS: Subject to the limitations prescribed by law, the Board of Directors (1) may declare dividends on the stock of the Company whenever and in such amounts as, in its opinion, the condition of the affairs of the Company shall render it advisable, (2) may use and apply, in its discretion, any part or all of the surplus of the Company in purchasing or acquiring any of the shares of stock of the Company, and (3) may set aside from time to time out of such surplus or net profits such sum or sums as it in its absolute discretion, may think proper as a reserve fund to

meet contingencies or for equalizing dividends, or for the purpose of maintaining or increasing the property or business of the Company, or for any other purpose it may think conducive to the best interest of the Company.

## ARTICLE VII

### OFFICES AND BOOKS

SECTION 1. OFFICES: The Company shall maintain an office at such place in the County of Monroe, State of New York, as the Board of Directors may determine. The Board of Directors may from time to time and at any time establish other offices of the Company or branches of its business at whatever place or places seem to it expedient.

### SECTION 2. BOOKS AND RECORDS:

(a) There shall be kept at one or more offices of the Company (1) correct and complete books and records of account, (2) minutes of the proceedings of the shareholders, Board of Directors and the Executive Committee, (3) a current list of the Directors and officers of the Company and their residence addresses, and (4) a copy of these By-Laws.

(b) The stock records may be kept either at the office of the Company or at the office of its transfer agent or registrar in the State of New York, if any, and shall contain the names and addresses of all shareholders, the number and class of shares held by each and the dates when they respectively became the owners of record thereof.

## ARTICLE VIII

### GENERAL

SECTION 1. SEAL: The corporate seal shall be in the form of a circle and shall bear the full name of the Company and the words and figures "Incorporated 1906, Rochester, N. Y.".

SECTION 2. INDEMNIFICATION OF DIRECTORS AND OFFICERS: Except to the extent expressly prohibited by law, the Company shall indemnify any person, made or threatened to be made, a party in any civil or criminal action or proceeding, including an action or proceeding by or in the right of the Company to procure a judgment in its favor or by or in the right of any other corporation of any type or kind, domestic or foreign, or any partnership, joint venture, trust, employee benefit plan or other enterprise, which any Director or officer of the Company served in any capacity at the request of the Company, by reason of the fact that he, his testator or intestate is or was a Director or officer of the Company or serves or served such other corporation, partnership, joint venture, trust, employee benefit plan or other enterprise, in any capacity, against judgments, fines, penalties, amounts paid in settlement and reasonable expenses, including attorneys' fees, incurred in connection with such action or proceeding, or any appeal therein, provided that no such indemnification shall be required with respect to any settlement unless the Company shall have given its prior approval thereto. Such indemnification shall include the right to be paid advances of any expenses incurred by such person in connection with such action, suit or proceeding, consistent with the provisions of applicable law. In addition to the foregoing, the Company is authorized to extend rights to indemnification and advancement of expenses to such persons by i) resolution of the shareholders, ii) resolution of the Directors or iii) an agreement, to the extent not expressly prohibited by law.

## ARTICLE IX

### FISCAL YEAR

SECTION 1. FISCAL YEAR: The fiscal year of the Company shall end on the 31st day of December in each year.

## ARTICLE X

### AMENDMENTS

SECTION 1. AMENDMENTS: By-Laws of the Company may be amended, repealed or adopted by vote of the holders of the shares at the time entitled to vote in the election of any Directors. If, at any meeting of shareholders, action is proposed to be taken to amend, repeal or adopt By-Laws, the notice of such meeting shall include a brief statement or summary of the proposed action. The By-Laws may also be amended, repealed or adopted by the Board of

Directors, but any By-Law adopted by the Board may be amended or repealed by shareholders entitled to vote thereon as hereinabove provided. If any By-Law regulating an impending election of Directors is adopted, amended or repealed by the Board of Directors, there shall be set forth in the notice of the next meeting of shareholders for the election of Directors the By-Law so adopted, amended or repealed, together with a concise statement of the changes made.

Restatement  
of  
XEROX CORPORATION  
UNFUNDED RETIREMENT INCOME GUARANTEE PLAN

XEROX CORPORATION, a New York corporation having its principal executive office in the City of Stamford, County of Fairfield and State of Connecticut, hereby adopts the XEROX CORPORATION UNFUNDED RETIREMENT INCOME GUARANTEE PLAN effective on the Effective Date as follows:

Restatement October 13, 1997

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XEROX CORPORATION  
UNFUNDED RETIREMENT INCOME GUARANTEE PLAN

ARTICLE 1  
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Definitions  
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When used herein, the words and phrases defined hereinafter shall have the following meaning unless a different meaning is clearly required by the context of the Plan. Terms used herein which are defined in Article 1 of the Funded Plan shall have the meanings assigned to them in the Funded Plan.

Section 1.1. Administrator. The Administrator appointed by the Vice President, Human Resources of the Company

Section 1.2. Average Monthly Compensation. Shall be determined under Article 1 of the Funded Plan, without regard to the dollar limitation contained therein.

Section 1.3. Board. The Board of Directors of the Company.

Section 1.4. Code. The Internal Revenue Code of 1986 as amended, or as it may be amended from time to time.

Section 1.5. Company. Xerox Corporation.

Section 1.6. Effective Date. The original effective date of the Plan was July 1, 1977. This Restatement is effective as of October 13, 1997.

Section 1.7. Employee. A Member in the Funded Plan.

Section 1.8. Funded Plan. The Xerox Corporation Retirement Income Guarantee Plan.

Section 1.9. Plan. The "Xerox Corporation Unfunded Retirement Income Guarantee Plan", as set forth herein or in any amendment hereto.

ARTICLE 2  
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Purpose of Plan  
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Section 2.1. Purpose. The Plan is designed to provide retirement benefits payable out of the general assets of the Company as provided in Section 4.1.

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ARTICLE 3  
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Eligibility  
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Section 3.1. Eligibility. All Employees and beneficiaries of Employees eligible to receive benefits from the Funded Plan shall be eligible to receive benefits under this Plan in accordance with Section 4.1 regardless of when the Employees may have retired.

ARTICLE 4  
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Benefits  
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Section 4.1. Amount of Benefits. The amount of the benefit payable under the Plan shall be equal to the monthly benefit which would be payable to or on behalf of an Employee under the Funded Plan as a Life Annuity if Section 9.5 of the Funded Plan were inapplicable and if the amount of any compensation deferred by the Employee was included in the calculation of Average Monthly Compensation (except the increase in compensation which became payable under the Company's policy of increasing compensation by the amount which cannot be added to an Employee's accounts under the Profit Sharing Plan by reason of the limitation contained in Section 415 of the Code), less the following:

(a) The monthly benefit actually payable as a Life Annuity to or on behalf of the Employee under the Funded Plan.

(b) The monthly benefit which could be purchased as a Life Annuity with the balance, if any, in the Employee's deferred compensation account under the Xerox Corporation Deferred Compensation Plan For Executives arising from the Retirement Account portion of the Profit Sharing Adjustment under Section 4 thereof.

(c) Any amount paid to the Employee from which FICA taxes are withheld related to nonqualified retirement benefits from a plan sponsored by the Company which have not been previously withheld (or deemed to be withheld because the maximum tax had already been paid) and are payable upon retirement but cannot be withheld from any single sum payment of compensation or other nonqualified plan benefits translated to an annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

(d) The amount of that certain provisional supplement provided to certain high-paid Employees in RIGP effective in 1989 when the RIGP benefit was modified payable to Employees in a lump sum translated to an annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

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Section 4.2. Form of Benefit Payments. The forms of benefit available under the Plan shall be for single Employees a 10-Year certain and life annuity or a life annuity and for married Employees a 50% or 100% joint and survivor annuity option, all as shall have been elected by Employee on forms provided by the Administrator. The benefit payable to a single Employee who has failed to make such an election shall be a life annuity and for any such married Employee a 50% joint and survivor annuity. The 10 year certain and life annuity is the actuarial equivalent of the life annuity and the 100% joint and survivor annuity is the actuarial equivalent of the 50% joint and survivor annuity. Except as otherwise provided in Section 5.1 in no event is the benefit payable in a lump sum.

Notwithstanding the above, the lump sum actuarial equivalent of any benefit otherwise payable as a monthly amount of one hundred dollars (\$100.00) or less, shall be distributed in accordance with Section 4.3. The interest rate used in computing the lump sum actuarial equivalent amount shall be the interest rate described in the section entitled "Optional Forms of Benefit Payment" of the Funded Plan.

Section 4.3 Death Prior to Benefit Commencement. The spouse of a Participant who dies before commencement of benefits under the Plan shall be entitled to a survivor benefit calculated in accordance with Article 7 of the Funded Plan in an amount equal to the amount determined under (a) or (b) below.

(a) In the case of a Participant who is eligible to retire under the Funded Plan on the date of his or her death, one-half of the retirement benefit to which the Participant would have been entitled under the Plan if he or she had retired on the last day of the month coincident with or next following the date of the Participant's death; or

(b) In the case of a Participant who is not eligible to retire under the Funded Plan on the date of his or her death, one-half of the retirement benefit to which the Participant would have been entitled under the Plan if he or she had terminated on his or her date of death and survived to the date of payment of benefits as determined under Section 4.4 below.

Section 4.4. Time of Benefit Payments. Benefits due under the Plan shall be paid coincident with the payment date of benefits under the Funded Plan or at such other time or times as the Administrator in his discretion determines.

Section 4.5. Employee's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Employee to receive benefits under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

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## ARTICLE 5

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### Change in Control

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Section 5.1 Change In Control. Notwithstanding anything to the contrary in this Plan, in the event of a change in control of the Company, as hereinafter defined, each Employee, including retired Employees, shall be entitled to a benefit hereunder without regard to his or her age or Years of Service at the time of such change in control. Upon the occurrence of a change in control of the Company, the benefit of each Employee shall be payable in a lump sum within 30 days of such change in control equal in amount to the then present value of a benefit expressed in the form provided in Section 4.1 hereof, commencing on the later of (i) the date of such change in control and (ii) the date the Employee would be eligible for a benefit under the Funded Plan, and based upon such Employee's Average Monthly Compensation and Years of Participation as of the date of such change in control. A "change in control of the Company" shall be deemed to have occurred if (A) any "person", as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any company owned, directly or indirectly, by the shareholders of The Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company

representing 20 percent or more of the combined voting power of the Company's then outstanding securities; or (B) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board, including for this purpose any new director (other than a director designated by a person who has entered into an agreement with the Company to effect a transaction described in this Section) whose election or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof.

Section 5.2. Termination of Employment Following Change in Control. Upon the termination of employment of a Employee following a change in control of the Company, such Employee, if he or she has otherwise satisfied the requirements of the Funded Plan for a benefit, shall be entitled to a benefit equal to the benefit to which he or she would have been entitled without application of Section 5.1, reduced (but not below zero) to reflect the value of the benefit he or she received pursuant to Section 5.1.

Section 5.3. Calculation of Present Value. For purposes of Section 5.1 hereof, the present value of a benefit shall be calculated based upon the interest rate which would be used by the Pension Benefit Guaranty Corporation for purposes of determining lump sums for benefits payable as immediate annuities with respect

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to plans terminating on the date on which the change in control of the Company occurs and the 1983 GAM mortality table, provided, however, that effective upon the date that the applicable interest rate as specified in Section 417(e) (3) (A) of the Code is adopted for use in the Funded Plan, the present value hereunder shall thereafter be determined under such applicable interest rate and the applicable mortality table as defined in Section 417(e) (3) (A) (ii) (1) of the Code. For purposes of the Funded Plan, each Employee shall be treated as if they terminated employment upon the change in control and had their benefits determined as if they were to begin receiving benefits on the commencement date used in developing the present value of the benefit in Section 5.1.

ARTICLE 6  
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Administration  
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Section 6.1. Duties of Administrator. The Plan shall be administered by the Administrator in accordance with its terms and purposes. The Administrator shall determine the amount and manner of payment of the benefits due to or on behalf of each Employee from the Plan and shall cause them to be paid by the Company accordingly.

Section 6.2. Finality of Decisions. The decisions made by and the actions taken by the Administrator in the administration of the Plan shall be final and conclusive on all persons, and the Administrator shall not be subject to individual liability with respect to the Plan.

ARTICLE 7  
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Amendment and Termination  
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Section 7.1. Amendment and Termination. It is the intention of the Company to continue the Plan indefinitely. The Company expressly reserves the right to amend the Plan at any time and in any particular manner, provided that any such amendment shall be made in accordance with ERISA. Such amendments, other than amendments relating to termination of the Plan or relating to benefit levels under Section 4.1 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors, or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to benefit levels under Section 4.1 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company

Section 7.2. Contractual Obligation. Notwithstanding Section 7.1, the Company hereby makes a contractual commitment to pay the benefits accrued under the Plan to the extent it is financially capable of meeting such obligations.

ARTICLE 8

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Miscellaneous

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Section 8.1. No Employment Rights. Nothing contained in the Plan shall be construed as a contract of employment between the Company and an Employee, or as a right of any Employee to be continued in the employment of the Company, or as a limitation of the right of the Company to discharge any of its Employees, with or without cause.

Section 8.2. Assignment. The benefits payable under this Plan may not be assigned or alienated except as may otherwise be required by law or pursuant to the terms of a domestic relations order that has been approved by the Plan Administrator.

Section 8.3. Law Applicable. This Plan shall be governed by the laws of the State of New York.

Restatement  
of  
XEROX CORPORATION  
UNFUNDED SUPPLEMENTAL RETIREMENT PLAN

XEROX CORPORATION, a New York corporation having its principal executive office in the City of Stamford, County of Fairfield and State of Connecticut, hereby adopts the XEROX CORPORATION UNFUNDED SUPPLEMENTAL RETIREMENT PLAN effective on the Effective Date as follows:

Restatement October 13, 1997

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UNFUNDED SUPPLEMENTAL RETIREMENT PLAN

Section 1. Plan Name

The plan name is the Xerox Corporation Unfunded Supplemental Retirement Plan (the "Plan").

Section 2. Effective Date

The original effective date of the Plan is June 30, 1982. The Plan was restated on three previous occasions, effective February 4, 1985, January 1, 1990, December 6, 1993 and December 9, 1996. This Restatement is effective as of October 13, 1997.

Section 3. Purpose of the Plan

The Plan is designed to address special circumstances involved in the retirement of executives.

Section 4. Covered Employees

The following employees of Xerox Corporation (the "Company") are covered by the Plan:

A. All employees who were corporate officers of the Company at grade level 25 and above on the original effective date of the Plan (the "Grandfathered Officers").

B. All employees who were corporate officers at grades 23 or 24 on the original effective date of the Plan or who first become corporate officers of the Company at grade level 23 and above after the original effective date of the Plan and do not fall within categories D through G below (the "Officers").

C. Certain employees who received a letter dated September 2, 1982 from David T. Kearns regarding Executive Retirement Guidelines (the "Guideline Employees").

D. All employees who are corporate officers of the Company on the date of this 1996 Restatement who first commenced employment with the Company on or after attainment of age 40 and whose names appear on Schedule A ("Schedule A") presented at the meeting of the Executive Compensation and Benefits Committee held December 9, 1996 and made part of the records of that

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meeting which Schedule is incorporated herein by reference and made a part of the Plan ("Grandfathered Mid-Career Officers").

E. All employees who after the date of the 1996 Restatement first

commence employment with the Company on or after attainment of age 40 who are elected corporate officers and whose names are added to Schedule A upon selection by the Chief Executive Officer of the Company as maintained with records of the Executive Compensation department of the Company which Schedule as so modified from time to time is incorporated herein by reference and made a part hereof ("Mid-Career Officer Hires").

F. All employees who are in payroll Band A of the Company on the date of the 1996 Restatement who first commenced employment with the Company on or after attainment of age 40 and whose names are set forth on Schedule B ("Schedule B") which has been approved by the Vice President responsible for Human Resources and placed with the records of the Executive Compensation department of the Company which Schedule is incorporated herein by reference and made a part of the Plan ("Grandfathered Mid-Career Band A Employees").

G. All employees who after the date of the 1996 Restatement first commence employment with the Company on or after attainment of age 40 who are hired into payroll Band A selected by the Vice President of the Company responsible for Human Resources, or his or her designee, such selection to be evidenced by the placement of the employee's name on Schedule C to be maintained from time to time by such Vice President or his or her designee, which Schedule is incorporated herein by reference and made a part of the Plan ("Mid-Career Band A Hires")

H. Grandfathered Mid-Career Officers, Mid-Career Officer Hires, Grandfathered Mid-Career Band A Employees and Mid-Career Band A Hires are sometimes together referred to as "Mid-Career Executives".

I. The employees referred to in paragraphs A through G above are together referred to herein as "Participants".

#### Section 5. Eligibility for Benefits

Participants must have attained the following age and completed the following Years of Service to be eligible for benefits under the Plan:

A. Grandfathered Officers and Guideline Employees -- age 55, Years of Service -- 5.

B. Officers -- age 60, Years of Service -- 10.

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C. Grandfathered Mid-Career Officers -- the age set forth opposite their respective names on Schedule A, Years of Service -- 5.

D. Mid-Career Officer Hires -- the age determined by the Chief Executive Officer of the Company as reflected in Schedule A, Years of Service -- 5.

E. Grandfathered Mid-Career Band A Employees -- the age set forth opposite their respective names on the Schedule B, Years of Service -- 5.

F. Mid-Career Band A Hires -- the age determined by the Vice President responsible for Human Resources or his or her delegate as set forth on Schedule C referred to above, Years of Service 5.

#### Section 6. Supplemental Retirement Benefit

A. The benefit payable under the Plan shall be a monthly retirement benefit equal to:

One and two-thirds percent of Average Monthly Compensation of the Participant multiplied by the number of full and fractional Years of Participation up to thirty less

a) One and two-thirds percent of the Social Security Benefit multiplied by the number of full and fractional Years of Participation up to thirty; and

b) The monthly retirement benefit payable under the Company's Retirement Income Guarantee Plan ("RIGP") (stated as a Life Annuity)\* as it is in effect as of and from time to time after January 1, 1990;

subject to the "Adjustments" set forth in subsections B through F below.

"Average Monthly Compensation" shall be determined under RIGP without regard to the dollar limitation contained in the Plan as required by Section 401(a)(17) of the Internal Revenue Code of 1986, as amended, or any successor thereto.

\* Defined terms in RIGP shall have the same meanings in the Plan, except as otherwise noted herein.

"Social Security Benefit" shall mean the monthly benefit which a retired Participant or a terminated Participant receives or would be entitled to receive at the age at which unreduced retirement benefits are then paid under the US Social Security Act (or at his sixty-second birthday, in the case of a retired

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Participant who has at least thirty Years of Service or who, on such Participant's retirement, is the pilot of an airplane operated by the Company), as a primary insurance amount under the U. S. Social Security Act, as amended, whether he or she applies for such benefit or not, and even though he or she may lose part or all of such benefit for any reason.

The amount of such Social Security Benefit to which the retired or terminated Participant is or would be entitled shall be computed by the Administrator for the purposes of the Plan as of the January 1 of the calendar year of retirement or termination. In computing such amount, the Administrator shall use estimated benefit tables developed by the Plan's actuary, the five-year average compensation of the Participant and the assumption that the Participant's compensation prior to the fifth year preceding the year of termination grew in accordance with average national wages.

B. Grandfathered Officers -- Adjustments shall be

1. The monthly benefit and the Social Security Benefit shall be calculated at the rate of 3 1/3% of Average Monthly Compensation and of the Social Security Benefit, respectively, for each full or fractional Year of Participation up to a maximum of 15 Years of Participation.

2. There shall be no reduction in the benefit payable upon retirement on or after attainment of age 55 on account of payment commencing prior to attainment of age 65.

3. Amounts included in the Participant's Executive Expense Allowance shall be included in determining Average Monthly Compensation.

C. Officers -- Adjustments shall be that there shall be no reduction in the benefit payable upon retirement on or after attainment of age 60 on account of payment commencing prior to attainment of age 65 and no part of the Executive Expense Allowance shall be included in determining Average Monthly Compensation.

D. Guideline Employees -- An adjustment shall be that there shall be no reduction in the benefit payable upon retirement on or after attainment of age 55.

E. Mid-Career Executives -- Adjustments shall be

1. The monthly benefit and the Social Security Benefit shall be calculated at the rate of 2.5% of the Average Monthly Compensation and of the Social Security Benefit, respectively, for each full or fractional Year of Participation up to a maximum of 20 Years of Participation.

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2. There shall be no reduction in the benefit payable upon retirement on or after attainment of age 60 on account of payment commencing prior to attainment of age 65 and no part of the Executive Expense Allowance, if any, shall be included in determining Average Monthly Compensation.

F. All Participants -- Adjustments shall be

1. Average Monthly Compensation shall be calculated including any compensation deferred by the Participant during the period used in calculating Average Monthly Compensation (except that there shall not be included any increase in Participant's compensation which became payable under the Company's policy of increasing compensation by the amount which cannot be added to the Participant's accounts under the Company's Profit Sharing and Savings Plan ("Profit Sharing Plan") by reason of the limitation contained in Section 415 of the Internal Revenue Code of 1986, as amended, hereinafter the "Code").

2. The following additional amounts shall be deducted from the hypothetical monthly benefit:

(a) The value of the portion of the Participant's Account under the Company's Deferred Compensation Plan For Executives, if any, resulting from the Retirement Account portion of the Profit Sharing Adjustment (as defined in such Deferred Compensation Plan) translated into an annuity (single life or joint and survivor, as appropriate) payable commencing on the date of retirement; and

(b) The benefit payable under the Company's Unfunded Retirement Income Guarantee Plan ("Unfunded RIGP").

(c) Any amount paid to the participant from which FICA taxes are withheld related to nonqualified retirement benefits from a plan sponsored by the Company which have not been previously withheld (or deemed to have been withheld because the maximum tax had already been paid) and are payable upon retirement but cannot be withheld from any single sum payment of compensation or other nonqualified plan benefits translated to an annuity (single or joint and survivor as appropriate) payable commencing on the date of retirement.

(d) The amount of that certain supplement provided to certain high -paid participants in RIGP effective in 1989 when the RIGP benefit was modified payable to the Participant in a lump sum translated to an

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annuity (single life or joint and survivor as appropriate) payable commencing on the date of retirement.

(e) The amount of any pension, retirement or other post-retirement income benefits paid or payable to a Participant under plans or arrangements provided by the Company or any subsidiary of the Company, whether incorporated or organized in the United States or in any other country of the world.

Section 7. Change In Control. A. Notwithstanding anything to the contrary in this Plan, in the event of a change in control of the Company, as hereinafter defined, each Participant, including retired Participants, shall be entitled to a benefit hereunder without regard to his or her age or Years of Service at the time of such change in control (including, without limitation, the benefit provided under Section 8 hereof, if applicable). Upon the occurrence of a change in control of the Company, the benefit of each Participant shall be payable in a lump sum within five days of such change in control equal in amount to the then present value of a benefit expressed in the form provided in Section 10 hereof, commencing on the later of (i) the date of such change in control, (ii) the date Guideline Employee or Grandfathered Officer attains age 55, (iii) the date the Officers attain age 60 or (iv) in the case of a Mid-Career Executive, the date such Participant attains the age specified in Schedule A, B or C, and based upon such Participant's Average Monthly Compensation and Years of Participation as of the date of such change in control. A "change in control of the Company" shall be deemed to have occurred if (A) any "person", as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any company owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 20 percent or more of the combined voting power of the Company's then outstanding securities; or (B) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board, including for this purpose any new director (other than a director designated by a person who has entered into an agreement with the Company to effect a transaction described in this Section) whose election or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof.

B. Upon the termination of employment of a Participant following a change in control of the Company, such Participant, if he or she has otherwise satisfied

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the requirements of Section 5 hereof, shall be entitled to a benefit equal to the benefit to which he or she would have been entitled without application of Section 7A, reduced (but not below zero) to reflect the value of the benefit he or she received pursuant to Section 7A.

C. For purposes of Section 7A hereof, the present value of a benefit shall be calculated based upon the interest rate which would be used by the Pension Benefit Guaranty Corporation for purposes of determining lump sums for benefits payable as immediate annuities with respect to plans terminating on the date on which the change in control of the Company occurs and the 1983 GAM mortality table, provided, however, that effective upon the date that the applicable interest rate as specified in Section 417(e)(3)(A) of the Code is adopted for use in RIGP, the present value hereunder shall thereafter be determined under the applicable interest rate and mortality table as defined in Section 417(e)(3)(A)(ii)(1) of the Code. For purposes of RIGP, each Participant shall be treated as if he or she terminated employment upon the change in control and had his or her benefits determined as if he or she were to begin receiving benefits on the commencement date used in developing the present value of the benefit in Section 7.A.

#### Section 8. Minimum Benefit

In no event shall the monthly retirement benefit payable to any Participant other than Mid-Career Executives under the Plan be less than an amount which, when added to the benefits payable under RIGP, 25% of the amount of the Social Security Benefit and the amounts described in Section 6F2 above, is equal to 25% of such Participant's Average Monthly Compensation as adjusted in Section 6F1 for Participants and Section 6B3 for Grandfathered Officers.

#### Section 9. Pre-Retirement Spouse's Benefit

The spouse of a Participant who dies after completing the appropriate age and number of Years of Service pursuant to Section 5 (but in no case less than 10) while still employed by the Company shall be entitled to a survivor benefit, commencing on the death of the Participant, in an amount equal to one-half of the retirement benefit to which the Participant would have been entitled under the Plan if the Participant had retired on the last day of the month coincident with or next following the date of the Participant's death.

#### Section 10. Form of Benefit

The forms of benefit available under the Plan shall be for single Participants a 10-Year certain and life annuity or life annuity and for married Participants a 50% or 100% joint and survivor annuity option, all as shall have been elected by Participant on forms provided by the Administrator. The benefit payable to

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single Participant who has failed to make such an election shall be a life annuity and for a married Participant a 50% joint and survivor annuity. The 10 year certain and life annuity is the actuarial equivalent of the life annuity and the 100% joint and survivor annuity is the actuarial equivalent of the 50% joint and survivor annuity. Except as otherwise provided in Section 7A in no event is the benefit payable in a lump sum.

#### Section 11. Participant's Rights Unsecured

The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of the Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive benefits under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

#### Section 12. Other Plan Provisions

Other Plan provisions necessary to determine any benefit under the Plan shall be the same as those described in RIGP.

#### Section 13. Duties of Administrator

The Plan shall be administered by the Administrator in accordance with its terms and purposes. The Administrator shall determine the amount and manner of payment of the benefits due to or on behalf of each Participant from the Plan and shall cause them to be paid by the Company accordingly. The Administrator shall be appointed by the Vice President, Human Resources of the Company.

#### Section 14. Finality of Decisions

The decisions made by and the actions taken by the Administrator in the administration of the Plan shall be final and conclusive on all persons, and the Administrator shall not be subject to individual liability with respect to the Plan.

#### Section 15. Amendment and Termination

It is the intention of the Company to continue the Plan indefinitely. The Company expressly reserves the right to amend the Plan at any time and in any particular manner, provided that any such amendment shall be made in accordance with ERISA. Such amendments, other than amendments relating to termination of the Plan or relating to benefit levels under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors, or (iii) the Vice President of the Company responsible for Human Resources or a representative thereof. In the event such office is vacant at

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the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to benefit levels under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

#### Section 16. No Employment Rights

Nothing contained in the Plan shall be construed as a contract of employment between the Company and a Participant, or as a right of any Participant to be continued in the employment of the Company, or as a limitation of the right of the Company to discharge any of its employees, with or without cause.

#### Section 17. Assignment

The benefits payable under this Plan may not be assigned or alienated except as may otherwise be required by law or pursuant to the terms of a domestic relations order that has been approved by the Plan Administrator.

#### Section 18. Law Applicable

This Plan shall be governed by the laws of the State of New York.

Restatement adopted and approved as of October 13, 1997.

As amended through  
October 13, 1997

## XEROX CORPORATION

## DEFERRED COMPENSATION PLAN FOR DIRECTORS

(Formerly 1989 Deferred Compensation Plan For Directors)

## AMENDMENT AND RESTATEMENT

Preamble. This Plan is a private unfunded nonqualified deferred compensation arrangement for Directors and all rights shall be governed by and construed in accordance with the laws of New York, except where preempted by federal law. It is intended to provide a vehicle for setting aside funds for retirement.

Section 1. Effective Date. The original effective date of the Plan is January 1, 1989. The effective date of this amendment and restatement is October 13, 1997.

Section 2. Eligibility. Any Director of Xerox Corporation (the "Company") who is not an officer or employee of the Company or a subsidiary of the Company is eligible to participate in the Plan (a Director who has so elected to participate is hereinafter referred to as a "Participant"). A Participant who terminates an election to defer receipt of compensation is not eligible to participate again in the Plan until twelve months after the effective date of such termination.

Section 3. Deferred Compensation Accounts. There shall be established for each Participant one or more deferred compensation Accounts (as hereinafter defined).

Section 4. Amount of Deferral.

(a) A Participant may elect to defer receipt of all or a specified part, expressed as a percentage of the cash compensation otherwise payable to the Participant for serving on the Company's Board of Directors or committees of the Board of Directors. Any amount deferred is credited to the Participant's Accounts on the date such amount is otherwise payable.

(b) In addition to the foregoing, there shall be credited to the deferred compensation accounts of each person who is serving as a Director on May 17, 1996 a sum computed by the Company as the present value of his or her accrued benefit under the Company's Retirement Income Plan For Directors, if any, as of such date and each such Director shall be given notice of such amount. The amount so computed shall be final and binding on the Company and each such Director. Within 30 days of the giving of such notice, each such Director shall make an election on a form provided

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by the Company as to the hypothetical investment of such amount and the payment methods as permitted under Sections 6 and 8 hereof as in effect on such date under the administrative rules adopted by the Administrator.

Section 5. Time of Election to Defer. The election to defer will be made prior to the individual's commencement of services as a Director for amounts to be earned for the remainder of the calendar year. In the case of an individual currently serving as a Director, the election to defer must be made prior to December 31, of any year for amounts to be earned in a subsequent calendar year or years. An election to totally terminate deferrals may be made at any time prior to the relevant payment date.

Section 6. Hypothetical Investment. Deferred compensation is assumed to be invested, without charge, in the (a) Balanced Fund, Income Fund, U.S. Stock Fund, International Stock Fund, Small Company Stock Fund or Xerox Stock Fund (or the successors thereto) (the "Funds") established from time to time under the Xerox Corporation Profit Sharing and Savings Plan (the "Profit Sharing Plan") (b) a fund with a variable fixed rate of return based upon the prime or base rate charged by one or more banks ("Prime Rate Investment") and (c) such other fixed income return investments ("Fixed Return Investment"), all as shall be made available from time to time by the Administrator in his or her administrative discretion ("Investments") as elected by the participant

It is anticipated that the Administrator will substitute the Prime Rate Investment for the Income Fund effective January 1, 1998. Amounts deferred prior to January 1, 1998 shall have a rate of return at the Income Fund or the Prime Rate Investment as elected by Participants on forms provided by the Administrator in connection with the implementation of the Prime Investment Rate.

Elections to make hypothetical investments in any one or more of the Investments shall be subject to administrative rules adopted by the Administrator from time to time.

No shares of Xerox stock will ever actually be issued to a Participant under the Plan.

Section 7. Value of Deferred Compensation Accounts and Installment Payments. The value of each Participant's Accounts shall reflect all amounts deferred, gains, losses and rates of return from the Investments, and shall be determined at the close of business on each day on which securities are traded on the New York Stock Exchange. Hypothetical investments in the Profit Sharing Plan shall be valued on each business day based upon the value of such hypothetical investment as determined under such Plan on the valuation date under such Plan coincident with or last preceding such business day. The value of Investments not made under the Profit Sharing Plan shall be determined from such available source or sources as the Administrator in his or her sole discretion shall from time to time determine. The date as of which investments are valued pursuant to the foregoing sentences are referred to herein as a Valuation Date.

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Section 8. Manner of Electing Deferral. A Participant may elect to defer compensation by giving written notice to the Administrator on a form provided by the Company, which notice shall include (1) the percentage to be deferred; (2) if more than one is offered under the Plan, the hypothetical investment applicable to the amount deferred; and (3) the payment method that will apply to the deferred compensation. A Participant may elect to a maximum of four separate payment methods during his or her participation in the Plan ("Accounts"). Such payment methods once made may never be changed. Each election to defer compensation under the Plan shall specify an Account from which payment will be made. The Accounts available under the Plan shall be:

ACCOUNT 1 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years). The last payment shall be on the July 15 of the year in which the Participant attains a certain age elected by the Participant.

ACCOUNT 2 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable on each subsequent July 15 until the number of payments elected by the Participant have been made.

ACCOUNT 3 which shall be payable on the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable as a single sum.

ACCOUNT 4 shall be available with respect to amounts deferred during 1998 and later years. This account is payable beginning on the July 15 of a specified year whether before or after retirement. In addition to this payment date, the Participant must elect the number of payments that are to commence on this date. The payment(s) from this account can be as a single sum or payable in up to four annual installments. Once Account 4 is established (an election is made to defer and the payment date is defined), deferrals to Account 4 shall cease for any calendar year in which a payment is scheduled to be made from this Account. The full account balance shall be distributed by the end of the installment period. Once the final payment is made from this Account, the Participant may elect to create a new Account 4. The initial election or any subsequent election to use this Account must be made by December 31 of the year preceding the calendar year in which deferrals will be allocated to this Account. The first payment date that can be elected is the July 15 of the calendar year that follows the calendar year of election (calendar year containing the December 31 due date for election) by three years.

Not later than December 31, 1997, Participants who are currently serving as Directors of the Company may change their payment elections previously made under the Plan which specified payment dates relating to termination, retirement, death, or disability, by selecting payments pursuant to the

above. Such change shall be effected by the Participant filing with the Administrator a change of election on a form or forms established by the Administrator for such purpose. Such change shall be effective only with respect to payments in 1999 or later for Participants who are serving on the Company's Board of Directors as of December 31, 1998.

The Administrator may adopt rules of general applicability for administration of payments under the Plan which may be elected by Participants, including without limitation, fixing the maximum age selected for payments to terminate and the maximum number of payments.

Section 9. Payment of Deferred Compensation.

(a) No withdrawal may be made from the Participant's Account, except as provided under this Section and Sections 10 and 11.

(b) Payments from a Participant's Account are made in cash in accordance with the elections made under Section 8 of the Plan based on the value of the Participant's deferred compensation Accounts as of the Valuation Date immediately preceding the date of payment.

(c) Unless otherwise elected by a Participant with the written approval of the Administrator, payments of deferred compensation shall be made pursuant to the following formula: the amount of the first payment shall be a fraction of the value of the Participant's deferred compensation account on the preceding Valuation Date, the numerator of which is one and the denominator of which is the total number of installments elected, and the amount of each subsequent payment shall be a fraction of the value on the Valuation Date preceding each subsequent payment date, the numerator of which is one and the denominator of which is the total number of installments elected minus the number of installments previously paid. Any other payment method selected with the written approval of the Administrator must in all events provide for payments in substantially equal installments.

(d) Upon termination of service on the Board of Directors, including termination resulting from death, prior to retirement, the total value of the Participant's Accounts under the Plan shall be paid to the Participant, or his or her estate, as the case may be, as soon as administratively possible after his or her date of termination.

(e) Upon the death of a Participant following retirement the total value of the Participant's Accounts under the Plan shall be paid in accordance with a onetime, irrevocable election made by such Participant as follows:

1. The total value shall be paid to the Participant's estate as soon as administratively possible after the death of a Participant, or

2. Payments shall continue under the election made by the Participant to the Participant's surviving spouse until the surviving spouse's death. Any remaining payments shall be paid as a single sum to the surviving spouse's estate.

(f) If a Participant dies after retirement without having made such irrevocable election, the total value of his or her Accounts under the Plan shall be paid in a single payment to the Participant's estate as soon as administratively possible after notice of his or her date of death has been received by the Administrator.

Section 10. Acceleration of Payment for Hardship.

(a) For Hardship. Upon written approval from the Board of Directors (with the Participant requesting the withdrawal not participating) a Participant may be permitted to receive all or part of his accumulated benefits if, in the discretion of such Board of Directors, it is determined that an emergency event beyond the Participant's control exists and which would cause such Participant severe financial hardship if the payment of his benefits were not approved. Any such distribution for hardship shall be limited to the amount needed to meet such emergency. A Participant who makes a hardship withdrawal cannot reenter the Plan for twelve months after the date of withdrawal.

(b) Upon a Change in Control. Within 5 days following the occurrence of a change in control of the Company (as hereinafter defined), each Participant shall receive a lump sum payment equal to the value of his or her Account. For purposes hereof, a "change in control of the Company" shall be deemed to have occurred if (A) any "person", as such term is used in Sections 13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act") other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any company owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 20 percent or more of the combined voting power of the Company's then outstanding securities; or (B) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board, including for this purpose any new director (other than a director designated by a person who has entered into an agreement with the Company to effect a transaction described in this Section) whose election or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period or whose election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof.

Section 11. Other Penalized Withdrawals. Notwithstanding the provisions of Sections 9 and 10, a Participant may be permitted to receive all or part of his accumulated benefits at any time provided that (A) the Administrator approves such distribution in his or her sole discretion, and (B) the Participant forfeits a portion of his account balance equal to a percentage of the amount distributed. The percentage reduction shall

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be the greater of (A) six percent, or (B) a percentage equal to one-half of the prime interest rate, as determined by the Administrator.

Section 12. Time Of Investment. Amounts deferred under the Plan shall begin to be credited with gains, losses and rates of return from Investments commencing on the date credited to the Participant's Accounts.

Section 13. Participant's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive future installments under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

Section 14. Statement of Account. Statements will be sent to each Participant by February and August and more frequently if the Administrator so determines as to the value of their deferred compensation accounts as of the end of December and June, respectively.

Section 15. Assignability. No right to receive payments hereunder shall be transferable or assignable by a Participant, except by will or by the laws of descent and distribution or except as provided under Section 9.

Section 16. Business Days. In the event any date specified herein falls on a Saturday, Sunday or legal holiday, such date shall be deemed to refer to the next business day thereafter.

Section 17. Administration. The Plan shall be administered by the Vice President of the Company having responsibility for human resources (the "Administrator"). The Administrator shall have the authority to adopt rules and regulations for carrying out the plan, and interpret, construe and implement the provisions of the Plan.

Section 18. Amendment. The Company expressly reserves the right to amend the Plan at any time and in any particular manner. Such amendments, other than amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors ("Committee"), or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

Upon termination the Administrator in his or her sole discretion may pay out account balances to participants. No amendment, modification or termination shall, without the consent of a Participant, adversely affect such Participant's accruals in his/her Accounts.

(As amended through 10/13/97)

## XEROX CORPORATION

DEFERRED COMPENSATION PLAN FOR EXECUTIVES  
(Formerly 1989 Deferred Compensation Plan For Executives)

## AMENDMENT AND RESTATEMENT

Preamble. This Deferred Compensation Plan For Executives, 1997 Amendment and Restatement (the "Plan") is a private unfunded nonqualified deferred compensation arrangement for executives and all rights shall be governed by and construed in accordance with the laws of New York, except where preempted by federal law. It is intended to provide a vehicle for setting aside funds for retirement.

Section 1. Effective Date. The original effective date of the Plan is January 1, 1989. The effective date of this amendment and restatement is October 13, 1997.

Section 2. Eligibility. Any employee of Xerox Corporation (the "Company"), and any employee of a wholly owned subsidiary of the Company which has adopted this Plan with the approval of the Company's Board of Directors or the Committee (as hereinafter defined) ("Participating Subsidiary"), who is in Corporate B and A (or its equivalent) or above, and such additional group or groups of employees of the Company or of a Participating Subsidiary as designated from time to time by the Administrator, are eligible to participate in the Plan (an individual who has so elected to participate is hereinafter referred to as a "Participant"). A Participant who terminates an election to defer receipt of compensation is not eligible to make deferrals again in the Plan until twelve months after the effective date of such termination.

Section 3. Deferred Compensation Account. There shall be established for each Participant one or more deferred compensation Accounts (as hereinafter defined).

Section 4. Amount of Deferral. A Participant may elect to defer receipt of compensation for services (up to 50% in the case of base salary and up to 100% in the case of any other long or short term compensation that is eligible for deferral) as an employee of the Company or a Participating Subsidiary otherwise payable to the Participant in the form of cash. Any amount deferred is credited to the Participant's Accounts on the date such amount is otherwise payable.

Section 5. Time of Election of Deferral. An election to defer compensation must be made by a Participant prior to the year in which the Participant would

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otherwise have an unrestricted right to such compensation. When an employee first becomes eligible to participate in the Plan, he or she may elect to defer any compensation to which he or she has yet to have an unrestricted right to payment. An election to totally terminate future deferrals may be made at any time prior to the relevant payment date.

Section 6. Hypothetical Investment. Deferred compensation is assumed to be invested, without charge, in (a) the Balanced Fund, Income Fund, U. S. Stock Fund, International Stock Fund, Small Company Stock Fund or Xerox Stock Fund (or the successors thereto) established from time to time under the Profit Sharing Plan, (b) a fund with a variable fixed rate of return based upon the prime or base rate charged by one or more banks ("Prime Rate Investment") and (c) such other fixed income return investments ("Fixed Return Investment"), all as shall be made available from time by the Administrator in his or her administrative discretion ("Investments"), as elected by the Participant.

It is anticipated that the Administrator will substitute the Prime Rate Investment for the Income Fund effective January 1, 1998. Amounts deferred prior to January 1, 1998 shall have a rate of return at the Income Fund or the Prime Rate Investment as elected by Participants on forms provided by the Administrator in connection with the implementation of the Prime Investment Rate.

Elections to make hypothetical investments in any one or more of the Investments shall be subject to administrative rules adopted by the Administrator from time to time.

No shares of Xerox stock will ever actually be issued to a Participant under the Plan.

Section 7. Value of Deferred Compensation Accounts and Installment Payments. The value of each Participant's Accounts shall reflect all amounts deferred, gains, losses and rates of return from the Investments, and shall be determined at the close of business on each day on which securities are traded on the New York Stock Exchange. Hypothetical investments in the Profit Sharing Plan shall be valued on each business day based upon the value of such hypothetical investment as determined under such Plan on the valuation date under such Plan coincident with or last preceding such business day. The value of Investments not made under the Profit Sharing Plan shall be determined from such available source or sources as the Administrator in his or her sole discretion shall from time to time determine. The date as of which investments are valued pursuant to the foregoing sentences are referred to herein as a Valuation Date.

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Section 8. Manner of Electing Deferral. A Participant may elect to defer compensation by giving written notice to the Administrator on a form provided by the Company, which notice shall include (1) the percentage to be deferred; (2) if more than one is offered under the Plan, the Investment applicable to the amount deferred; and (3) the payment method that will apply to the deferred compensation. A Participant may elect up to a maximum of four separate payment methods during his or her participation in the Plan ("Accounts"). Such payment methods once made may never be changed. Each election to defer compensation under the Plan shall specify an Account from which payment will be made. The Accounts available under the Plan shall be:

ACCOUNT 1 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years). The last payment shall be on the July 15 of the year in which the Participant attains a certain age elected by the Participant.

ACCOUNT 2 which shall be payable beginning the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable on each subsequent July 15 until the number of payments elected by the Participant have been made.

ACCOUNT 3 which shall be payable on the July 15 of a calendar year that follows the calendar year of retirement by the number of years elected by the Participant (0, 1, 2, 3, 4, or 5 years) and is payable as a single sum.

ACCOUNT 4 shall be available with respect to amounts deferred during 1998 and later years. This account is payable beginning on the July 15 of a specified year whether before or after retirement. In addition to this payment date, the Participant must elect the number of payments that are to commence on this date. The payment(s) from this account can be as a single sum or payable in up to four annual installments. Once Account 4 is established (an election is made to defer and the payment date is defined), deferrals to Account 4 shall cease for any calendar year in which a payment is scheduled to be made from this Account. The full account balance shall be distributed by the end of the installment period. Once the final payment is made from this Account, the Participant may elect to create a new Account 4. The initial election or any subsequent election to use this Account must be made by December 31 of the year preceding the calendar year in which deferrals will be allocated to this Account. The first payment date that can be elected is the July 15 of the calendar year that follows the calendar year of election (calendar year containing the December 31 due date for election) by three years.

Not later than December 31, 1997, participants who are currently employed by the Company may change their payment elections previously made under the Plan which specified payment dates relating to termination, retirement, death, or

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disability, by selecting payments pursuant to the methods described in Accounts 1 through 3 above. Such change shall be effected by the Participant filing with the Administrator a change of election on a form or forms

established by the Administrator for such purpose. Such change shall be effective only with respect to payments in 1999 or later for participants who are employed by Xerox as of December 31, 1998.

The Administrator may adopt rules of general applicability for administration of payments under the Plan which may be elected by participants, including without limitation, fixing the maximum age selected for payments to terminate and the maximum number of payments.

#### Section 9. Payment of Deferred Compensation.

(a) No withdrawal may be made from the Participant's Account, except as provided under this Section and Sections 10 and 11.

(b) Payments from a Participant's Account are made in cash in accordance with the elections made under Section 8 of the Plan based on the value of the Participant's deferred compensation Accounts as of the Valuation Date immediately preceding the date of payment.

(c) Unless otherwise elected by a Participant with the written approval of the Administrator, payments of deferred compensation shall be made pursuant to the following formula: the amount of the first payment shall be a fraction of the value of the Participant's deferred compensation account on the preceding Valuation Date, the numerator of which is one and the denominator of which is the total number of installments elected, and the amount of each subsequent payment shall be a fraction of the value on the Valuation Date preceding each subsequent payment date, the numerator of which is one and the denominator of which is the total number of installments elected minus the number of installments previously paid. Any other payment method selected with the written approval of the Administrator must in all events provide for payments in substantially equal installments.

(d) Upon termination of employment, including termination resulting from death, prior to retirement, the total value of the participants Accounts under the Plan shall be paid to the Participant, or his or her estate, as the case may be, as soon as administratively possible after his or her date of termination.

(e) Upon the death of a Participant following retirement the total value of the Participant's Accounts under the Plan shall be paid in accordance with a one-time, irrevocable election made by such Participant as follows:

1. The total value shall be paid to the Participant's estate as soon as administratively possible after the death of a Participant, or

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2. Payments shall continue under the election made by the Participant to the Participant's surviving spouse until the surviving spouse's death. Any remaining payments shall be paid as a single sum to the surviving spouse's estate.

(f) If a Participant dies after retirement without having made such irrevocable election, the total value of his or her Accounts under the Plan shall be paid in a single payment to the participant's estate as soon as administratively possible after notice of his or her date of death has been received by the Administrator.

#### Section 10. Acceleration of Payment.

(a) For Hardship. Upon written approval from the Company's Chief Executive Officer (the Company's Board of Directors, in the case of a request from the Chief Executive Officer), a Participant may be permitted to receive all or part of his accumulated benefits if, in the discretion of the Chief Executive Officer (or the Board, if applicable), it is determined that an emergency event beyond the Participant's control exists and which would cause such Participant severe financial hardship if the payment of his benefits were not approved. Any such distribution for hardship shall be limited to the amount needed to meet such emergency. A Participant who makes a hardship withdrawal cannot reenter the Plan for twelve months after the date of withdrawal.

(b) Upon a Change in Control. Within 5 days following the occurrence of a change in control of the Company (as hereinafter defined), each Participant shall receive a lump sum payment equal to the value of his Account.

For purposes hereof, a "change in control of the Company" shall be deemed to have occurred if (A) any "person", as such term is used in Sections

13(d) and 14(d) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), other than the Company, any trustee or other fiduciary holding securities under an employee benefit plan of the Company, or any company owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 20 percent or more of the combined voting power of the Company's then outstanding securities; or (B) during any period of two consecutive years, individuals who at the beginning of such period constitute the Board, including for this purpose any new director (other than a director designated by a person who has entered into an agreement with the Company to effect a transaction described in this Section) whose election or nomination for election by the Company's shareholders was approved by a vote of at least two-thirds of the directors then still in office who were directors at the beginning of the period or whose

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election or nomination for election was previously so approved, cease for any reason to constitute a majority thereof.

Section 11. Other Penalized Withdrawals. Notwithstanding the provisions of Sections 9 and 10, a Participant may be permitted to receive all or part of his accumulated benefits at any time provided that (A) the Administrator approves such distribution in his or her sole discretion, and (B) the Participant forfeits a portion of his account balance equal to a percentage of the amount distributed. The percentage reduction shall be the greater of (A) six percent, or (B) a percentage equal to one-half of the prime interest rate, as determined by the Administrator.

Section 12. Time Of Investment. Amounts deferred under the Plan shall begin to be credited with gains, losses and rates of return from Investments commencing on the date credited to the Participant's Accounts.

Section 13. Participant's Rights Unsecured. The benefits payable under this Plan shall be unfunded. Consequently, no assets shall be segregated for purposes of this Plan and placed beyond the reach of the Company's general creditors. The right of any Participant to receive future installments under the provisions of the Plan shall be an unsecured claim against the general assets of the Company.

Section 14. Statement of Account. Statements will be sent to each Participant by February and August and more frequently if the Administrator so determines as to the value of their deferred compensation accounts as of the end of December and June, respectively.

Section 15. Assignability. No right to receive payments hereunder shall be transferable or assignable by a Participant, except by will or by the laws of descent and distribution or except as provided under Section 9.

Section 16. Business Days. In the event any date specified herein falls on a Saturday, Sunday or legal holiday, such date shall be deemed to refer to the next business day thereafter.

Section 17. Administration. The Plan shall be administered by the Vice President of the Company having responsibility for human resources (the "Administrator"). The Administrator shall have the authority to adopt rules and regulations for carrying out the plan, and interpret, construe and implement the provisions of the Plan.

Section 18. Amendment. The Company expressly reserves the right to amend the Plan at any time and in any particular manner. Such amendments, other than amendments relating to termination of the Plan or relating to Investments

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under Section 6 of the Plan, may be effected by (i) the Board of Directors, (ii) a duly constituted committee of the Board of Directors ("Committee"), or (iii) the Vice President of the Company responsible for human resources or a representative thereof. In the event such office is vacant at the time the amendment is to be made, the Chief Executive Officer of the Company shall approve such amendment or appoint a representative. Amendments relating to termination of the Plan or relating to Investments under Section 6 of the Plan shall be effected pursuant to a resolution duly adopted by the Board of Directors of the Company, or a duly constituted committee of the Board of Directors of the Company, in accordance with the Business Corporation Law of

the State of New York.

Any amendment, alteration, modification or suspension under subsection (iii) of the preceding paragraph shall be set forth in a written instrument executed by any Vice President of the Company and by the Secretary or an Assistant Secretary of the Company.

Upon termination the Administrator in his or her sole discretion may pay out account balances to participants. No amendment, modification or termination shall, without the consent of a Participant, adversely affect such Participant's accruals in his/her Accounts.

This Schedule Contains Summary Financial Information Extracted From Xerox Corporation's September 30, 1997 Financial Statements And Is Qualified In Its Entirety By Reference To Such Financial Statements.

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9-MOS	DEC-31-1997	
	SEP-30-1997	62
		0
		13,931
		424
		3,092
		10,517
		5,106
		2,819
		27,248
		7,304
		13,006
		637
		709
		327
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		12,754
		3,635
		6,761
		4,618
		176
		450
		1,375
		478
		927
		0
		0
		0
		927
		2.70
		2.57