

Business review

The Business review describes the business of BT and its activities during the 1999 financial year.

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Introduction

BT's aim is to be the most successful worldwide communications group. To achieve this, we have to generate shareholder value by seizing opportunities in the communications market worldwide, building our current business and focusing on high growth segments, while playing our part in the community and achieving the highest standards of integrity, customer satisfaction, and employee motivation.

We aim to do this by continuing our strategy of recent years of:

- serving the needs of multinational companies, wherever they are based;
- moving into growth markets around the world, such as Europe, the Asia-Pacific region and Latin America;
- building our activities in high growth areas such as mobile communications, network-based communications solutions for businesses, and the "datawave", i.e. data, multimedia and the Internet;
- continuing to develop and grow our business in the UK, which we believe to be the most open and competitive telecommunications market in the world.

Outside the UK, our strategy is to work with local partners. We now have a number of key alliances around the world and have made a significant investment in international services. Mobile services form an important and increasing part of these activities.

The group's operating profit is derived predominantly from UK local and national calls and international calls. Within the UK, our major services and products are local and national calls, the provision of exchange lines to homes and businesses, international calls made from and to the UK, the supply of mobile communications services and equipment to businesses and individuals, the provision of private circuits to businesses and the supply of telecommunication equipment for customers' premises.

The principal components of BT's turnover during each of the last five financial years are shown in the table on page 9. In the 1999 financial year, approximately 96% of BT's group turnover arose from operations in the UK.

Global venture with AT&T

The major event of the year was the announcement on 26 July 1998 that BT and AT&T, the major US long-distance telecommunications operator, were to form a global venture to serve the communications needs of multinational companies and organisations and the international calling needs of individuals and businesses around the world.

Turnover summary – ongoing activities	1995	1996	1997	1998	1999
YEARS ENDED 31 MARCH	£m	£m	£m	£m	£m
Inland calls	4,941	4,882	4,874	4,924	5,178
Exchange lines	2,753	2,900	3,033	3,180	3,337
International calls	1,935	1,980	1,809	1,553	1,501
Mobile communications	657	856	949	1,089	1,400
Private circuits	1,024	1,056	1,124	1,149	1,165
Customer premises equipment supply	1,041	946	914	896	870
Receipts from UK operators	246	265	319	496	645
Yellow Pages and other directories	371	408	438	466	491
Other UK sales and services	737	831	994	1,332	1,770
Non-UK operations	188	322	481	555	596
Group turnover	13,893	14,446	14,935	15,640	16,953
Share of associates' and joint ventures' ongoing turnover (a)	7	24	86	399	1,270
Total turnover – ongoing activities	13,900	14,470	15,021	16,039	18,223

(a) Excludes associates and joint ventures no longer part of the group.

Owned equally by BT and AT&T, the venture will combine trans-border assets and operations of both companies, including the majority of our cross-border international networks, our international traffic, and our international products for business customers, including an expanding set of Concert services. Concert Communications Services (Concert) is one of the world's leading providers of seamless, global communications services.

BT will transfer the majority of its international communications activities, including Concert and our business with selected multinational customers, to the global venture.

Through the venture, BT and AT&T aim to serve the fast-growing global communications services market. The venture, together with partners around the world, will provide an extensive range of global trans-border services, greater than either company could provide alone or with their current partners.

The deal has gained regulatory approval from the European Commission. We have applied for approvals from the US Department of Justice and the Federal Communications Commission and these are expected later in 1999, prior to the launch of the global venture.

It is proposed that the venture will have three key businesses:

- a global voice and data business to develop network-based communications solutions for multinational companies and organisations around the world;
- a global sales and service business to serve directly the communications needs of multinational customers from selected industries;

- an international carrier services business to manage all of the international correspondent relationships.

Supporting these businesses the venture will have a correspondent international network which will reach 237 countries and territories and its own managed network with 6,000 nodes in 52 countries covering nearly 1,000 cities.

The venture will have its own board of directors, which will comprise executives from both companies, and its own management team. Sir Iain Vallance will be the venture's first Chairman and David Dorman its Chief Executive Officer. Mr Dorman, who was appointed on 1 April 1999, has extensive US experience in communications gained with Pacific Bell, Sprint and PointCast.

With its operational headquarters in the eastern United States, the venture will employ initially about 5,000 people worldwide. It will have its own sales force to serve corporate customers.

Concert Communications Services

Concert is wholly owned by BT. It was created in 1993 to serve multinational customers with trans-border and global communications needs. Since its inception, Concert has developed and launched a strong portfolio of managed global services.

With more than 4,700 customers in 52 countries, Concert has become one of the world's leading providers of managed global services. Concert services are offered through 47 distributors around the globe, many of which are companies within the BT group, or joint venture companies of BT.

In the United States, Concert services are now available through three non-exclusive distributors, AT&T, BT North America Inc., and MCI WorldCom. AT&T has offered Concert services under the brand AT&T Concert since November 1998. MCI WorldCom will continue to offer Concert services until September 2000.

With approximately 1,600 employees in 13 countries, and one of the world's largest managed ATM backbone networks, Concert will be a key contributor to the global venture being established by BT and AT&T. ATM is the industry standard for integrated broadband communications.

Europe

Europe continues to present major opportunities for BT. We are moving to take advantage of these opportunities on two fronts: by continuing to grow, strengthen and develop our joint ventures and alliances and by investing in technologically-advanced networks.

We now, alone or in partnership, run or have licences to run fixed-line services in Belgium, France, Germany, the Republic of Ireland, Italy, the Netherlands, Spain, Sweden and Switzerland and mobile services in France, Germany, the Netherlands and Spain. We have a stake in Internet companies in France, Germany, the Netherlands, Sweden and Switzerland and own Arrakis, an Internet service provider in Spain.

Our partnerships in each of these countries distribute Concert services. In Europe, excluding the UK, BT now has, through its joint ventures and alliances, more than 7.5 million customers for mobile communications and almost 800,000 Internet customers.

Cegetel, in which BT has a 26% stake, is already the main competitor to France Telecom. Cegetel provides the full range of telecommunications services in France, with mobile services through its subsidiary, SFR. SFR now has more than four million customers and its GSM digital network covers 97% of the French population.

BT's joint venture in Germany is Viag Interkom in which BT has a 45% stake. In 1998, Viag Interkom successfully launched a full range of fixed, mobile and Internet services for the business and residential markets. Viag Interkom plans, during the coming year, to expand its mobile network to cover 70% of the German population, and recently launched its advanced Home Zone product, which combines both fixed and mobile services from a single provider. We believe that Viag Interkom is positioned as a strong provider of the full range of telecommunications services in the largest market in Europe.

Telfort, BT's Dutch 50/50 joint venture with national railway company Nederlandse Spoorwegen, has moved into the mobile market with the launch of Telfort Pak&Bel (Take & Talk). Initially, the service was available in the Raandstad area, including Amsterdam, Rotterdam, Utrecht and the Hague. Coverage is planned to increase during 1999. BT Payphones have signed a ten-year contract to provide more than 800 payphones, branded as Telfort, in Dutch railway stations.

In April 1998, our joint venture in Italy, Albacom, was awarded a fixed-network licence enabling it to negotiate interconnect agreements to offer fixed services throughout Italy. Albacom's main target clients are the 230,000 small and medium-sized companies in Italy. It is the national distributor of the Concert portfolio, with main offices in Rome and Milan.

In Spain, BT operates through Airtel, BT Telecomunicaciones SA (BT Tel) and Arrakis. Airtel, in which at 31 March 1999 BT had a 17.8% interest, is the second mobile operator in Spain and has a 31% share of the Spanish market. BT Tel is the distributor of Concert services and, in December 1998, was awarded a full fixed network licence. It intends to launch basic voice services by June 1999. In February 1999, we acquired Arrakis, a leading Internet service provider in Spain, with a 15% market share.

BT's other joint ventures in Europe include Ocean in the Republic of Ireland, which offers a wide range of services to business and commercial customers, Telenordia in Sweden, whose Internet service provider has over 250,000 customers and Sunrise Communications in Switzerland, which offers fixed services and carries over half of all Swiss Internet traffic. BT also has operations in the Isle of Man and Gibraltar.

BT UK, Albacom, BT Belgium, Sunrise, Telfort, Viag Interkom and Cegetel have combined to form the largest pan-European network, with points of presence in more than 200 cities. This enables us to meet customers' rapidly increasing demand for high quality, low cost Internet and high-speed telecommunications services. Phase two of the network build will include roll-out in the Republic of Ireland, Spain and the Nordic countries later this year and phase three will extend the network to other parts of southern and eastern Europe.

By linking the in-country networks and using the latest technology, BT, our joint ventures and Concert should enjoy substantial operating efficiencies and economies of scale.

Asia Pacific

BT believes that, despite recent economic difficulties in the area, the Asia-Pacific region continues to be an important market that offers great opportunities in the medium and long term. We have offices and ventures in Australia, China, Hong Kong, India, Indonesia, Japan, the Republic of Korea, Malaysia, New Zealand, the Philippines, Singapore, South Africa, Taiwan and Thailand.

Japan Telecom, one of Japan's largest telecommunications groups, BT and AT&T announced in April 1999 a strategic and operational partnership, aimed at further enhancing Japan Telecom's ability to deploy new services and technologies to serve customers in Japan. The companies have entered into an agreement for BT and AT&T to acquire a 30% stake in Japan Telecom for about £1.2 billion (Yen 220 billion).

Regulatory clearances for BT and AT&T's investment in Japan Telecom are currently being sought from the European Commission, the Department of Justice and the Federal Communications Commission in the United States. Subject to these clearances being obtained, the transaction is expected to close by autumn 1999.

Japan Telecom, with some 17 million customers, serves the full range of business and consumer customers and operates in the international, long-distance, data, Internet and local markets in Japan. It also has significant interests in digital mobile telecommunications companies which have more than six million customers.

Under the agreement, BT and AT&T will each subscribe for 15% of the equity in Japan Telecom. Through a holding company, BT and AT&T will have economic interests of 20% and 10%, respectively. BT and AT&T will jointly manage their investment.

Japan Telecom will also become the sole distributor of BT and AT&T global venture branded services and a preferred supplier of services to the proposed global venture.

During the year, BT Communications Services Limited (BTCS), our existing venture in Japan owned jointly with the Marubeni Corporation, was granted a telecommunications licence and broadband radio licences allowing the company to build and own its own infrastructure. BTCS will be integrated into Japan Telecom.

In November 1998, we launched the Harmonix brand to unify all of our products and services in Japan under one name. The Harmonix portfolio offers services from voice, data and Internet services to advanced multimedia and electronic commerce (e-commerce).

In Malaysia, we made a £279 million investment to acquire a 33.3% stake in Binariang Berhad, a major Malaysian telecommunications group operating a mobile communications business and providing fixed and international gateway services in Malaysia. Binariang's mobile company, Maxis, has a 22% market share and Binariang's broadband network can be accessed by 70% of Malaysian corporate customers and multinational companies. The network is fully compatible with Concert services, of which Binariang is now a non-exclusive distributor, together with Telekom Malaysia.

In Hong Kong, we acquired a 20% stake in SmarTone, a leading mobile telephone operator, for around £240 million in May 1999. SmarTone has half a million customers and an 18% market share.

In the Republic of Korea, we acquired, for £234 million, a 23.5% stake in LG Telecom, a leading mobile telephone operator, with 2.4 million customers.

In Singapore, BT is part of StarHub in partnership with ST Telecommunications Pte Limited, Singapore Power and Nippon Telegraph and Telephone Corporation. StarHub plans to provide broadband services to the home, a regional first. StarHub has started providing Internet services through its subsidiary, CyberWay.

Latin America

In April 1999, BT acquired a 20% stake in ImpSat, a leading telecommunications company with networks in major cities in Argentina, Brazil, Colombia, Ecuador, Mexico and Venezuela. The company provides large corporate customers with an advanced range of voice, data, Internet and e-commerce services. Under the terms of the deal, ImpSat will also become a distributor of Concert services.

Syntegra

Syntegra is a market-leading systems integration business with customers in more than 50 countries. More than half of Syntegra's turnover comes from outside the UK. It offers a range of services, including the design, support and development of information and communication systems and their underlying network and service platforms, as well as electronic solutions for business customers.

The UK

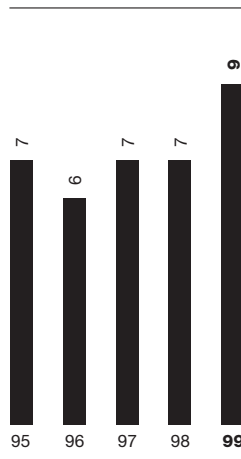
UK fixed network

Within the UK, BT has 28 million customer lines (exchange line connections) of which approximately 20 million are residential lines and eight million are business lines. On average, approximately 100 million

UK local and national calls are made each day. These comprise voice and non-voice calls, such as facsimile and data transmission, including calls to the Internet.

UK inland local and national calls accounted for approximately 31% of the group's turnover in the 1999 financial year.

% annual inland call volume growth
YEARS ENDED 31 MARCH



Call growth in recent years has been stimulated largely by price reductions and by growth in the UK economy. The estimated growth rates in call volumes increased more this year than in each of the last five financial years, largely because of the expanding use of the Internet (around 18% of our UK local call minutes in March 1999 was Internet-related traffic) and a significant increase in calls to mobile phones.

The price structure for call charges varies with distance, duration, time of day, usage and the applicability of discount schemes. BT charges for the exact duration of the call, subject to a minimum charge.

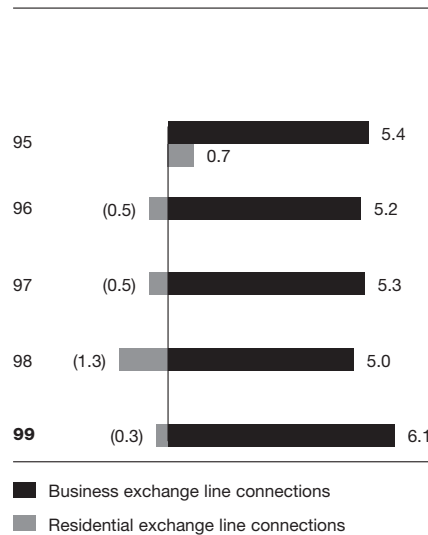
Exchange lines

In the 1999 financial year, UK exchange line rental and connection charges accounted for approximately 20% of the group's turnover. Our exchange line customers are generally charged a uniform quarterly rental per line. The charge for business lines is higher than for residential lines. The increase in exchange line turnover reflects mainly the growth in business lines in general and high-speed digital Integrated Services Digital Network (ISDN) lines in particular. Residential lines declined slightly, mitigated by the large number of customers installing second lines.

However, since the beginning of 1995, BT has experienced a small net reduction in residential line

connections as a result of the continuing competition from cable operators which offer integrated television and telephony services. Business connections have shown a steady increase over the same period.

Exchange line connections
% growth (fall) over previous year
YEARS ENDED 31 MARCH



International calls

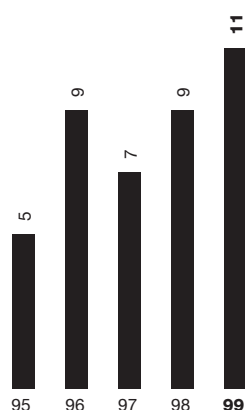
International calls accounted for approximately 9% of the group's turnover in the 1999 financial year.

International call revenues are derived from outgoing calls made by customers in the UK and from receipts from non-UK telecommunications operators for incoming and transit calls that use BT's facilities. In turn, BT makes payments to non-UK operators for the use of their facilities, primarily for terminating calls.

The UK remains one of the world's principal telecommunication transit centres, enabling calls originating and terminating outside the UK to be routed through it. International direct dialling from BT's UK network is available to virtually all countries and almost all international calls originating from BT's UK network are direct dialled. In the 1999 financial year, the greater part of BT's international call traffic was generated from a limited number of routes and 75% of outgoing call volume was to 15 countries.

BT continues to seek reductions in interconnection rates, the charges that telecommunications providers in other countries make for carrying international calls originating in the UK. Historically, these have not kept pace with reductions in the underlying costs of providing international service except on the more liberalised routes. We welcome the decision of the European

**% annual international
call volume growth**
YEARS ENDED 31 MARCH



Commission, taken in August 1998, to exclude BT from its continuing investigations into the high level of interconnection rates in Europe. We believe that the Commission's decision to concentrate its investigations on arrangements involving seven other European operators recognises the competitive nature of the UK market for international communications.

The volume of international calls continues to grow, partly because of significant price reductions. However, these price reductions and increased competition continue to have an adverse effect on revenues.

It is intended that much of our international call business will be transferred to our proposed global venture with AT&T later in 1999 once regulatory approvals are obtained.

Mobile services in the UK

Mobile communication services and products supplied by BT in the UK mainly comprise cellular telephony, together with radiopaging and voice messaging.

We have a 60% stake in BT Cellnet, one of the four cellular telephone network operators in the UK licensed by HM Government. BT Cellnet had 4.5 million customers at 31 March 1999, representing 30% of the UK market. During the course of the year, HM Government indicated that it would no longer object if BT decided to buy the 40% of BT Cellnet owned by Securicor.

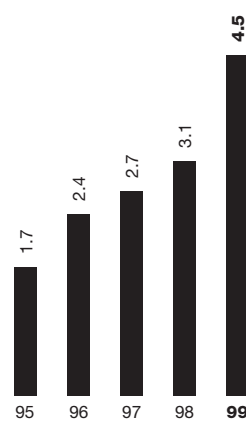
In March 1999, BT Cellnet acquired an 80% stake in the mobile service provider Martin Dawes Telecommunications (MDT) for approximately £130 million. MDT, which will continue to be run as a separate business unit at least for the 2000 financial year, has 800,000 customers, mainly small and

medium-sized businesses. Vodafone holds the remaining 20% of MDT and, until September 1999, has the right to sell it to BT Cellnet.

The market for mobile services is expanding faster than most other sectors of the UK telecommunications market but is extremely competitive with great pressure on prices. Throughout the year, BT Cellnet has responded with a number of marketing initiatives: discount offers specifically designed for particular types of customer (marketed as "BT Cellnet First"), products and services aimed at young people and, most notably, "pre-paid" phones. These can be bought over the counter at a range of outlets, including supermarkets and electrical stores, complete with a set amount of call time which can be topped up later, so avoiding the need for written contracts and monthly subscriptions. They have proved very popular and have been a major contributor to the large increase in BT's mobile communications customer base (up 47% over the 1999 financial year) and turnover (up 29% over the year, even after significant price reductions).

BT Cellnet has continued to invest in its digital cellular GSM network to improve its quality and capacity.

**BT Cellnet customers
(millions)**
AT 31 MARCH



Vodafone, Orange and One 2 One are the other licensed mobile operators in the UK. They had 5.6 million, 2.5 million and 2.3 million connections, respectively, on 31 March 1999, up from 3.4 million, 1.3 million and 1.2 million at the same time last year.

As a result of an Inquiry by the Monopolies and Mergers Commission (MMC) (renamed the Competition Commission from 1 April 1999), the price of calls to BT Cellnet and Vodafone was reduced from 30 April 1999 on

average by around 25%. These reductions have continued the downward trend in prices of calling from a BT line to a mobile phone, with prices at 31 March 1999 20% lower than two years earlier. This is covered in more detail in the mobile services section of *Regulation, competition and prices* below.

In the 2000 financial year, HM Government plans to auction licences for spectrum for the new third generation Universal Mobile Telecommunication Standard (UMTS). UMTS provides greater bandwidth than current technology, enabling high-speed data and multimedia applications.

Private circuits

We provide customers with private circuits, lines between fixed points reserved for the exclusive use of a customer, leased at a fixed rate irrespective of usage. Some 48% of these circuits are now digital. Private circuit revenues accounted for approximately 7% of the group's turnover in the 1999 financial year.

Customer premises equipment supply

We sell and rent a wide range of equipment for customer premises, from telephones for use in the home to advanced private exchange equipment for businesses. These activities accounted for approximately 5% of the group's turnover in the 1999 financial year.

Interconnect

Many other licensed operators in the UK use our network to help deliver their customers' calls. The emergence of many new operators in both the fixed and mobile markets led to a 30% increase in this turnover in the 1999 financial year, which accounted for approximately 4% of the group's turnover.

Yellow Pages and other directories

Yellow Pages is the UK's leading business information "bridge" linking buyers and sellers. The group manages a portfolio of products including *Yellow Pages*, *Business Pages* and *YELL*, its growing Internet and e-commerce service. Sales of Yellow Pages products accounted for approximately 3% of the group's turnover in the 1999 financial year. Revenue from volume growth of advertisements published by Yellow Pages increased by approximately 6% in the 1999 financial year compared with the previous year.

Payphones

BT operates more than 140,000 public payphones throughout the UK. More than 96% are in service at any one time.

During 1999 and 2000, BT Payphones is installing 1,000 *Multiphones*, the first of a new generation of BT multimedia payphones using touch screen technology and

full interactive screen display. BT believes that *Multiphone* is an exciting breakthrough in public communications, combining fast and easy public access to e-mail and the Internet with a range of interactive features.

Other UK sales and services

Other UK sales and services, which accounted for approximately 10% of the group's total turnover in the 1999 financial year, include Syncordia Solutions, advanced services, audioconferencing, videoconferencing and multimedia.

Syncordia Solutions specialises in the end-to-end provision, maintenance and billing of value-added voice and data services. These services are brought to the international market by Concert. Syncordia Solutions also supplies communications outsourcing services to manage the complex international communications needs of organisations for voice and data, including the management of call centres.

We provide advanced voice services, primarily through our FeatureNet service, and advanced data services.

We provide freephone services, visual communications services, including the distribution of television material for broadcasting organisations, videoconferencing and closed circuit television.

Multimedia and Internet

The rapid growth in the use of multimedia and the Internet proved to be one of the most notable features of the year. The Internet, in particular, is increasingly becoming part of everyday life both for individuals and businesses. We have now over 600,000 Internet customers in the UK.

BT offers a range of consumer and business Internet and interactive multimedia services, including full-featured Internet access through BT Internet and BT Connect to Business; flexible Internet access through BT ClickFree, with e-mail included via *talk21*; eBusiness services to enhance the security and flexibility of trading across the Internet, multimedia payphones and interactive TV.

In February 1999, we launched BT ClickFree, a free no-registration UK Internet service. Customers can access the Internet at the cost of a local call, or less if they belong to one of BT's call discount schemes such as Friends & Family or PremierLine.

Our new Highway service, launched during the year, is a mass-market digital communications service which, for the first time, enables UK customers to surf the Internet at high speeds and make calls or send faxes simultaneously over their existing telephone line.

In February 1999, we announced an agreement with Microsoft to develop a new range of Internet, intranet and corporate data services for mobile customers around the world. Services are expected to be available in several countries by early 2000.

In January 1999, BT acquired a 50% share in Excite UK, a subsidiary of the US-based global Internet media company, Excite, for £6 million. The agreement further develops our presence in Internet advertising and transactions – two important on-line revenue generators.

A joint venture formed in September 1998 between BT and Scitex Corporation, Vio Worldwide, provides graphic arts users worldwide with a secure network for rapid data transfers.

Open, the interactive TV service provided by British Interactive Broadcasting (BiB), a joint venture with BSkyB, HSBC and Matsushita, will enable high street businesses to offer interactive services, including home shopping, home banking, travel and holiday services.

Since April 1998, more than one in six schools have signed up to BT's Schools Internet Caller, which provides unlimited access via a standard phone or ISDN line for a set annual fee. BT Schools Internet Caller is a significant step towards the realisation of the Government's pledge of getting all of the UK's primary and secondary schools connected to the Internet National Grid for Learning by 2002.

Customer satisfaction and quality of service

BT's quality of service, and our customers' satisfaction with that service, is extremely important to us. To ensure our customers are satisfied with our service and to understand ways we can improve it, we talk to thousands of our customers every month, in the UK and throughout the world, asking for their opinion. We also run an extensive market research programme to focus on wider issues and to help us match our product and service offerings to customer requirements.

Every month, specialist market research agencies, acting on our behalf, talk to 23,500 residential and 14,000 business customers in the UK about all aspects of the service we provide.

For the period October 1998 to March 1999, overall satisfaction with BT among residential customers rose to 90% from 89% in the previous six months, while 86% of business customers continued to be satisfied overall.

At the start of this period, we changed our survey methodology for measuring business customers'

satisfaction with our provision and repair services. We are now interviewing more customers whose orders or repairs did not require a visit from BT, reflecting the increase in this type of work. Taking this into account, satisfaction with both the business installation and repair services remained stable with around eight out of ten customers saying they are happy with the services they received. Among residential customers, satisfaction with our installation service continued to improve and 83% of customers were satisfied with our repair service.

When the UK telecommunications operator Ionica ceased to trade, we successfully connected more than 43,000 of its former customers to the BT network at very short notice, with the majority of the work being done in a six-week period.

We are continuing with our programme to make our network more resilient to the weather. This includes overnight testing of lines, so that we can identify problems before they become apparent to customers.

Some 86% of users are satisfied with our public payphone service, with a significant improvement in the number who are very satisfied.

We have continued to maintain high levels of performance in our 24-hour operator services, despite an increase in calls of 11% to operator assistance in the past year alone.

We regularly survey opinion formers throughout the world to find out their views on BT and on international telecommunications matters in general. Continuing the trend of previous surveys, in our November 1998 survey we found that BT and AT&T are two of the most recognised telecommunications brands throughout the world. The environment in which we operate is coming to be seen as increasingly diverse, with local operators (including our joint ventures) becoming recognised as significant players. There has been an increase in Europe in the number of BT's joint ventures being nominated by opinion formers as the best alternative to the incumbent supplier.

Marketing, promotion and pricing offers

Our marketing focus in the year has been on the launch of new services, including Highway for both residential and business customers, call stimulation, and major efforts to reinforce the reasons why customers should come back to BT.

We focused on promotions such as "Chatterday", and reducing calling rates at weekends to encourage people to make more calls.

We introduced a campaign “Thousands are coming back”, which highlights the benefits that we can offer both our residential and business customers, such as the wide range of services and value for money. We also underpinned this campaign with attractive promotional prices in areas such as the connection of second lines.

The reconnection charge for residential customers was abolished in April 1999. Customers who wish to rejoin BT from a competitor can now do so free of charge, providing the former wiring is still in place.

At the same time, the cost of installing a new residential line was cut by 15% from £116.33 to £99.00 (including VAT).

In recognition of the growing importance of on-line marketing, the year saw us shift a significant emphasis onto our website, www.bt.com, as well as banner advertising on key websites of others. The Highway launch used on-line marketing to stimulate high levels of customer interest via the Internet.

A programme to redesign, refocus and relaunch our UK shops is underway. They will now concentrate on meeting the complete communications needs of individuals and small businesses. Some 22 of our 94 shops had been relaunched by 31 March 1999 and the target is to complete the programme during the next two to three years.

As well as these products and service campaigns, we have been running press advertisements highlighting the contribution that BT, in particular, and telecommunications in general, can make and are making to the social well-being of the UK. Areas covered include healthcare, disability, crime prevention and support for the elderly.

In April 1998, the cost of local calls made in the evening on weekdays came down from 1.7p to 1.5p a minute – a cut of more than 10%.

During the year, we also introduced a range of attractive discount plans which are targeted to meet the needs of a wide range of customers. In the business market, we launched the “Keys” plans, which can be customised to give discounts on Key Numbers, Key Cities, Key Regions and Key Countries. Another new plan is BT Dual Discount, which is designed to give extra savings to business customers based on their combined call spend for outgoing telephone and incoming **Lo-call** and **Freefone** calls.

BT Call & Save, introduced in January 1999, is available to residential customers whose quarterly call bill is more than £25. It gives a 10% discount on direct-dialled local,

regional, national and international calls. When combined with other discount schemes these savings can be even greater. For example, used together with Friends & Family, savings of up to 20% on calls are possible.

Exchange line rental charges for business and residential customers rose during the year, but in both cases the increase was less than the rate of inflation.

Over the last five years, after taking account of inflation, the average residential bill has fallen by 21% and the bill for the average business customer by nearly 28%.

Network development and capital expenditure

The group’s expenditure on transmission equipment, exchange and other network equipment accounted for 73% of total capital expenditure in the 1999 financial year.

We continued to invest heavily in ATM and SDH networks, the world standard for broadband, video, data and voice services. During the year, the number of ATM switches increased from 23 to 103 and the number of SDH nodes in the network more than doubled from 400 to 850, covering all major towns and cities across the UK, and the overall traffic capacity of the SDH network also doubled. Wavelength division multiplexing equipment has been introduced onto the optical fibre network to increase the traffic-carrying capacity of a single pair of fibres by at least sixteenfold.

During the year, BeTaNet, an advanced Internet protocol (IP) and multimedia optical fibre network, came into operation. BeTaNet, which interfaces with today’s conventional telephone network, is a product of major investments in advanced switching and transmission equipment. It offers virtually unlimited bandwidth over a single link for simultaneous voice, data, video and Internet services. Supporting services such as eBusiness, interactive call centres and new intranet-based solutions for commercial and industrial customers, BeTaNet will be fully integrated, with more than 20,000 existing fibre nodes and over 300 more are being added every month. Over time, the need for multiple telephone lines and separate high-speed data networks will be reduced, and a wide range of multimedia services, such as Internet, eBusiness, voice over IP, interactive television and broadband data, will all be delivered in an integrated format.

BT has reached a framework agreement with a major manufacturer for the development and supply of the next generation of switches designed to meet the needs of the rapid data traffic growth in the UK. The agreement, potentially worth up to £270 million, will secure BT’s

network capacity into the next decade. The switches are expected to be deployed over the next four years, providing initial switching capabilities of up to 160 gigabits a second and future growth into terabits. (A gigabit is one billion bits, equivalent to about 120 novels. A terabit is a thousand gigabits). Gigabit switch trials began early in 1999, with the first switch scheduled to go live in August 1999.

BT is committed to investing in Information Services (IS) to provide and support the core information infrastructure on which BT operates. BT is determined to optimise its investment by looking at ways of exploiting this infrastructure for the benefit of shareholders and customers. Examples of this are programmes which involve sharing the risk of our IS investment with other large corporations and establishing the principle of managed services with our information technology suppliers.

Research and development

We believe that, in a technologically-advanced industry such as telecommunications, well-directed and creative research and development activity is critical to gaining and retaining competitive advantage. We have world-class research and development centres at Martlesham (Suffolk), London, Cardiff, Belfast, Glasgow and in Reston and San Jose in the United States. In late 1998, in a MORI survey of directors of UK companies, BT was judged to be the fifth most innovative company in the world.

In the 1999 financial year, we spent £268 million on research and development, the majority of which was directed towards the development of new and improved networks and services for customers. Major areas of work include software systems for managing networks and the services they carry, speech and image processing, Internet and interactive services, mobile applications, information and system security, new ways of operating call centres, information management techniques, data services and the application of information and telecommunications technology in healthcare and education.

Property

The group had a property portfolio of approximately 8,000 buildings at 31 March 1999, the majority of which are freehold, located principally throughout the UK. Specialised buildings account for the majority of properties, both in number and book value. They house mainly exchange equipment and are needed as part of the group's continuing operations. They do not readily adapt to other uses. General purpose properties consist chiefly

of offices, depots, computer centres and shops. We are engaged in a programme of disposing of a small number of surplus properties.

The principal categories of BT's plant and equipment are exchanges and transmission equipment. Transmission equipment comprises: copper, fibre and radio access; underground ducts for copper and fibre access; equipment for the trunk network; and cellular and other transmission equipment.

Organisation and employees

Organisation

BT is currently organised into two main operations: BT UK and BT Worldwide. Later this year, Syntegra and Syncordia Solutions will be combined to form a new solutions business. A number of support units in the group's headquarters provide specialised services.

The organisational structure of BT UK was realigned during the year to provide increased customer focus and competitiveness. Markets is responsible for developing customer relationships and managing sales channels across all markets and market sectors in the UK, and developing the value of the BT brand; Customer Service covers field engineering, operator services and call reception; Networks and Information Services is responsible for the network and information system's infrastructure; Mobility is responsible for BT Cellnet and BT's other mobility products; Products and Solutions offers products and end-to-end solutions to our customers; Enterprises comprises our stand-alone businesses which operate under their own brands. Other BT UK units provide support services.

BT Worldwide includes BT Europe, which manages our growing family of ventures and alliances across the region, and Strategic Markets which addresses the growth opportunities across the Asia-Pacific region.

In the proposed global venture with AT&T, there will be three distribution channel organisations aimed at specific customer groups. There will also be a separate unit to develop established product lines and new IP services, and a Network and Systems organisation to build and operate the global network.

Employees

At 31 March 1999, BT employed around 125,000 people throughout the world with 119,000 in the UK, making us one of the UK's largest employers. The following chart shows the total number of BT employees at the end of each of the last five financial years.

Employees (thousands)
AT 31 MARCH



The number of BT's employees in the UK has been relatively stable over the past year, following substantial reductions in the early 1990s. BT expects to continue to use a wide range of other resources where this is appropriate in the context of our overall strategy and the maintenance of positive industrial relations.

BT has extended its global operations in the year through its increasing network of joint ventures and alliances. This has meant significant growth in people terms. At the beginning of the 1999 financial year, the BT Worldwide family of alliances consisted of approximately 17,000 people, mainly employed by our joint ventures and alliances. As at 31 March 1999, this number had doubled to over 33,500 people.

Our people are critical to our success and we believe that a reputation as a good employer helps us to win and retain customers.

To help our people balance work and home responsibilities, we have a range of flexible working arrangements, including annualised hours, teleworking, part-time working and job sharing.

BT encourages people to acquire shares in their company to enable them to share in its success. £64 million has been set aside this year for the allocation of shares to employees under the BT Employee Share Ownership Scheme. Employees also have the opportunity to buy shares at a discount under the popular BT Employee Sharesave Scheme, a savings-related share option scheme.

Most BT employees are members of the BT Pension Scheme, which is controlled by trustees who are company or union nominees.

An estimated 80% of the company's UK employees belong to one of two main trade unions recognised by the

company. The pattern of industrial relations in the last few years has been stable and we continue to have constructive relationships with both unions.

BT is an equal opportunities employer and is committed to developing a working culture which enables all employees to make their own distinctive contribution. We actively encourage the employment and development of people with disabilities, including those who develop a disability during their career.

The application of our equal opportunities policies has seen BT win a number of awards, including the Opportunity 2000 "Framework for Success" award, which recognises best practice in encouraging women's participation in the workforce. As well as Opportunity 2000, we are members of, or are represented on, the key committees of Race for Opportunity, supporting the employment of ethnic minorities, and the Employer's Forum on Disability. We are also a founder member of the Employer's Forum on Age.

BT runs a number of employee attitude surveys, the most important of which is CARE – Communications and Attitude Research for Employees. Once feedback is received, managers work with their teams to explore any issues which may need attention.

BT prides itself on being a "learning organisation". We spend around £180 million a year on the training and development of our people. They have access to a comprehensive portfolio of development and training options, which include technical and commercial training, personal skills and management development.

In October 1998, BT achieved Investors in People accreditation, the largest organisation in the UK to have done so. Investors in People is a national quality standard for effective investment in the training and development of people to achieve business goals. The standard provides a framework for improving business performance and competitiveness, through a planned approach to setting and communicating business objectives and developing people to meet those objectives.

Two of our businesses, BT Northern Ireland and Yellow Pages received European Quality Awards prizes in September 1998. BT Payphones won the UK Quality Award for Business Excellence in October 1998.

BT in the community

We were a founder member of the Per Cent Club in 1986. Through our Community Partnership Programme we commit a minimum of 0.5% of our UK pre-tax profits to activities in support of society. Other contributions in

support of community activities and programmes are estimated to bring this up to about 1%. Our Community Partnership Programme, the largest of its kind in the UK, concentrates its efforts on education, health and welfare issues, as well as assisting the arts and disability, and has a growing focus on supporting the community activities of BT people. Our expenditure has grown from £10 million in 1987 to £15 million in the 1999 financial year, including donations to charity of £2.6 million. No donations were made to any political party.

Telecommunications has a large part to play in improving the quality of life of the elderly and disabled. BT spends £20 million a year to ensure that these customers can get the most from our products and services. Many of our products and services are designed specifically to help overcome disabilities or infirmity: induction loops in handsets, large button dialpads, amplifiers and loud bells etc. We also support Tynetalk, a teletext service operated by the Royal National Institute for Deaf People, which enables people with hearing difficulties to use the phone.

BT and the Millennium

BT is playing a large part in the activities taking place in the UK to mark the new Millennium. Through a wide-ranging programme of activities, we plan, under the FutureTalk banner, to offer everyone in the UK the chance to improve their skills at interpersonal communication and make greater use of the communication technology of the digital age. We have already distributed nearly two million copies of TalkWorks, a self-help guide to better everyday conversations, and will be staging special performances in thousands of schools throughout the UK. Futuretalk will have a spectacular presence within the Millennium Dome in London.

Environment

BT takes its responsibility to the environment very seriously. We were one of the first major British companies to produce an environmental policy and an annual environmental report. We were also among the first to introduce comprehensive environmental management systems and to form a policy on sustainable development. We are confident that we are leading the way in this area and we have committed BT in the UK to achieve ISO14001 registration, the international environmental management system standard, progressively from March 1999.

BT has a long and widely recognised record of energy management. We reduced our energy consumption by more than 13% in the five years to April 1997 and are

now aiming for a further 11% reduction by March 2002. We have an extensive programme for recycling and recovering materials, including metal from redundant exchange units, cables, toner cartridges, office paper and electronic waste.

BT's first social report, *An issue of responsibility*, which reviews the social impact of BT activities, will be published shortly.

Education

BT is developing Internet-based services to support on-line training and education in workplaces and homes. Solstra, jointly developed by BT and Futuremedia, provides companies with an enterprise-wide solution to on-line delivered and managed knowledge, training and productivity tools. Solstra can deliver learning material on-line to anyone authorised to receive it, at any time (in any time zone) anywhere in the world. It is a system with the potential to deliver training on a global scale.

Education is about more than just technology. BT and its people offer support and help in many other ways. In particular, a number of programmes foster links between education and business, introducing pupils to the world of work and helping them to prepare for their working life. Our award schemes provide around £1 million a year to schools and further and higher education establishments, enabling a range of innovative projects and the use of new technology. We also host visits from teachers to raise their awareness of industry and skills needs. Away from work, more than 1,000 BT people are school governors.

Regulation, competition and prices

The commercial environment in the UK and in the countries in which BT operates or wishes to operate is increasingly competitive and dynamic. However, we remain subject to extensive regulation, particularly in the UK, which can materially affect the way in which the company carries out its business.

Regulation in the UK

The regulatory structure for telecommunications in the UK is set out principally in the Telecommunications Act 1984, which gives regulatory authority to the Secretary of State for Trade and Industry and the Director General of Telecommunications who heads the Office of Telecommunications (OfTel). The Secretary of State and the Director General are required to ensure, as far as reasonably practicable, that demand for telecommunication services, including certain community services, is met and to secure the ability of licensed operators to finance the provision of those services. In addition, they are

required to promote the interests of consumers, purchasers and other users in the prices, variety and quality of telecommunication services and equipment, and to promote and maintain efficiency and effective competition among the UK telecommunications operators.

With limited exceptions, a licence under the Telecommunications Act is required to run a telecommunication system and provide telecommunication services in the UK. The Secretary of State is responsible for issuing licences after consulting the Director General. Any modifications to a licence may be made by the Director General with the licensee's consent. Alternatively, changes to the licence may be referred to the Competition Commission (CC). In either case, the Telecommunications Act requires public consultation before a licence modification may be made. Licences may also be modified by legislation, including legislation implementing European Union directives in UK law. The Secretary of State has recently consulted on proposals to change the procedures for modifying licences in certain instances.

The BT Licence

BT operates in the UK under a number of licences granted under the Telecommunications Act, the most important of which is its public telecommunications operator licence to operate its fixed-linked public telecommunication network (the Licence). The Licence is for a period of 25 years from 5 August 1984 and can be revoked after ten years' notice (not to be given before 22 June 1999) and may also be revoked at any time on various grounds, including non-compliance with its terms.

The Licence contains terms and conditions designed principally to ensure the provision in the UK of widespread telecommunication services, to protect the interests of consumers and to encourage the development of effective competition in telecommunication services and equipment within the UK.

The company is required by the Licence to provide, throughout nearly all of the UK, telecommunication services, including rural and international services, which satisfy all reasonable demands to the extent that it is practicable to provide such services (the universal service obligation). The company must also make certain services and facilities available to the public.

The company is required to connect to its telecommunications system on non-discriminatory standard terms and conditions any other system run under a licence which authorises connection to the company's system.

The company must comply with a variety of fair trading obligations, such as a prohibition on showing undue preference or discrimination in the provision of certain services or unfairly favouring any part of its own business as against competitors; a prohibition on the unfair cross-subsidy of certain activities of the company; and a general prohibition on anti-competitive acts or omissions, in particular, agreements or concerted practices which may prevent, restrict or distort competition and any abuse of a dominant position.

The Licence contains price control formulae, the overall effect of which requires the company to reduce, or restricts the extent to which it can increase, the prices of many of its telephony services to the bulk of the residential market. In addition, the Licence contains certain specific restrictions on the terms on which BT can trade. In particular, the company is required to publish and adhere to standard prices and other terms for providing certain services and, in general, to apply uniformly a published scale of charges for installing residential exchange lines on premises to be served by a single line.

The Licence also contains provisions enabling the Director General to monitor the company's activities, including requirements for BT to supply him with information he requests and to maintain segregated accounting records for specified parts of its business. Where it appears to the Director General that an unfair cross-subsidy exists in relation to specified parts of its business, BT must take such steps as the Director General may direct to remedy the situation.

UK telecommunications licences, including the BT Licence, are currently being amended to meet the harmonisation requirements of the European Union Licensing Directive.

Competition and regulation

The UK telecommunications market is fully open to entry and is highly competitive. As a result, HM Government and Oftel have indicated their expectation that it will be appropriate to move away from specific licence-based regulation to greater reliance on the increased powers under the Competition Act 1998, which comes into effect in March 2000 (see *Future regulation* below).

However, as described above, Oftel currently regulates BT mainly through the provisions in the Licence. Although it is some years since the Telecommunications Act 1984 abolished the monopoly in telecommunications, obligations placed on BT are generally more onerous than for other licensees.

Pricing regulation

BT is subject to price controls on its fixed network services in the UK at two levels: retail and network. Competitors are generally not subject to price controls.

Retail price controls

BT is subject to two sets of UK retail price controls, one on certain public switched telephony call charges and exchange line rentals, and one on certain private circuits. Each price control is based on a formula calculated by reference to the UK Retail Prices Index (RPI). The weighted average decreases in prices charged for the services covered by the controls, in each twelve-month period beginning 1 August, cannot be less than a fixed percentage below the change in RPI (referred to as "RPI minus" the fixed percentage) for the twelve months to the preceding 30 June. The retail price control for public switched telephony, applying from August 1997 to July 2001, is RPI minus 4.5. Although it is measured on services used by the lowest 80% of BT's residential customers classified by bill size, controlled prices must be offered to all customers.

BT has also given an assurance that a normal residential bill will (for the same level of usage) not increase by more than RPI and that a "control" price package will be made available to business customers. The "control" package for business customers provides that call charges, which are no higher than the prices used for calculating adherence to the residential price control, and line rental increases will be no more than the increase in RPI.

The price control for private circuits, applying from August 1997 to July 2001, applies to analogue and lower speed digital private circuits, the prices of which cannot be increased by more than the change in the RPI in any year. Each discrete international private circuit price is subject to a safeguard cap of RPI.

Network charge control

The company operates under interconnection agreements with most other licensed operators.

A network charge control regime running to 30 September 2001 gives BT the freedom to set reasonable charges based on long-run incremental costs for its standard interconnection services. Depending on the degree of competition for these services, charges are basket controlled (i.e. at RPI minus 8), price cap controlled (i.e. no increases above RPI), or no longer subject to price controls. Those services considered unlikely to become competitive in the near future are subject to basket controls; those likely to become competitive are subject to price cap control; whereas fully competitive services are not subject to price controls.

The network charge controls are based around RPI minus 'X' rules. The value of 'X' in the 'RPI minus' formula has been set at 8% for the period of control. BT must publish a notification to the Director General and other licensed operators if it intends to amend existing charges or to offer new services.

BT is not allowed to discriminate unduly among operators or between BT's retail operations and other operators with respect to both price and quality of service. BT is also

The price control formula and the company's performance against the formula since 1 August 1994 have been as follows:

Price control formula	YEARS COMMENCING 1 AUGUST				
	1994	1995	1996	1997	1998
% RPI movement for the relevant period (a)	2.62	3.52	2.14	2.94	3.75
RPI formula in effect (b)	(7.50)	(7.50)	(7.50)	(4.50)	(4.50)
% required reduction in prices (c)	(4.86)	(1.38)	(4.92)	(1.56)	(0.73)
% reduction in prices overall	(7.35)	(1.82)	(4.92)	(1.56)	(0.73)

(a) Annual increase in RPI to previous June.

(b) From 1 August 1997, the RPI formula covers the main switched telephone services provided to the lowest 80% by bill size of BT's residential customers. The previous formula covered such services supplied to all residential and business customers.

(c) After permitted carry forward of any unused allowance or shortfall from previous years.

required to publish and have audited financial statements for the regulatory “businesses” and “activities”, in order to support the linkage of costs with interconnect prices and with a view to providing demonstrable evidence that BT is neither behaving in a discriminatory fashion nor unfairly subsidising its activities. The regulatory “businesses” for which separated accounts are currently produced are: access; apparatus supply; network; retail systems; supplemental services; and residual services.

Review of the price controls

In May 1999, Oftel issued proposals to amend BT's Licence to allow for a possible extension of the current retail price controls for eight months, and network charge controls for six months, from 31 July 2001 and 30 September 2001, respectively. This will allow Oftel to complete a more up-to-date assessment of the telecommunications markets and the need for any further price controls from 2001. The current controls would only be extended should Oftel and BT be unable to agree on future arrangements for price control, and the issue was referred to the CC.

Non-UK regulation

In developing its business internationally, BT must take account of the regulatory regimes in the countries in which it operates or wishes to operate.

United States

In the United States, the Federal Communications Commission (FCC) has extensive authority to regulate interstate and foreign services and services provided by common carriers, as well as the authority to implement policies that promote competition for all telecommunication services.

European Union

The European Commission has been pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since 1 January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the European Union. Specific directives imposed new rules in relation to voice telephony, leased lines and interconnection, with particular emphasis on organisations with significant market power and with a common set of principles for licensing and enforcement. These have largely been implemented in national legislation. The Commission will be reviewing progress during 1999 and is expected to propose further measures.

Japan

Japan is taking a staged approach to deregulation. Full liberalisation (save a 20% ceiling on foreign ownership in Nippon Telegraph and Telephone Corporation) was

implemented in 1998. A move to more effective regulation – especially in the areas of interconnection, carrier pre-selection and number portability – is anticipated in 2000.

Rest of the world

The World Trade Organisation's Agreement on Basic Telecommunications, signed in February 1997, has created a framework for the progressive opening of telecommunication markets, in accordance with world trade standards. The agreement provides assurance that commitments made by the 69 participating nations can be legally enforced. However, the commitments themselves provide only limited opportunities in some markets. A further round of World Trade Organisation negotiations will start at the end of 1999.

Future regulation

In addition to regulation relating to the telecommunications industry, BT is subject to general competition law.

The Competition Act 1998, which comes into effect in March 2000 brings the UK into line with European Union law by prohibiting anti-competitive agreements and concerted practices and the abuse of a dominant market position. Enforcement will be by the Director General of Fair Trading and, in the case of telecommunications, the Director General of Telecommunications will have concurrent powers with the Director General of Fair Trading. They will have significant new powers of investigation. Breach of the prohibitions could lead to fines of up to 10% of group turnover and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity. However, the Act will also introduce a new statutory independent appeals mechanism and the general fair trading condition in BT's Licence will be removed.

Other significant changes and issues

Domestic obligations in a global market

As a result of BT's growing global interests, a Licence condition prohibits BT from doing anything, by act or omission, that would detract materially from its ability to meet its Licence obligations to provide telecommunications services in the UK and to do so to any standards specified by the Director General of Telecommunications. BT's directors are required to submit an annual compliance certificate to the Director General.

HM Government's review of utility regulation

HM Government has initiated a review of utility regulation, with proposals for regulatory reform which include a tiered regime with little or no regulation for fully competitive industries, ranging to more close regulation for those industries where competition has not developed

sufficiently. BT believes the development of competition in the telecommunications market means that the need for a special telecommunications regulatory regime is diminishing.

Universal service

The Director General will review BT's obligations for the universal provision of telephony services during 1999, in particular whether to establish a universal service fund.

Mobile services

BT has a majority share in BT Cellnet and resells cellular services through its mobile communications business.

In March 1998, the Director General referred BT, BT Cellnet and Vodafone to the MMC for investigation into BT's retail charges for calls made from BT's fixed network to BT Cellnet and Vodafone's networks and BT Cellnet and Vodafone's charges to BT for terminating such calls.

The subsequent Licence modifications recommended by the MMC have led to an initial reduction of about 25% in the price of calls from a BT line to mobile phones from 30 April 1999. Specifically, the MMC require a reduction in BT's average retention (the amount BT keeps to cover costs and an element of profit after paying a termination charge to the mobile operator completing the call) from 5.8 pence per minute (ppm) to 3.4 ppm for the 2000 financial year; this retention will then come under a price control of RPI minus 7 for two years. The MMC also recommended that BT Cellnet and Vodafone make price reductions on their average termination charges, from 14.8 ppm to 11.7 ppm for the 2000 financial year; this price will then also come under a price control of RPI minus 9 for two years.

Oftel recently consulted on a proposal to require Vodafone and BT Cellnet to provide indirect access to competing service providers. BT believes this to be unnecessary given the high level of competition already existing for mobile services.

Broadcasting policy

HM Government policy has been to restrict BT from competing in the conveyance and provision of broadcast visual services to homes, but HM Government has announced the lifting of these restrictions on BT and other national telecommunications operators by 2001. This will allow BT to develop broadband access services to homes that could incorporate broadcast elements.

Higher bandwidth services

In December 1998, Oftel began a consultation to assess the market demand for and supply of higher bandwidth

services, such as access to the Internet in the UK, with particular reference to the small and medium-sized enterprises and residential sectors. Oftel propose that this demand might be met by some form of local loop unbundling (i.e. giving competing operators separate access to the lines connecting BT's local exchanges to its customers), and are seeking views on several options. BT is assessing the possibly significant implications of these proposals.

European Union Review

From 1 January 2000, the European Union will require the availability of both carrier pre-selection, from operators with significant market power, and number portability at a fixed location between all fixed-network operators. Carrier pre-selection allows customers to opt for certain defined classes of call to be carried by an operator selected in advance without having to dial a routing prefix or follow any other different procedure to invoke such routing. For technical and operational reasons, the UK is seeking a derogation for the introduction of carrier pre-selection for a period until the end of 2000.

Numbering

Number portability on mobile networks, already available on fixed telephone lines, was introduced on 1 January 1999. This enables customers switching mobile networks to keep their number.

Relationship with HM Government

HM Government collectively is BT's largest customer, but the provision of services to any one department or agency of HM Government does not comprise a material proportion of BT's revenues. Except as described below, the commercial relationship between BT as supplier and HM Government as customer has been on a normal customer and supplier basis.

BT can be required by law to do certain things and to provide certain services for HM Government. The Licence obliges BT to provide certain services for HM Government departments, such as priority repair of certain telephone lines. In addition, the Secretary of State has statutory powers to require BT to take certain actions in the interests of national security, international relations and the detection of crime.

Legal proceedings

The company does not believe there are any pending legal proceedings which would have a material adverse effect on the financial position or results of operations of the group. See note 27 to the financial statements.