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All customer numbers are given as at 31 March 2001, unless stated otherwise.

EBITDA = Earnings before interest, taxation, depreciation and amortisation

Introduction

BT is one of Europe's leading providers of communications services, including:

- exchange lines and private circuits, and fixed local, national and international voice and data calls to homes and businesses in the United Kingdom (UK);
- wireless voice and data communication services and equipment for businesses and individuals in the UK and internationally;
- international new-wave products and services, including internet, multimedia, data transport and solutions;
- interconnection services for other UK operators; and
- classified advertising directories in the UK and United States (USA).

In the 12 months to 31 March 2001 (the 2001 financial year), 9% of BT's group revenues derived from activities outside the UK, compared with around 5% in the previous financial year. This excludes our proportionate share of the revenues of our joint ventures and associates.

The table on page 9 sets out a summary of our turnover for our products and services for the years ended 31 March 1999, 2000 and 2001.

Our new structure

During the 2001 financial year, we began a radical restructuring of our group. As a result, some of our activities have been grouped by market sector, rather than geography, to form four businesses with potential for high growth:

- **BT Wireless** – an international mobile business, with particular strengths in mobile voice, data and next generation services;
- **BT Ignite** – an international, data-centric solutions and broadband IP business focused on European corporate and wholesale markets;

- **BTopenworld** – a mass-market internet business focused increasingly on broadband services; and
- **Yell** – an international directories business.

These new lines of business have been operating since 1 July 2000.

In October 2000, management of the UK communications services businesses was split as follows:

- **BT Retail** – the UK's leading communications business and the prime UK channel to market for our other businesses; and
- **BT Wholesale** – the provider of network services and solutions to communications companies, network operators and service providers, including BT Retail, BT Wireless and BT Ignite.

These six businesses operate alongside Concert, our global joint venture with AT&T, launched in January 2000 which is a leading communications provider for multinational business customers, international carriers and ISPs worldwide.

In November 2000, we announced details of a restructuring plan which was drawn up following the identification of potential benefits which should follow from a separation of the group into a number of operating units with defined management accountability. We recognised the merits of separate flotations, following such restructuring, to improve our focus on value generation through the creation of distinct equity for each quoted entity. Our plan was to optimise the positioning of our individual businesses within their respective markets. We said we would focus on Western Europe and Japan and seek to float up to 25% of each of BT Wireless and Yell, and a possible separate flotation of BT Ignite would be reviewed by the end of 2001. In addition, we described proposals to create a new

holding company to enhance corporate flexibility and provide scope for further subsidiary listings where advantageous to shareholders. We also detailed plans to create a new network company, NetCo, which would be both structurally and managerially separate. Following this corporate reorganisation, and subject to the satisfactory outcome of necessary discussions with the UK Government and Oftel, our intention was to seek a separate listing for up to 25% of NetCo.

During 2000, we had borrowed to finance acquisitions with the intention of reducing the level of indebtedness by asset sales and other means. We identified the need to introduce new equity capital into the business to support the reduction in the unsustainable level of group debt and we indicated our intention to raise new equity through the sale of minority stakes, notably of BT Wireless.

Our aim was to reduce the net debt of the group by December 2001 by at least £10 billion using the cash proceeds from the issue of equity in the various initial public offerings (IPOs), together with the proceeds of disposals of non-core businesses and assets. The weakness of the IPO market, particularly for telecommunications companies, has caused us to review whether the sale of equity in BT Wireless and Yell still constitutes the best option to strengthen the group's capital base.

The Board has concluded that shareholders' interests are best served by a rights issue to the company's existing shareholders. On 10 May 2001, the Board announced that BT is proposing to raise approximately £5.9 billion, after expenses, through a rights issue. The new equity introduced by the issue, together with cash from the disposals discussed below, should allow us to meet our debt reduction target of £10 billion

by December 2001. Furthermore, the rights issue enables the implementation of structural change.

We now intend to demerge BT Wireless, which we expect will include all of BT's wireless assets in the UK (BT Cellnet), the Isle of Man (Manx Telecom), Germany (Viag Interkom), the Republic of Ireland (Esat Digifone) and The Netherlands (Telfort). BT Wireless will also include Genie, one of Europe's leading mobile internet portals.

We continue with our plans to create a new holding company to give us corporate flexibility and to facilitate other potential acquisitions, demergers, disposals or IPOs. We have determined that, in order to demerge BT Wireless efficiently, the new holding company structure should be put in place at the same time as the demerger. On demerger, the capital structure of BT Wireless is planned to include up to £2 billion of debt. We are reviewing our plans for Yell

Years ended 31 March	2001 £m	2000 £m(a)	1999 £m(a)
Turnover summary			
Fixed-network calls	5,655	5,908	6,026
Exchange lines	3,674	3,526	3,351
Receipts from other operators	2,814	1,974	1,417
Wireless products	2,760	2,170	1,400
Private services	1,091	1,135	1,140
Solutions	1,074	915	746
Yellow Pages and other directories	754	642	491
Customer premises equipment supply	726	847	870
Other sales and services	1,879	1,598	1,512
Group turnover	20,427	18,715	16,953
Share of associates' and joint ventures' turnover	9,937	3,364	1,270
Trading between group and principal joint venture	(698)	(176)	–
Total turnover	29,666	21,903	18,223
(a) Figures for the 1999 and 2000 financial years have been restated to conform with the method of classification used in the 2001 financial year.			

Years ended 31 March	2001 £m	2000 £m	1999 £m
Group turnover on basis of origin			
UK	18,642	17,866	16,364
Europe, excluding the UK	1,183	285	240
Americas	368	383	237
Asia and Pacific	234	181	112
Total	20,427	18,715	16,953

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and are currently considering proposals to sell or demerge this business, following a ruling from the UK Secretary of State for Trade and Industry on a report produced by the Office of Fair Trading that the prices charged for advertising in UK Yellow Pages directories should be subject to an RPI minus 6 price cap from January 2002.

Future BT strategy

Future BT will be a focused European network and retail business concentrating on voice and data services. It will also develop and market new higher value broadband and internet products and services to its large customer base. Future BT will comprise principally four separately managed lines of business, BT Retail, BTopenworld, BT Wholesale and BT Ignite, with Concert providing international connectivity. It will have a balanced portfolio of businesses with well-established, market-leading and cash generative UK retail and wholesale businesses and, in BT Ignite and BTopenworld, rapidly developing businesses in internet solutions and broadband in the UK and elsewhere in Europe. We are discussing a variety of strategic alternatives to the Concert joint venture, which could include all, or a substantial portion, of the business currently within BT Ignite. See "Discussions with AT&T regarding Concert and BT Ignite" on page 17.

Acquisitions

BT has made a number of significant acquisitions during the past three financial years, including taking stakes in Japan Telecom and J-Phone and control of Esat Telecom. We also transferred assets and businesses to Concert, our global joint venture with AT&T. During the 2001 financial year, we took sole control of Telfort and Viag Interkom, and, shortly after the end of

the year, took sole control of Esat Digifone.

Telfort

In June 2000, we took full control of Telfort, our Dutch joint venture, when we acquired, for £1.21 billion (NLG 4.2 billion), the 50% of Telfort that we did not already own.

Viag Interkom

In January and February 2001, we took sole control of Viag Interkom by acquiring the remaining 45% which we did not already own from E.ON (formerly VIAG AG) for £4.6 billion, having already bought Telenor's 10% interest for £1.0 billion.

Esat Digifone

In April 2001, we acquired, for £0.85 billion, the remaining part of Esat Digifone, a mobile operator in the Republic of Ireland, which we did not already own. This follows our acquisition of control of Esat Telecom Group in March 2000, for approximately £1.5 billion.

Disposals

During the past three financial years, we disposed of an interest in sunrise communications and we have recently announced the prospective disposal of our interests in Airtel, Japan Telecom, J-Phone and Maxis Communications.

sunrise communications

On 30 November 2000, we sold our 34% stake in sunrise communications in Switzerland to Tele Danmark for the equivalent of £464 million in cash, realising a profit of over £400 million.

Japan Telecom and Airtel

On 2 May 2001, we announced that we had agreed to sell our interests in Japan Telecom, J-Phone and Airtel to Vodafone for £4.8 billion in cash. The sale comprises our 20% stake in Japan Telecom, our 20% stake in J-Phone Communications and shares to be converted from a call option, which

represents 4.9% direct stakes in each of the J-Phone regional operating companies. The sale also includes our 17.8% stake in Airtel.

This deal values the Japanese investments at £3.7 billion and the investment in Airtel at £1.1 billion. As part of the deal, BT will exercise an option it holds in the J-Phone regional operating companies for a total of £380 million. In addition, Vodafone will take on £782 million of BT debt guarantees in favour of Japan Telecom.

Closure of the deal is conditional upon relevant regulatory and procedural approvals in Europe and Japan.

Maxis Communications

On 4 May 2001, we announced that we had agreed in principle to sell our 33.3% holding in Maxis Communications in Malaysia to our partner in Maxis, Usaha Tegas, for £350 million in cash. The sale is subject to final documentation, regulatory and other approvals.

Lines of business

The following table sets out the total turnover for each of our lines of business in the 2001 financial year. These lines of business were established earlier in the year. This turnover includes our proportionate share of the results of ventures.

Year ended 31 March 2001:	Total turnover ⁽ⁱ⁾ £m
BT Retail	11,813
BT Wholesale	11,493
BT Wireless	3,947
BT Ignite	3,861
Concert	2,576
Yell	778
BTopenworld	212
Eliminations and other ⁽ⁱⁱ⁾	(5,014)
Total	29,666
<i>(i)</i> Includes turnover between businesses.	
<i>(ii)</i> Includes intra-group revenues.	

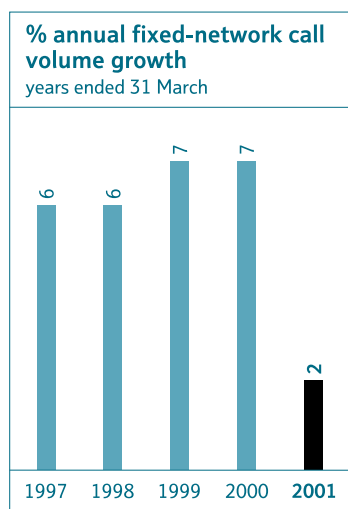
BT Retail

Year ended, or as at, 31 March 2001:	
Total turnover	£11,813m
EBITDA	£1,188m
Operating profit before goodwill amortisation	£1,004m
Capital expenditure on plant, equipment and property	£157m
Net operating assets	£1,114m
Employees	53,600

At 31 March 2001, BT had 28.9 million customer lines (exchange line connections). Around eight million of these were business lines and lines for other service providers. The remainder were lines for residential customers.

In a very competitive market, BT Retail's strategy is to maintain turnover and EBITDA margins, in the medium term, at 2001 levels by seeking ongoing productivity improvements from existing businesses and new business opportunities in higher value internet and broadband services.

In the 2001 financial year, BT's operating profit derived predominantly from fixed-network calls in the UK (fixed-network calls comprise calls within the UK and calls made from the UK to other countries). Calls on the UK fixed network accounted for about 28% of group turnover.

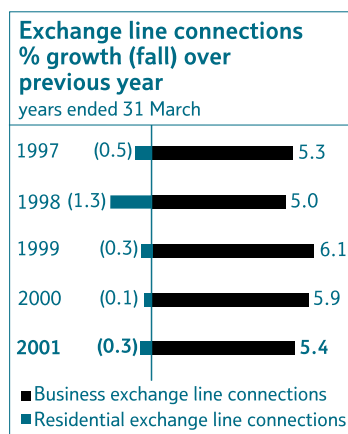


On average, about 90 million UK local and national calls are made every

day. Call volumes continue to grow. The number of calls made from fixed to mobile phones and the level of internet usage both increased strongly. This largely offset the decline in traditional fixed-line local, national and international call volumes caused by mobile phone substitution and intense competition from other UK operators.

Exchange line turnover, comprising rental and connection charges, accounted for about 18% of group revenues in the 2001 financial year. Revenue from these activities continues to grow, mainly because of the increase in the number of business lines, particularly high-speed ISDN lines. Charges for business lines are higher than for residential lines.

The number of residential lines declined slightly over the year. Since the beginning of 1995, we have experienced a small net reduction in the number of our residential line connections as a result of increasing competition from cable operators, particularly in urban areas. Business connections have shown a steady increase over the same period.



We provide many of our business customers with private circuits. These are lines between fixed points reserved for a customer's exclusive use and charged at a fixed rate irrespective of usage. Revenue from this activity accounted for approximately 5% of group turnover in the 2001 financial year.

Among the other services we offer are: the sale or rent of communications equipment; public payphones; advanced data and voice services; visual services, including distributing television material for broadcasting organisations and closed circuit television operators; and audio and videoconferencing.

Marketing and pricing

BT has continued to reduce prices and simplify its pricing structure, while at the same time introducing new options to give customers greater choice and control over how they are charged for using our products and services. All of our residential customers (except those on special schemes for low users) now get an inclusive call allowance included as part of the standard rental.

The new BT Together range of pricing plans provides residential and smaller business customers with competitive prices, inclusive call allowances and other features for a fixed monthly fee. From 1 September 2000, customers on BT Together and BT Working Together plans have also benefited from an evening and weekend calling rate of nine pence per minute to 13 of our most popular international destinations.

On 1 December 2000, we launched the new choices package from BT Together. This offers unlimited off-peak voice and/or internet calls for a fixed monthly fee. More than one million of the new packages were sold in the first seven weeks following their launch. Over eight million customers are now benefiting from one of the choices from BT Together. These customers, who account for more than half of our total call traffic, are showing more positive calling trends and lower churn levels than the remainder of our consumer customer base.

SurfTime, BT's low-cost internet access service, which offers unlimited

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internet calls for a fixed fee, was launched in June 2000 and has more than 446,000 customers.

An independently audited report, published in January 2001, compared the best prices offered at that time by major UK telecoms suppliers. Five typical residential customer bill profiles were analysed. In each case, BT was the cheapest operator providing nationwide coverage.

BT has also introduced the BT Commitment option to deliver competitive prices to corporate business customers.

Our website, **bt.com**, provides residential and business customers with an e-commerce channel for accessing information and services for all their communication needs. It has around 1.5 million registered users and, on average, every week some 100,000 users view a bill on the site. Orders for more than £100 million worth of products and services were made or initiated through **bt.com** during the 2001 financial year.

Customer satisfaction

BT's quality of service and our customers' satisfaction with that service is extremely important to us. To ensure that our customers are satisfied with our service and to understand ways in which we can improve it, we talk to thousands of our UK customers every month. 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.

During the 2001 financial year, specialist market research agencies, acting on our behalf, talked to around 300,000 residential and business customers in the UK about all aspects of the services we provide. We also closely monitor our performance against a number of key business measures, including providing services in response to orders and remedying faults when they appear.

Results for the period October 2000 to March 2001 showed that, despite problems caused by the knock-on effects of the fuel strike in September 2000, the wettest autumn since records began and the outbreak of foot-and-mouth disease in farm animals, all of which made access to customers in many parts of the country difficult, over 97% of business and residential orders were completed by the date agreed with the customer. For provision of services, 82% of small and medium-sized business customers and 87% of residential customers stated that they were satisfied with BT's performance.

Repair services too came under pressure, particularly from the bad weather and flooding, which increased the number of faults and made it more difficult for us to deal with them. We aim to rectify faults within nine hours for residential customers and five hours for business customers, or by some other mutually agreed time. Despite all the difficulties, we cleared 82% of business faults and 65% of residential faults within these objective times, and customer satisfaction with the repair service was broadly maintained.

To achieve this, as many as 600 BT people were transferred to the most seriously affected areas, we employed over 200 outside contractors to support our efforts, and, for a number of weeks, we deployed over a thousand man days of extra resource per week by employing people beyond their scheduled hours.

BT Wholesale

Year ended, or as at, 31 March 2001:	
Total turnover	£11,493m
EBITDA	£4,278m
Operating profit before goodwill amortisation	£2,540m
Capital expenditure on plant, equipment and property	£2,273m
Net operating assets	£12,511m
Employees	30,000

BT Wholesale provides network services within the UK to communication

companies, network operators and service providers. Together, BT Retail, BT Ignite and BT Wireless currently account for some 70% of its turnover, the majority of which is subject to regulatory price control.

BT Wholesale will build on its reputation for delivery of wholesale network solutions to BT Retail and other communications companies. BT Wholesale's strategy is to extract efficiencies from the scale and scope of its operations, broaden its customer base and expand next generation services by, among other things, satisfying demand for bandwidth and applying new technology to boost capacity, expand its product portfolio and reduce costs. We believe this should minimise erosion of market share and generate attractive returns on capital.

During the 2001 financial year, we continued to invest in our UK network to meet increasing demand for high-quality fixed-network products and services, both narrowband and broadband. During the year, network reliability remained good. On average, customers will experience a fault with our network only once in seven years.

Many other telecommunications operators use our network to help deliver their customers' calls. This interconnect activity has increased rapidly as competition in the fixed and mobile sectors has intensified. The receipts from other operators for this activity accounted for about 14% of group revenues in the 2001 financial year.

Growth in UK core network traffic was met in the year by replacing 46 trunk exchanges with Next Generation Switches (NGS), which have double the capacity of the replaced exchanges. This means that, in less than a year, nearly half of the trunk exchanges, which took five years to install in the 1980s, have been replaced. Plans are in place for introducing a further 13 NGSs, and the upgrade and expansion of 27 of the switches to include Asynchronous

Transfer Mode (ATM) switching, by March 2002, again potentially doubling the capacity of each switch.

We are upgrading our network to meet the growing demand for bandwidth. We believe that BT is ahead of similar European operators in large-scale deployment of high-capacity Synchronous Digital Hierarchy (SDH) and Wavelength Division Multiplexing (WDM) technology.

We are also upgrading our exchange-based switches to provide carrier pre-selection (CPS). This enables customers to pre-select an alternative carrier for their calls without having to dial additional access codes. CPS was introduced, on an interim basis, by means of auto-diallers installed on customers' premises. An exchange-based solution became available for national and international calls in December 2000, and should be available for all calls by December 2001.

Digital Subscriber Line (DSL) services turn a normal copper telephone line into a high-speed digital access line, providing residential and business customers with fast access to high-value, multimedia-rich content. BT launched its first DSL-based services in June 2000. At 31 March 2001, 839 UK exchanges were equipped to provide Asymmetric DSL (ADSL). This means that 50% of UK households are now in areas currently served by an ADSL-enabled exchange.

During the 2001 financial year, BT participated in implementing and accelerating the local loop unbundling (LLU) programme in the UK. LLU enables other telecommunications operators to use the existing local loop (the connections between customers' premises and the exchange) to connect directly with their customers to provide telecommunications services, including DSL-type broadband services. Operators install their own equipment either in exchanges or in nearby buildings to provide this service.

We have been offering LLU since December 2000. The roll out of LLU has been the subject of an amendment to the BT Licence, a specific EU regulation and, in the UK, agreements with Oftel. BT has met all of the requirements set out in the EU regulation and has also met the objectives concerning implementation, as set by Oftel.

In November 2000, BT and Crown Castle UK entered into an agreement to provide infrastructure to 3G mobile and wireless operators. This should enable us to receive significant rental income through the development of the roof-space and surroundings of, initially, 4,000 of our exchange buildings. The programme has the potential to be extended to cover all of our operational buildings. Agreements have been signed with three of the 3G licence holders, including BT Wireless, for use of the combined BT and Crown Castle portfolio.

BT Wireless

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£3,947m
Group turnover	£3,408m
EBITDA before exceptional items	£220m
Operating loss before goodwill amortisation and exceptional items	£(225)m
Capital expenditure on plant, equipment and property	£1,105m
Net operating assets	£18,634m
Share of ventures' net assets, including goodwill	£27m
Employees	14,900

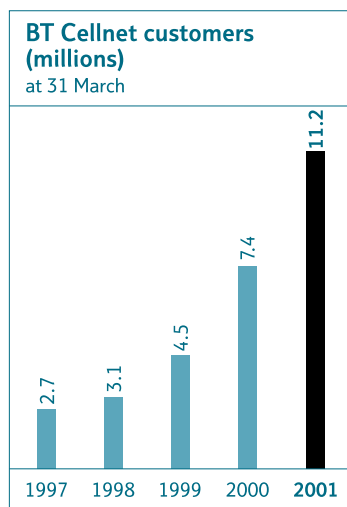
BT Wireless consists of our wholly-owned interests in European wireless operations, including BT Cellnet in the UK, Viag Interkom in Germany, Telfort in The Netherlands and Esat Digifone in the Republic of Ireland. BT Wireless has approximately 16.9 million customers. BT Wireless also includes Genie, our mobile internet business, one of Europe's leading mobile portals.

BT Wireless' strategy is to attract and retain high-value customers and increase revenues per customer by positioning itself as a leader in the European mobile data market. Being wholly owned, the wireless businesses will be managed on a unified basis, facilitating the development of common technology and the swift roll out of services, such as the Genie mobile internet portal and associated content and applications, across the BT Wireless networks. BT Wireless has developed relationships with a large number of applications and content developers through its application developer forum. It will seek productivity improvements through these cross business synergies and seek network sharing options with others to reduce build out costs where allowed.

The UK

BT Cellnet is our wholly-owned wireless business in the UK and is the second largest mobile network operator in the UK, with 11.2 million customers, an increase of more than 50% during the 2001 financial year. This represents an estimated market share of approximately 26%. BT Cellnet's total turnover for the 2001 financial year was £3,031 million, with EBITDA for the same period of £591 million. In the UK wireless markets, BT Cellnet has the second largest market share by customer base and a strong position in the business market.

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The UK market grew rapidly during the 2001 financial year and remained extremely competitive, reflecting significant demand for competitively priced pre-pay products.

BT Cellnet launched General Packet Radio Service (GPRS) services in June 2000. In the UK Government's 3G licence auction, which concluded in April 2000, BT obtained a licence for £4.03 billion to operate 3G mobile services.

In April 2000, BT Cellnet purchased, for £45 million, the 60% of The Mobile Phone Store that it did not already own, as part of BT Wireless' initiative to obtain increased control over its distribution channels.

Germany

BT Wireless' German operations are conducted through Viag Interkom, which, since February 2001, has been our wholly-owned subsidiary. Viag Interkom launched mobile telephony services in October 1998 as the fourth entrant into the German market and, by 31 March 2001, had achieved an estimated 7% market share with over 3.7 million customers. Viag Interkom's turnover, including its fixed business, for the year ended 31 March 2001 was £1,078 million, with negative EBITDA for the same period of £407 million before exceptional items. The fixed business market formerly addressed by

Viag Interkom is now served by BT Ignite Germany.

The German market is currently a highly competitive four-player market, and two further entrants are possible following the auction of six 3G licences carried out by the German Government in August 2000. Viag Interkom holds one of the 3G licences, which was purchased for £5.13 billion.

The construction of Viag Interkom's Global System for Mobile communications (GSM) network is ongoing. It currently covers an estimated 81% of the German population, but a national roaming agreement with T-Mobil allows Viag Interkom to offer service covering approximately 99% of the German population.

Viag Interkom launched GPRS services in January 2001.

Viag Interkom is developing other initiatives to achieve a greater share of the business market, such as cooperation arrangements with specialised service providers. It is also seeking to improve network costs per minute by increasing use of its network from selected wholesale opportunities and by other initiatives, such as outsourcing functions to achieve cost efficiencies.

Republic of Ireland

Our wireless operations in the Republic of Ireland are conducted through Esat Digifone, which became a wholly-owned subsidiary in April 2001. Esat Digifone entered the Irish market in March 1997 and, by 31 March 2001, it was serving over 1.1 million customers, representing an estimated market share of approximately 41%. Esat Digifone's turnover for the year ended 31 March 2001 was £312 million, with EBITDA for the same period of £69 million. Esat Digifone expects to apply for one of the four licences to be offered by the Irish Government to build and operate a 3G network in Ireland.

The Netherlands

Telfort launched its service in 1998 in the Dutch mobile market. It now has a network covering over 97% of the population and more than 918,000 customers representing an estimated market share of approximately 8%. Telfort's turnover, including its fixed business, for the year ended 31 March 2001 was £301 million, with negative EBITDA for the same period of £118 million before exceptional items. The fixed business market formerly addressed by Telfort is now served by BT Ignite Netherlands.

Telfort was awarded a 3G licence in July 2000 for £267 million.

Genie

Genie is BT's mobile internet portal, comprising web and WAP portals in the UK, France, Germany, Hong Kong, Italy, The Netherlands and Spain. With more than four million registered customers, according to Red Sheriff Services' data collection software, Genie is one of the major players in the mobile internet portal market, offering content including entertainment, m-commerce, games, and the latest sports, news and business information.

Genie also functions as an Application Service Provider (ASP) to network operators, offering hosted, secure access to enterprise applications through an integrated customised portal, and provides mobile internet communications and portal services on a hosted basis in the Asia-Pacific region.

In November 2000, Genie launched the UK's first exclusively online mobile service, offering mobile phones with mobile internet access through text messaging and WAP.

By offering high quality content and applications and developing personalised relationships with our customers, we believe Genie will assist in increasing average revenues per user and reducing churn.

BT Ignite

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£3,861m
Group turnover	£3,470m
EBITDA before exceptionals	£47m
Operating loss before goodwill amortisation and exceptionals	£(380)m
Capital expenditure on plant, equipment and property	£936m
Net operating assets	£3,584m
Share of ventures' net assets, including goodwill	£178m
Employees	18,800

BT Ignite, our solutions and broadband IP business, delivers a range of services, including customer solutions, application service packages, web hosting and data transport to European business customers.

Building on its position as a leading business in the European services market, as measured by customer and revenue base, BT Ignite plans to continue to build its revenues from the high end of the value chain – value-added services and complex solutions – from current levels of 50% of revenue. It aims to use its large sales force to add more business customers and increase revenue per customer by selling more of these higher value products and migrating customers towards tailored services, such as moving customers through hosting and applications to solutions. Its strategy for moving into profitability also includes increasing the throughput in its existing network infrastructure of cables and data hosting to benefit from operational gearing. We also expect to generate synergies across BT Ignite by establishing functional responsibilities, including single network management and single product management across the business. We are discussing a variety of strategic alternatives to the Concert joint venture which could include all, or a substantial portion, of the business currently within BT Ignite. See “Discussions with AT&T

regarding Concert and BT Ignite” on page 17.

Across Europe, BT Ignite is primarily a service business supported by its own infrastructure. BT Ignite has a sales force of 4,000 employees, including 2,000 solutions consultants. It sells directly to businesses in Europe and sells to businesses in the UK through BT Retail's sales force.

Value-added services

BT Ignite's international solutions businesses had turnover of £2,082 million, including work done for other parts of BT, in the 2001 financial year. External turnover from solutions accounted for 5% of group turnover in the same period.

Syntegra, our global consulting and systems integration business, is a market leader in creating new systems, which, through the use of the internet and associated technologies, are transforming business-to-business relationships around the world. Syntegra has customers in more than 60 countries.

BT Ignite Solutions (formerly Syncordia Solutions) is a leading provider of integrated information and communications solutions. Underpinned by the internet and associated technologies, these solutions are based on end-to-end managed IP networks and the provision of e-business and e-CRM (electronic Customer Relationship Management) applications on these networks.

BT Ignite offers a range of advanced web hosting application and network services, utilising its 21 internet data centres in Europe. BT Ignite's internet data centres provide the hardware, software and high-speed communications connections required by customers to run their websites and other online business applications, allowing these customers to focus on their core business and meet growing requirements for e-commerce.

BT Ignite Application Services provides software over IP networks to large and small companies, generally on a per user rental basis. Application Services has developed partnerships with key software providers, including Microsoft, Lotus, Commerce One and Verisign, to provide a range of e-mail, collaborative e-commerce and security applications.

European network

BT Ignite, with its European partners, has a pan-European fibre network which provides coverage to the top 100 commercial centres and serves over 400,000 business customers with 52,000 route kilometres of fibre cable connecting 250 towns and cities through Belgium, Denmark, France, Germany, the Republic of Ireland, Italy, The Netherlands, Norway, Spain, Sweden, Switzerland and the UK.

BT Ignite is responsible for broadband services based on DSL technology in the UK, selling wholesale DSL products to more than 150 service providers and corporate clients. These enable service providers to offer their own customers fast access to high-value content and applications. They also enable corporate customers to provide their teleworkers with fast, remote access to their private networks on the internet.

Yell

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£778m
Group turnover	£774m
EBITDA	£223m
Operating profit before goodwill amortisation	£210m
Capital expenditure on plant, equipment and property	£21m
Net operating assets	£710m
Share of venture's net assets, including goodwill	£2m
Employees	5,300

Yell is a leading provider of classified advertising directories and associated products and services, principally to small

Business review

and medium-sized enterprises and consumers in the UK and USA. Yell's products and services are designed to generate business leads by connecting buyers and sellers through an integrated portfolio of advertising solutions, including printed telephone, and internet-based, directories. In addition, Yell provides a growing range of business-to-consumer and business-to-business products and services through new media, primarily the internet.

In the UK, Yell distributes approximately 28.9 million copies of directories to households and businesses, and publishes 861,000 advertisements on behalf of 418,000 advertisers. In the 2000 financial year, Yellow Book USA, Yell's US business, distributed approximately 17.5 million copies of directories to households and businesses, and published 1,155,000 advertisements on behalf of 170,000 advertisers. The revenues from Yell products and services, including Yellow Book USA, represented about 4% of group turnover in the 2001 financial year.

Yell's principal activity is the sale of advertising in, and the preparation and publication of, classified directory products. Yell maintains, develops and regularly updates extensive databases of information on businesses, the core of which is small and medium-sized enterprises in the UK, and in the eastern, mid-western and southern USA.

Yell's principal products and services are:

- *UK Printed Directories*, comprising Yellow Pages and Business Pages;
- *US Printed Directories*, comprising Yellow Book;
- *On-line Services*, incorporating the Yell.com and Yellowbook.com internet sites, and website design and hosting services in the UK and USA; and

- *Other Products and Services*, including the following products and services in the UK:

- *Talking Pages*, a telephone-based, operator-assisted, classified information service;
- *The Business Database*, which provides customer-specific, direct marketing and database development services to businesses;
- *Service Call*, a telephone answering service; and
- sales agent services which Yell provides for the BT Phone Book white pages directories.

BTopenworld

Year ended, or as at, 31 March 2001:	
Total turnover, including share of ventures	£212m
Group turnover	£167m
EBITDA loss	£(253)m
Operating loss before goodwill amortisation	£(296)m
Capital expenditure on plant, equipment and property	£25m
Net operating liabilities	£(17)m
Share of ventures' net assets, including goodwill	£12m
Employees	700

BTopenworld brings together, in a single mass-market business, all of our UK ISPs and portals (both dial-up and broadband) serving the needs of both the consumer and the small and medium-sized business customer.

BTopenworld's strategy focuses on growing average revenue per customer through added-value services, such as narrowband internet, fast internet and video centric services.

Internet services earn us revenue directly, through subscriptions, e-commerce and advertising, and indirectly, through increased network usage.

BTopenworld has approximately 1.25 million active customers (i.e. customers accessing BTopenworld's

internet products on a regular basis) on its dial-up narrowband internet (BTinternet, Connect2Business and BTAccess) and BTopenworld broadband services.

BTopenworld remains one of the largest unmetered internet access providers in the UK, with almost 700,000 customers on its unmetered access packages (including 25,000 customers on its BTopenworld broadband service).

BTopenworld also manages our other internet ventures in the UK:

- our 50/50 joint venture with LookSmart, a leading US-based online navigation company, which creates and distributes internet portal services throughout Europe and Asia;
- ExciteUK, our joint venture with Excite, in which we have a 42% stake; and
- our virtual ISP services, which provide internet access service on a wholesale basis for companies such as Dell, WH Smith and ONdigital.

BTopenworld has launched a range of mass-market broadband services aimed at consumers, small businesses and teleworkers. We continue to develop a range of tools, including communications, navigation and personalisation, all of which will be linked and made available through a Personal openworld Portal accessible across a number of devices.

Concert

BT's share for the year ended, or as at, 31 March 2001:	
Turnover	£2,576m
EBITDA	£170m
Operating profit before goodwill amortisation	£19m
Share of venture's net assets, including goodwill	£1,430m

Concert is a major global communications joint venture owned equally by BT and AT&T. It combines what were the trans-border assets and operations of BT and AT&T, including the majority of their international networks, international

traffic and international products for business customers.

Supporting Concert, BT, AT&T and their respective families of joint ventures is a common networking architecture planned to provide seamless service to customers. Concert's frame relay network reaches every major city in the UK and USA and extends to over 200 cities in 60 countries. Its global public network reaches 237 countries directly. Concert also has investments in 115 undersea cables totalling more than 480,000 kilometres globally.

In addition to using BT and AT&T's extensive networks in the UK and USA, Concert has built a high-speed IP backbone network, spanning 21 cities in 17 countries. This supports a wide range of internet access, internet backbone and IP virtual private network services. Concert's IP network is interconnected with BT and AT&T's domestic IP backbone networks, which distribute Concert services in the UK and USA.

Work is underway to converge Concert's network, infrastructure and managed services with those of AT&T Global Network Services, previously IBM Global Network. When this is complete, the Concert IP backbone network should extend to more than 60 cities worldwide and the combined portfolio of IP, data and virtual private network services will be offered through Concert, AT&T and BT Ignite distribution channels, particularly for delivery in Europe, Asia Pacific and Latin America. See "Discussions with AT&T regarding Concert and BT Ignite", below.

Discussions with AT&T regarding Concert and BT Ignite

We and AT&T are discussing ways to improve the performance of the business and strengthen the scope of the relationship between us and AT&T in business services. These discussions

include a variety of strategic alternatives to the Concert joint venture, including the sale to, or other business combination of our business services operations with, AT&T's business services unit upon its planned separation from the remainder of AT&T. Such a transaction could include all or a substantial portion of our business services operations, including BT Ignite and our interest in Concert, in exchange for some mixture of cash, equity and/or other instruments in the combined business. These discussions may or may not lead to any sale or other business combination and may or may not lead to any change in the existing alliance arrangements. As possible alternatives to such a transaction, we have also been considering a narrowing of Concert's business scope, as well as its termination as a joint venture. There can be no assurances, however, that agreement could be reached with AT&T with regard to either of such alternatives.

The BT Board believes that the BT Ignite and Concert businesses will generate potentially significant value for the group in the future. The Board will keep under review whether this value is best achieved for shareholders by a combination of these businesses with AT&T's business services unit, a disposal of all or part of the businesses or their separation from BT by way of IPO or demerger from BT. Where necessary, we will seek the approval of our shareholders.

Other

We hold a 26% stake in Cegetel, a leading French telecommunications company providing a broad range of telecommunications services, including mobile and fixed telephony, internet access, data services and transmission. We currently intend to retain our shareholding in Cegetel. We also have fixed and wireless operations in Canada,

Hong Kong, India, Italy, Singapore and South Korea.

Future BT will also include a number of other business units, including Information Systems Engineering, fleet operations, logistics and procurement services and BTextact Technologies, a world-renowned research and development capability.

Research and development

Our commitment to research and development is fundamental to ensuring that we can continue to provide our customers with advanced information and communication services.

In the 2001 financial year, we invested £364 million in research and development, compared with £345 million and £268 million in the 2000 and 1999 financial years, respectively.

Major areas of work included next-generation internet, broadband wireless and fixed access networks; advanced data services; information and network security; 3G mobile multimedia services; and software systems to support the management and integrity of our networks worldwide. We are also undertaking research on the impact of advanced communications on lifestyles, education and healthcare in the connected society of the twenty-first century.

On 1 April 2001, we launched BTextact Technologies, a wholly-owned business comprising our engineering and technology research and development activities. BTextact Technologies' principal customers are the BT lines of business and our alliance partners. However, we also intend to offer a select portfolio of professional and consultancy services to external customers. BTextact Technologies plans to exploit BT's extensive intellectual property rights where this is to our commercial and strategic advantage.

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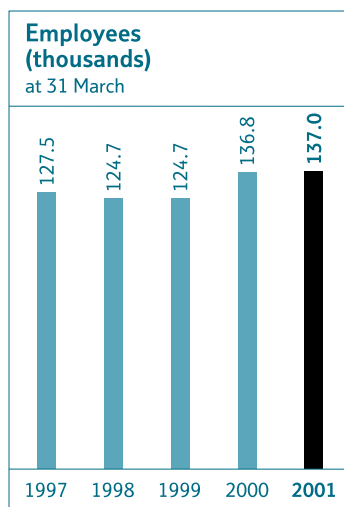
BTextact Technologies will include Brightstar, our in-house technology incubator. Brightstar aims to help BT people get the best hi-tech business ideas launched as start-up businesses. Three such businesses were launched in the 2001 financial year and a further 11 are currently in development.

Our research and development centre at Aadastral Park in the UK is complemented by a wide range of partnerships with leading technology suppliers and universities on a global scale. To provide advanced communications research, the BT MIT Disruptive Lab in Boston, USA, has been created in association with the Massachusetts Institute of Technology, and the Asian Research Centre has been opened in Malaysia.

Our people

Years ended 31 March	2001 '000	2000 '000	1999 '000
Number of employees in the group:			
UK	117.9	126.0	118.9
Non-UK	19.1	10.8	5.8
Total employees	137.0	136.8	124.7

At 31 March 2001, BT employed around 137,000 people throughout the world, with 117,900 in the UK, making us one of the UK's largest employers. Additionally, we employed, on average, around 13,000 temporary people during the 2001 financial year. A total of 7,500 people joined the group from Telfort and Viag Interkom. These additions were offset by people leaving the company through voluntary means, including redundancy, moving to Concert, and joining e-peopleserve, our human resources (HR) joint venture, and other outsourced activities.



As part of the continuing programme of reshaping the group, during the 2001 financial year, we ran a voluntary redundancy programme under which some 3,500 managers and professionals left the company. In February 2001, we launched NewStart, a new approach to managing our people resource, based around retraining and reskilling, rather than company-wide voluntary redundancy programmes.

In a move designed to bring significant value to BT, we have formed a joint venture with Accenture (formerly Andersen Consulting) to deliver outsourced human resources services to large organisations. The venture, e-peopleserve, came into being on 1 August 2000 and offers end-to-end, e-enabled, integrated global HR solutions to large companies.

Following the setting up of the venture, e-peopleserve has a five-year contract to deliver transactional HR services to BT. This is one of the largest HR outsourcing contracts agreed to date anywhere in the world. e-peopleserve is a natural product extension for both BT and Accenture and should enable BT to create value from an existing cost base. Enshrined in the agreement is a commitment by e-peopleserve to reduce transactional HR costs to BT year on year. There is also an incentive

programme linked to their overall service performance, which places a heavy emphasis on the customer experience. The joint venture should deliver to BT new services of a high quality, as well as customer-friendly e-solutions to existing services, at reduced cost.

Our people are critical to our success and we believe that a reputation as a good employer helps us win and retain customers. As part of this responsibility, we take the wellbeing of our people seriously. The 2001 financial year saw the launch of an innovative 'top down' health and safety strategy, which maintains our commitment to set and achieve high standards in this area.

To help our people balance work and home responsibilities, we have a range of flexible working arrangements, including alternative attendance patterns, homeworking, part-time working and job sharing.

During the year, BT further developed its eBT portfolio. We have an award-winning e-HR programme, which provides BT people with an online, self-service approach to a broad range of HR products and services.

We encourage our people to acquire shares in their company to enable them to share in its success. The BT Employee Share Ownership Scheme is operated annually and a percentage of the pre-tax profits is set aside to purchase shares for employees, which are held in trust for three years. £32 million has been set aside this year for the allocation of shares to employees under the Scheme. Participants in the Scheme will be able to benefit from the rights issue announced on 10 May 2001. Employees also have the opportunity, from time to time, to buy shares at a discount under the popular BT Employee Sharesave Scheme, a savings-related share option scheme. Share options are normally exercisable on completion of a three or five-year save-as-you-earn contract.

There is a similar savings-related scheme for employees based outside the UK, and an employee stock purchase plan for employees in the USA. Appropriate adjustments will be made to the allocation of shares under these plans to take account of the rights issue.

The BT New Ideas scheme, under which BT people are encouraged to put forward suggestions for improvements in the company's activities, generated more than 8,000 suggestions in the year, contributing to savings of around £85 million.

We run CARE, an annual employee attitude survey, and encourage managers and their teams to put in place action plans to address the issues that it highlights.

Most BT employees are members of the BT Pension Scheme, which is controlled by trustees who are company or union nominees. On 1 April 2001, we introduced a defined contribution scheme for new employees after closing the BT Pension Scheme to new entrants. The defined contribution scheme has been established under a separate trust from the existing BT Pension Scheme, but also has company and union-nominated trustees.

An estimated 75% of the company's UK employees belong to one of two main trade unions recognised by the company. We have a good record of industrial relations and continue to have constructive relations with both unions, built on partnership and mutual respect.

BT is an equal opportunities employer and is committed to developing a working culture that enables all employees to make their own distinctive contribution. BT seeks to realise the potential of disabled people to contribute to our business performance. During the year, BT supported the launch of AbilityNet's London Centre. AbilityNet is a charity that brings the benefits of computer technology to adults and

children with disabilities, both in BT and in the communities in which it operates. New BT people should benefit from pre-recruitment assessments designed to ensure that they have the most productive and comfortable equipment available as soon as they join the company. Existing BT people should also benefit from easier access to expert assessment and advice, and earlier provision of appropriate reasonable adjustments to their working environment.

BT prides itself on being a learning organisation. We spend around £200 million a year on the training and development of our people. They have access to a comprehensive portfolio of development and training options, including technical and commercial training, personal skills and management development. Increasingly, we are using the internet to deliver training and development programmes. The BT Academy is a web-based corporate learning portal that delivers world-class e-learning to BT people via the company's intranet.

During the year, BT became the largest company to achieve re-accreditation as a Corporate Investor in People; a further demonstration of BT's commitment to the development and growth of all our people.

Property

At 31 March 2001, the group had a property portfolio of approximately 8,000 buildings, with a total floor space of six million square metres, located principally throughout the UK.

Specialised operational 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 activities. They do not readily adapt to other uses.

General purpose properties consist chiefly of offices, depots, computer centres and shops.

In January 2001, we announced that we were in negotiations to realise the value of our UK property portfolio. This, we believe, should enable us to take a more flexible approach to our office arrangements and building requirements. However, we intend to retain the freehold and right to occupy our operational buildings. In April 2001, Telereal Group, a 50/50 joint venture between Land Securities Trillium and William Pears Group, was selected as the preferred bidder for the proposed acquisition of the BT property portfolio and the subsequent provision of certain buildings and management services to BT.

On 1 May 2001, we announced that, in view of the reduced number of people requiring accommodation in the group centre at the end of the restructuring process, and consistent with a less centralised group, we have decided to vacate and sell our BT Centre headquarters building in London.

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.

Regulation, competition and prices

The commercial environment in the United Kingdom 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.

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Regulation in the UK

The regulatory structure for UK telecommunications 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 (Ofcom). The Secretary of State and the Director General are required to ensure, as far as reasonably practical, that all reasonable demand for telecommunication services, including certain community services, is met and to secure the ability of licensed telecommunications operators to finance the provision of the services which they are licensed to provide. In addition, they are required, among other things, 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 UK telecommunications operators.

With limited exceptions, a licence under the Telecommunications Act is required to operate a telecommunication system in the UK. The Secretary of State is responsible for issuing licences after consulting the Director General.

The BT Licence

BT operates in the UK under a number of licences, the most important of which is its licence to operate its fixed-line public telecommunications network (the "Licence"). The Licence remains in force indefinitely, but the Secretary of State may revoke the Licence on 10 years' notice. The Licence can 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 widespread provision of telecommunication services in the UK, to protect the interests of consumers and to

encourage the development of effective competition in telecommunication services and network provision within the UK.

Under the Licence, BT has to fulfil reasonable requests for access to voice telephony, low-speed data and fax transmission services, and reasonable access to public call boxes throughout nearly all the UK, including rural areas (these being the principal elements of the Universal Service Obligation).

Under the Licence, the company must allow other licensed operators to interconnect with its telecommunications systems on cost-oriented, transparent and non-discriminatory terms.

The company must comply with a variety of fair trading obligations, such as:

- a prohibition on showing undue discrimination or unfairly favouring any part of its own business as against competitors on the basis of price terms or quality of service; and
- a prohibition on the unfair cross-subsidy of certain activities of the company.

BT must publish audited financial statements for the regulated "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. If it appears to the Director General that an unfair cross-subsidy exists between specified parts of its own business, BT must take such steps as the Director General may direct to remedy the situation. The regulatory businesses for which separated accounts are currently produced are access, apparatus supply, network, retail systems, supplemental and residual services. In addition, for the first time, BT produced separated financial statements for its mobile business for the 2000 financial year. The Licence also contains provisions enabling

the Director General to monitor the company's activities, including requirements for BT to supply him with information requested.

The Licence permits the imposition of 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 and also the prices for its interconnection services. 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.

The Director General may make modifications to a licence if the licensee does not object or if the amendment is deregulatory. Alternatively, he may refer proposed changes to the licence to the Competition Commission ("CC"). In either case, the Telecommunications Act requires public consultation before a licence can be modified.

Licences may also be modified by legislation, including legislation implementing European Commission directives into UK law.

Implementation of Licensing Directive

In September 1999, modifications to the Licence came into force to meet the harmonisation requirements of the European Community Licensing Directive (the "Directive"). The intention of the Directive was to prevent excessive or unjustified regulation through licensing of telecommunications. The modifications included the removal, from January 2001, of restrictions that prevented BT from competing in the conveyance and provision of broadcast visual services to homes in the whole of the UK.

Competition

Competition Act

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

The *Competition Act 1998*, which came into effect in March 2000, brings the UK in line with European Community law by prohibiting anti-competitive agreements and concerted practices and the abuse of a dominant market position. In the case of telecommunications, the Director General of Telecommunications has concurrent investigatory and enforcement powers with the Director General of Fair Trading. They have significant new investigative powers. Breach of the relevant prohibitions could lead to fines of up to 10% of UK turnover for each year of infringement (up to a maximum of three years) and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity.

There is a new statutory independent appeals mechanism for decisions under the Competition Act.

The competitive environment

The UK telecommunications market is fully open to entry and highly competitive. As a result, the UK Government (HM Government) and Oftel have indicated their expectation that it will be appropriate to move away from sector-specific (including licence-based) regulation to greater reliance on the Competition Act.

However, as described above, Oftel currently regulates BT mainly through the provisions in the Licence. BT has commenced discussions with Oftel on amendments that BT believes should be made to the Licence to take account of the introduction of the Competition Act.

Although it is some years since the Telecommunications Act abolished the company's monopoly in telecommunications, obligations placed on BT are generally more onerous than for other licensees. BT believes the separation of the wholesale and retail businesses should mean that the retail business will be regulated in a similar manner to other equivalent businesses.

Pricing regulation

Fixed network

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) and an efficiency factor, X.

For services covered by the controls, weighted average prices cannot increase in each year beginning 1 August by more than the annual change in RPI minus X.

In times of low inflation, the overall effect of this control requires the company to reduce its prices.

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. The price control formula and the company's performance against the formula are set out in the table below.

BT has also given an assurance that a "control" price package will be made available to business customers. The control package for small business customers provides that call charges will be no higher than the prices used for calculating adherence to the residential price control, and line rental increases will be no more than the change in RPI.

Under the price controls for private circuits, applying from August 1997 to July 2001, prices for domestic analogue and low-speed digital private circuits 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, operating until 30 September 2001, gives BT the freedom to set reasonable charges based on long-run incremental costs for

Years commencing 1 August	1995	1996	1997	1998	1999	2000
Price control formula (RPI-X)						
% RPI movement for the relevant period (a)	3.52	2.14	2.94	3.75	1.35	3.32
X in price control formula (b)	7.50	7.50	4.50	4.50	4.50	4.50
% required reduction in prices (c)	(1.38)	(4.92)	(1.56)	(0.73)	(3.15)	(1.09)
% reduction in prices overall	(1.82)	(4.92)	(1.56)	(0.73)	(3.24)	(1.20)(d)
(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% of BT's residential customers by bill size						
(c) After permitted carry forward of any unused allowance or shortfall from previous years						
(d) Price changes implemented up to 22 May 2001						

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its standard interconnection services. Depending on the degree of competition for these services, charges are cap controlled (presently at RPI minus 8), safeguard cap controlled (i.e. no increases above RPI during any relevant year), or no longer subject to direct charge controls. Those services which Oftel considers unlikely to become competitive in the near future are subject to charge cap controls; those which it considers likely to become competitive are subject to safeguard cap controls and those services considered fully competitive (or which have been introduced by BT since the start of the network charge control regime) are not subject to direct charge controls.

We must publish a notification to the Director General and other licensed operators if we intend to amend existing charges or to offer new services.

Review of retail price controls and network charges

In February 2001, Oftel published its Proposals for Network Charge and Retail Price Controls which included draft licence modifications. In this Statement, Oftel proposed to extend the current retail price cap of RPI minus 4.5 by one year until 31 July 2002, rather than remove controls or introduce the usual new four-year control, and to consult again to determine whether there is sufficient competition to remove retail price controls from 1 August 2002. Should Oftel decide that there is insufficient competition at that stage, then it would consider renewing price controls and/or introducing other regulatory measures.

Oftel's network proposals include retaining the broad structure of interconnect (network) services for another four years. It proposes varying levels of "X" within the RPI minus X price-cap formula of between 7.5% and

13% for each of the five services, compared to the current level of 8%.

BT has accepted Oftel's proposals.

Mobile networks

Licence modifications required by the CC led to a reduction of about 25% in the price of calls from a BT line to mobile telephones from 30 April 1999, followed by an annual RPI minus 7 reduction for a further two years. Specifically, the CC required 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 3.09 ppm for the 2001 financial year. Under their latest proposals for the Price Control Review, Oftel has extended the current controls by four months until 31 July 2002, and will review them as part of the broader retail price control review.

The CC also recommended that BT Cellnet and Vodafone made price reductions on their average termination charges, from 14.8 ppm to 10.9 ppm for the 2000 financial year; this price came under a price control of RPI minus 9 for three years. Oftel is currently consulting to determine whether controls on their termination charges should be extended beyond the present period, which runs out in March 2002. Oftel has broadened the consultation to also consider the termination rates for mobile to mobile calls, and whether the two other UK wireless network operators, One2One and Orange, should fall within any future controls. Oftel expects to complete the review by July 2001.

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.

European Union

The European Commission is pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the European Union (EU). Specific directives imposed rules for, among other things, 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 European Commission reviewed progress during 1999 and 2000 and is proposing a simplified regulatory framework, which will include a more uniform regulatory treatment of different communications technologies and a revision of the concept of significant market power to be applied by national regulatory authorities.

United States

In the United States, the Federal Communications Commission 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.

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 forward-looking costs for interconnection, carrier pre-selection and number portability, is planned.

In April 2000, the Japanese government invited applications for 3G mobile licences. In June 2000, J-Phone

was granted a 3G licence, one of three awarded.

Rest of the world

The World Trade Organisation's Agreement on Basic Telecommunications, signed in February 1997, created a framework for the progressive opening of telecommunications markets in accordance with world trade standards. The agreement provides assurance that commitments made by the 73 participating nations can be legally enforced. However, the commitments themselves provide only limited opportunities in some markets. Detailed implementation schedules are required in many of those countries in which BT has an interest. A further round of World Trade Organisation negotiations on services is due to take place, although the timetable is unclear.

Other significant changes and issues

Local loop unbundling

In April 2000, following consultation, BT accepted an amendment to its Operating Licence which required it to provide unbundled local loops to other operators, to enable them to provide telecommunications services, including broadband DSL-type services, to end customers. The amendment came into force in August 2000, with local loop unbundling (LLU) to be available from July 2001.

The EU thereafter passed a regulation requiring LLU, line sharing and sub loop unbundling to be offered from December 2000, thereby bringing forward the implementation date. BT published a revised standard reference offer on 29 December 2000.

During 2001, BT will introduce line sharing as required by the EU regulation. Oftel will determine the prices for the broadband frequency band of a shared loop after consultation and input by BT of relevant cost calculations.

Carrier pre-selection

From 1 January 2000, the European Commission required the provision of carrier pre-selection (CPS) by Member State operators with significant market power. CPS allows customers to opt for certain classes of call to be carried by an alternative operator, selected in advance, without having to dial additional access codes.

Software changes to BT's local exchanges could not be introduced before January 2001 (for national and international calls) and January 2002 (for all other calls) and HM Government applied to the European Commission for a deferment of BT's obligation. The European Commission granted a limited deferment until 1 April 2000, but decided that CPS should be provided in the interim by means of auto-diallers on customers' premises.

BT introduced permanent CPS service (for national and international calls) ahead of schedule on 12 December 2000.

Leased lines

Oftel published a Direction in respect of partial private circuits (PPCs) on 29 March 2001. This resulted from a review of the competitiveness of the national leased lines market in the UK and the need for regulation in this sector. The Direction followed a consultation in August 2000 and an Oftel statement in December 2000. Oftel has concluded that more competition is needed in the provision of wholesale "terminating segments" and has proposed that BT offer PPCs to other operators at cost-based prices. Oftel has given time limits for the conclusion of negotiations. It is expected that the proposals will be implemented during the second half of 2001.

Mobile services

BT Cellnet operates under its own Mobile Public Telecommunications Operators licence that authorises provision of a range of mobile telecommunications services.

The Director General has previously determined, and is in the process of re-determining, that BT Cellnet and Vodafone have "market influence". A determination of market influence triggers, among other things, an obligation to supply independent service providers with wholesale airtime on their networks on fair and non-discriminatory terms for resale.

As a pre-condition to eligibility for bidding in the 3G licence auction, BT Cellnet and one other existing second generation (2G) mobile operator, Vodafone, were required to agree to amendments to their licences to incorporate a "roaming condition". This obliges BT Cellnet and Vodafone to allow the one new 3G entrant to roam onto their networks. The roaming condition will come into effect at the latest once this new entrant has rolled out its network to cover an area in which at least 20% of the UK population live.

BT Cellnet and Vodafone will be expected to negotiate roaming agreements with the new 3G entrant. If they are unable to agree, the matter may be referred to the Director General for resolution. The roaming condition will remain in force until 31 December 2009.

In addition to the consultation on termination charges for calls to mobiles, Oftel has issued a consultation document assessing the state of competition in the mobile market and the form of regulatory regime going forward. Oftel has indicated that its initial view is that the mobile market is not yet effectively competitive and that two or more of the mobile operators in the UK are likely to be subject to some regulation to promote competition.

Business review

Universal service

In September 2000, Oftel issued a further consultation on BT's Universal Service Obligation (USO). BT endorses Oftel's view that, at this point, BT's USO should not be extended to cover broadband services. Whilst BT welcomes Oftel's revision of costs and benefits set out in the previous consultation, BT is disappointed by Oftel's failure to acknowledge the strong case for industry funding of the significant net costs that fall on BT in providing universal service. BT still believes social telephony would be better funded through an industry-wide fund. BT awaits Oftel's final conclusions.

HM Government's review of telecommunications and broadcasting regulation

HM Government has initiated a review of telecommunications and broadcasting regulation. HM Government published a White Paper in December 2000 proposing regulatory reform concerning the convergence of the communications industries. A new regulatory body is proposed, to be called the Office of Communications (OFCOM), that will amalgamate the roles of five existing regulatory agencies: Office of Telecommunications; Independent Television Commission; Broadcasting Standards Commission; Radio Authority and Radiocommunications Authority. OFCOM will be headed by a chairman and chief executive supported by executive and non-executive board members.

The main change for telecoms would be the proposed introduction of fines for breach of regulatory obligations. BT supports HM Government's vision for the converging sector and welcomes the intention not to apply broadcasting rules to internet content. However, BT, along with many others, is seeking full rights of appeal against regulatory decisions and the incorporation within OFCOM of

incentives to reduce the level of regulation when appropriate.

Oftel strategy statement

In January 2000, Oftel published a strategy statement based on the principle that regulation should go no further than the minimum necessary to protect consumers. The two key features of the strategy are increased use of industry self- and co-regulation, and reviews of the effectiveness of competition in major market sectors. BT supports the proposal for an extension of self- and co-regulation, which has the potential to result in regulation which is more flexible, more responsive and more pragmatic. BT is discussing with other stakeholders how this can best be put into practice, especially in consumer-related areas.

BT also supports the aim of the effective competition reviews, which are intended to ensure that the regulatory framework responds to changed competitive conditions. The reviews will be carried out over the next few years according to a schedule which Oftel has published: where it is found that competition is delivering benefits to consumers in the sectors reviewed, regulation will be reduced or withdrawn, as appropriate. Sectors for which reviews have already been initiated or completed include national leased lines and mobile telephony. BT supports Oftel's plans to review the duplication between licence conditions and the Competition Act during the current financial year.

Interconnection product

On 26 May 2000, Oftel issued a determination stating that BT should provide an interconnection product under its licence for flat rate internet access call origination (FRIACO). The determination requires BT to provide call origination for internet access, not on the standard pence per minute basis but with charging based upon network capacity purchased. The

determination directed BT to offer FRIACO at the local exchange level from 1 June 2000. BT complied with this direction. BT had concerns at potential network congestion should FRIACO have to be made available at the next level up from the local exchange (DMSU). Oftel has acknowledged these concerns and, on 13 November 2000, began consulting on proposals that would make FRIACO available at the DMSU level, although with safeguards in place for one year to ensure the network does not become congested. A final determination on DMSU FRIACO was issued on 15 February 2001 requiring BT to offer such a product but with safeguards, including requirements on other operators to re-arrange traffic, to prevent network congestion. The charges for both FRIACO services are to be incorporated in the network charge control regime.

Office of Fair Trading review of Yellow Pages

On 11 May 2001, the Director General of Fair Trading issued a statement that, at the request of the Secretary of State for Trade and Industry, the OFT is to seek further undertakings from BT in respect of Yell's fees for advertising in its printed UK consumer classified directories (Yellow Pages). BT is being asked, amongst other things, to cap the fees at RPI minus 6 for four years from January 2002.

The decision follows a review by the OFT of undertakings entered into by BT in 1996. The existing undertakings were given following a 1996 Monopolies and Mergers Commission (now Competition Commission) report on the supply of classified directory advertising services. They cap Yell's advertising rates at RPI minus 2. They also require Yell to publish a rate card, ensure that directory areas do not overlap and to provide financial statements to the OFT.

Had the revised price cap been in effect during the 2001 financial year, it would have applied to around 65% of Yell's group turnover and we estimate that, assuming no change in advertising volume, Yell's revenues would have been reduced by approximately £20 million.

Domestic obligations in a global market

As a result of BT's international 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 UK telecommunication services, and to do so to any specified standards. BT's directors are required to submit an annual compliance certificate to the Director General.

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. In addition, the Secretary of State has statutory powers to require BT to take certain actions in the interests of national security or international relations.

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.