0000024887

KELLEY DRYE & WARREN LLP

A LIMITED LIABILITY PARTNERSHIP INCLUDING PROFESSIONAL ASSOCIATIONS

1200 19TH STREET, N.W.

SUITE 500

WASHINGTON, D.C. 20036

(202) 955-9600

FACSIMILE

(202) 955-9792

NEW YORK, NY
LOS ANGELES, CA
MIAMI, FL
CHICAGO, IL
STAMFORD, CT
PARSIPPANY, NJ

BRUSSELS, BELGIUM
HONG KONG

AFFILIATE OFFICES
BANGKOK, THAILAND
JAKARTA, INDONESIA
MANILA, THE PHILIPPINES
MUMBAI, INDIA
TOKYO, JAPAN

RECEIVED
AZ CORP COMMISSION
MAY 4 10 03 AM '99
DOCUMENT CONTROL

ORIGINAL

April 29, 1999

Arizona Corporation Commission
DOCKETED

MAY 04 1999

DOCKETED BY

Mr. Jack Rose
Executive Secretary
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Re: Concert Communications Sales LLC Application for Authority to Provide Local Exchange Services in Arizona

Dear Mr. Rose,

Enclosed please find an original, a duplicate and ten copies of the above-referenced application for local exchange authority. Please date-stamp the duplicate and return in the pre-stamped envelope provided. If there are any questions regarding this filing, please call me at (202) 887-1238. Thank you for your assistance with this filing.

Cordially,

Winafred Brantl

Winafred Brantl
Legal Assistant

enclosures

T-03731A-99-0234

Docket Control Center

Memo

To: Kevin Mosier

From: Connie L. Northrop

Date: 4/30/99

Re: Concert Communications Sales LLC.

Sufficiency Review

Please Check the appropriate Boxes:

Docket Application: Yes ☑, No ☐

Please Check all of the CC&N types that apply to this application.

- ☑ Local Exchange Reseller (RLEC)
- ☐ Intrastate Long Distance Reseller (R-LD)
- ☐ CLEC
- ☐ Incumbent/Facilities Based Intrastate Long Distance
- ☐ Interstate Long Distance (IXC)

Please Initial & Date this memo & return it to Docket Control.

kh 5/3/99

FORM A

ARIZONA CORPORATION COMMISSION

Application and Petition for Certificate of Convenience and Necessity to Provide Local Exchange Services as a Reseller

Mail original plus 10 copies of completed application to:	For Docket Control Only: (Please Stamp Here)
Docket Control Center Arizona Corporation Commission 1200 West Washington Street Phoenix, Arizona 85007-2927	
If you have current applications pending in Arizona as an Interexchange reseller, AOS provider, or as the provider of other telecommunication services.	
Type of Service: Interexchange Docket No.: Not yet docketed Date: April 26, 1999	Docket No. ____________
Type of Service: ______________________ Docket No.: __________ Date: _________	Docket No. _____________

A. Company and Telecommunications Service Information
(A-1) The name, address, and telephone number (including area code) of the applicant(company): **Concert Communications Sales LLC** **11921 Freedom Drive** **Reston, VA 20190** **(703) 707-4000 (tel)** **(703) 707-4080 (fax)**
(A-2) If doing business (d/b/a) under a name other than the applicant (company) name listed above, specify: **Not applicable**

(A-3) The name, address, telephone number (including area code) and facsimile number of the management contact.

Cheryl Lynn Schneider
Regulatory Counsel, Americas
Concert Communications Sales LLC
11921 Freedom Drive
Reston, VA 20190
(703) 707-4000 (tel)
(703) 707-4080 (fax)

(A-4) The name, address, and telephone of the Attorney, if any, representing the applicant:

Joan M. Griffin
Kelley Drye & Warren, LLP
1200 19th St., NW #500
Washington, DC 20036
(202) 955-9786 (tel)
(202) 955-9792 (fax)

(A-5) What type of legal entity is the applicant?

☐ Sole proprietorship

☐ Partnership: ____limited, _____general, ____ Arizona, _____ Foreign

X Limited liability company **(formed in Delaware)**

☐ Corporation: ____ □S□, ____ □C□, _____ non-profit, ____ Arizona, _____ Foreign

☐ Other, specify:

(A-6) Include Attachment A. Attachment A must list names of all owners, partners, limited liability company managers, or corporation officers and directors (specify), and indicate percentages of ownership.
See Attachment A.

(A-7) 1. Is your company currently offering any telecommunication services in Arizona? If yes, list each service offered and provide the date that you began offering each such service in Arizona.

CCS is not currently offering telecommunications services in Arizona.

2. If the answer to 1. Is "no", when does your company plan to begin reselling services in Arizona?

CCS's commencement of service in the state is largely driven by the requirements of its multinational customers. At this time, CCS estimates that it could commence service in the state as early as the 3rd quarter 1999, subject to the receipt of all necessary regulatory approvals.

(A-8) Include Attachment B. Attachment B, your proposed tariff, must include proposed rates and charges for each service to be provided. State the tariff (maximum) rate as well as the price to be charged, and state other terms and conditions, including deposits, that will apply to provision of the service(s) by your company.

The Arizona Corporation Commission provides pricing flexibility by allowing competitive telecommunications service companies to price their services at levels equal to or below the tariff (maximum) rates. The prices to be charged by the company are filed with the Commission in the form of price lists. See the "Illustrative Tariff/Price List Example□ attached. Note: Price list rate changes that result in rates that are lower than the tariff rate are effective upon concurrent notice to the Commission
(See Rule R14-2-1109 (B)(2)). See Rule R14-2-1110 for procedures to make price list changes that result in rates that are higher than the tariff rate.

(A-9) The geographic market to be served is:

X statewide.

☐ other, describe and provide a map depicting the area.

(A-10) List the states in which you currently offer, or have been approved to offer, services similar to those you intend to resell in Arizona.

CCS is not yet approved for provision of interexchange or local telecommunication services in any state.

(A-11) List the companies with which you have signed resale agreements, along with the states in which they were approved.

Not applicable

(A-12) Include Attachment C. (All Applications must include a resale agreement or contract). Attachment C is a copy of the resale agreement or contract between your company and an applicable local exchange service provider.

CCS anticipates at this time that it will resell the local exchange services of AT&T. Thus, it is not clear to CCS at present that it will need interconnection agreements with the incumbent LECs, and the technical and compensation issues of interconnection and collocation have not yet been determined. Should CCS need to enter into interconnection agreements with the incumbent LECs, CCS expects that any resolution of the technical and compensation issues of interconnection will be consistent with most interconnection agreements already approved by the Commission. Indeed, should CCS need to enter into interconnection agreements with the incumbent LECs, CCS will likely seek to adopt an existing and approved interconnection agreement of another CLEC in the state.

(A-13) Provide the name, address, and telephone number of the company□s complaint contact person.

Bob Johnson
Director – Customer Support Services
11921 Freedom Drive
Reston, VA 20190
(703) 707-4127 (tel)
(703) 707-4075 (fax)

(A-14)	Provide a list of states in which you have sought authority to resell telecommunications services and in which the state granted the authority with major changes and conditions or did not grant your application for those services. For each state listed, provide a copy of the Commissions decision modifying or denying your application for authority to provide telecommunications services. **Not applicable.**
(A-15)	Has the company been granted authority to provide or resell telecommunications services in any state where subsequently the authority was revoked? If "yes", provide copies of the State Regulatory Commission's decision revoking its authority. **Not applicable.**
(A-16)	Has the company been or is the company currently involved in any formal complaint proceedings before any State or Federal Regulatory Commission? If "yes", in which states is the company involved in such proceedings and what is the substance of these complaints. Also, provide copies of Commission orders that have resolved any of these complaints **Not applicable.**
(A-17)	Has the applicant been involved in any civil or criminal investigations related to the delivery of telecommunications services within the last five years? If "yes", in which states has the applicant been involved in investigations and why is the applicant being investigated? **Not applicable.**
(A-18)	Has the applicant had judgment entered against it in any civil matter or been convicted of criminal acts related to the delivery of telecommunications services within the last five years? If yes, list the states where judgment or conviction was entered and provide a copy of the court order. **Not applicable.**
	B. Technical Information
(B-1)	If your company is a non-facilities based reseller (you do not own your own facilities), provide the name of the company or companies whose services you resell and skip to question (B-2). If you are a facilities based reseller, complete the remainder of this section. **CCS anticipates at this time that it will resell the local exchange services of AT&T; however CCS requests authority to resell the local exchange services of any and all certificated carriers.** Include Attachment D. Attachment D should provide the following information: A diagram of the applicant's network. This diagram should show how applicant's customers are connected to this network and how the net work is interconnected to other carriers networks.

	If other carriers facilities are used in conjunction with your own facilities to provide basic exchange service, indicate who owns the facilities that are used (i.e. provide a list of the facilities-based local exchange carriers whose facilities are used to serve the applicant's customers).
(B-2)	Explain what actions the applicant has taken to ensure that basic exchange service to applicant□s customers will not be interrupted in the event the applicant ceases to do business. **The nature of the competitive local exchange market ensures that the transition of customers among providers can be seamlessly achieved. In the unlikely scenario that CCS should cease operations, CCS will provide its customers with significant advance notice as well as information regarding alternative providers within the exchange and will make every effort to facilitate the implementation of customers' selections.**

C. Financial Review Questions For LECS

(C-1) Include "Attachment E". Attachment E **must** include a copy of your Company's balance sheet, income statement, audit report (if audited) and all related notes to these financial statements for the two most recent years your Company has been in business.

(C-2) If your Company does not have financial statements for the two most recent years, please give the date your Company began operations.

CCS was formed on February 22, 1999.

(C-3) If the balance sheets you submit do not have retained earnings accounts, please provide this account information on a separate sheet for each of the two years.

See Attachment E.

(C-4) If your Company is a subsidiary, please provide your Parent Company's financial statements, in addition to your Company's financial statements.

See Attachment E.

(C-5) If your Company intends to rely on the financial resources of its Parent Company, please provide a written statement from your Parent Company attesting that it will provide complete financial backing if your Company experiences a net loss or a business failure and that it will guarantee re-payment of customers; advances, prepayments or deposits held by your Company if, for some reason, your Company cannot provide service or repay the deposits.

This statement is being prepared and will be late-filed as soon as available.

I certify that if the applicant is an Arizona corporation, a current copy of the Articles of Incorporation is on file with the Arizona Corporation Commission and the applicant holds a Certificate of Good Standing from the Commission. If the company is a foreign corporation or partnership, I certify that the company has authority to transact business in Arizona. I certify that all appropriate city, county and/or State agency approvals have been obtained. Upon signing of this application, I attest that I have read the Commission's rules and regulations relating to the regulations of telecommunications services and that the company will abide by Arizona State Law including the Arizona Corporation Commission Rules and Regulations. I agree that the Commission's rules apply in the event there is a conflict between those rules and the company's tariff, unless otherwise ordered by the Commission. I certify that to the best of my knowledge the information provided in this Application and Petition is true and correct.

Michelle Gallagher
(Signature of Authorized Representative)

March 26, 1999
(Date)

MICHELLE GALLAGHER
(Print Name of Authorized Representative)

ASSISTANT SECRETARY
(Title)

SUBSCRIBED AND SWORN to before me this 26th day of March, 1999

Mary B Stafford
NOTARY PUBLIC

My Commission Expires May 31, 1999

ATTACHMENT A

OWNERSHIP INFORMATION

Concert Communications Sales LLC
Application for Certificate of Convenience & Necessity
To Provide Local Exchange Services As a Reseller
Attachment A

Ownership

Concert Communications Sales LLC ("CCS") is a limited liability company organized under the laws of Delaware. The sole member of CCS is Concert Global Networks (USA) Inc., a Delaware corporation located at 11921 Freedom Drive, Reston, VA 20190.

CCS is an indirect wholly-owned subsidiary of Concert Communications Company, which is in turn an indirect wholly-owned subsidiary of British Telecommunications plc ("BT"). BT is one of the world's leading providers of fixed and mobile communications services. On July 26, 1998, BT and AT&T Corp. ("AT&T") announced their intention to create a $10 billion global venture. Upon consummation of the transaction, CCS will become an indirect subsidiary of the joint venture, in which BT and AT&T will each hold 50 percent ownership. CCS will notify the Commission in writing in the event the transaction is consummated and there is a change in ownership.

Corporate Officers/Managers

PeterMacleod	Chief Executive Manager	11921 Freedom Drive, Reston, VA 20190
Steve Clutton	Chief Financial Manager	11921 Freedom Drive, Reston, VA 20190
William Flynn	Tax Manager	11921 Freedom Drive, Reston, VA 20190
Geoff Webster	Secretary Manager	11921 Freedom Drive, Reston, VA 20190
Geoffrey Beedham	Assistant Secretary Manager	11921 Freedom Drive, Reston, VA 20190
Cheryl Schneider	Assistant Secretary Manager	11921 Freedom Drive, Reston, VA 20190
Cindy Perkinson	Assistant Secretary Manager	11921 Freedom Drive, Reston, VA 20190
Kha Nguyen	Assistant Secretary Manager	11921 Freedom Drive, Reston, VA 20190
Michelle Gallagher	Assistant Secretary Manager	11921 Freedom Drive, Reston, VA 20190

ATTACHMENT B

PROPOSED TARIFF

COMPETITIVE LOCAL CARRIER

TARIFF SCHEDULE
APPLICABLE TO
LOCAL EXCHANGE SERVICES,
AND PRIVATE LINE AND SPECIAL ACCESS SERVICES
WITHIN
THE STATE OF ARIZONA
ISSUED BY

Concert Communications Sales LLC

Service may be furnished by means of communications including but not limited to, fiber optic and coaxial cables, microwave radio, or other suitable technology or any combination thereof.

Manager, Rates and Tariffs
Concert Communications Sales LLC
11921 Freedom Drive
Reston, Virginia 20190

TABLE OF CONTENTS

CHECK SHEET

The title page and sheets 1 - 42 inclusive of this tariff are effective as of the date shown. Original and revised sheets, as named below, comprise all changes from the original tariff in effect.

Page	Revision	Page	Revision
Title Page	Original	22	Original
1	Original	23	Original
2	Original	24	Original
3	Original	25	Original
4	Original	26	Original
5	Original	27	Original
6	Original	28	Original
7	Original	29	Original
8	Original	30	Original
9	Original	31	Original
10	Original	32	Original
11	Original	33	Original
12	Original	34	Original
13	Original	35	Original
14	Original	36	Original
15	Original	37	Original
16	Original	38	Original
17	Original	39	Original
18	Original	40	Original
19	Original	41	Original
20	Original	42	Original
21	Original		

Manager, Rates and Tariffs
Concert Communications Sales LLC
11921 Freedom Drive
Reston, Virginia 20190

EXPLANATION OF SYMBOLS, REFERENCE MARKS, AND ABBREVIATIONS OF TECHNICAL TERMS USED IN THIS TARIFF

The following symbols shall be used in this tariff for the purpose indicated below:

(C)	To signify changed regulation.
(R)	To signify decreased rate.
(I)	To signify increased rate.
(T)	To signify a change in text but no change in rate or regulation.
(S)	To signify a reissued matter.
(M)	To signify text relocated without change.
(N)	To signify a new rate or regulation.
(D)	To signify a discontinued rate or regulation.
(Z)	To signify a correction.

TARIFF FORMAT

Page Numbering – Page numbers appear in the upper right hand corner of each page. Pages are numbered sequentially, when a new page is added between pages it will be numbered with an additional number preceded by a “.”. A page inserted between pages 10 and 11 would be page 10.1.

Revision Numbers - Revision numbers also appear in the upper right corner of the page. These numbers are used to determine the most current page version on file. For example, the 4th revised page 34 cancels the 3rd revised page 34. Because of deferrals, notice periods, etc., the most current page revision number on file is not always the tariff page in effect. Consult check sheets and supplements for the page currently in effect.

Numbering Sequence - There are nine levels of alpha-numeric numbering. Each level is subservient to its next higher level. The following is an example of the numbering sequence used in this tariff. Alpha-numeric coding is used for paragraph identification. Each level is subservient to the previous higher number/letter. Following is the sequence used in this tariff.

2.
2.1.
2.1.1.
2.1.1.A.
2.1.1.A.1.
2.1.1.A.1.(a)
2.1.1.A.1.(a)I
2.1.1.A.1.(a)I.i
2.1.1.A.1.(a)I.i(1)

CONCURRING, CONNECTING AND OTHER PARTICIPATING

Concurring:

None

Connecting:

None

Other Participating Carriers:

None

APPLICATION OF TARIFF

This tariff sets forth the service offerings, rates, terms and conditions applicable to the furnishing of intrastate end-user local exchange communications services by Concert Communications Sales LLC., hereinafter referred to as the Company or CCS, to Customers within the State of Arizona. In the event of any conflict between the provisions of this tariff and the provisions of a Service Order submitted by the Customer to the Company, the provisions of this Tariff shall control to the extent required by law.

The provisioning of local telecommunications services are subject to existing regulations and terms and conditions specified in this tariff and the Company's other related tariffs, and may be revised by superceding filings.

Section 1: DEFINITIONS

Certain terms used generally throughout this tariff are defined below.

Advance Payment: Part or all of a payment required before the start of service.

Automatic Number Identification (ANI): Allows the automatic transmission of a caller's billing account telephone number to a local exchange company, interexchange carrier or a third party subscriber. The primary purpose of ANI is to allow for billing of toll calls.

Availability: The ability of a connection to transmit and receive the Customer's voice, data and other electronic signals between the Network Points at the ordered Bit rate.

Bit: The smallest unit of information in the binary system of notation.

Commission: The Arizona Corporation Commission.

Communications Channel: A path for the transmission of communications between two or more points.

Communications Services: The Company's intrastate toll and local exchange switched telephone services offered for both intraLATA and interLATA use.

Company or CCS: Concert Communications Sales LLC., the issuer of this tariff.

Company Equipment: Any telecommunications equipment owned or leased by the Company and that forms part of the Network, including any such Company Equipment situated at any Location, but excluding Customer Premises Equipment. Company Equipment also includes Company Facilities.

Company Facilities: Facilities, equipment, software or wiring supplied by or on behalf of the Company for the purpose of furnishing Service. Company Facilities do not include the facilities, equipment, software or wiring supplied by Other Facilities Suppliers.

Connection: A Communications Channel over which voice, data and other electronic signals can be transmitted by the Customer or User.

Customer: A person, firm, corporation or any other entity that orders Service and is responsible for the payment of Charges and compliance with the Company's regulations. A person, firm, corporation or any other entity that reasonably appears to be acting with the Customer's authority shall be deemed to be acting on behalf of the Customer.

Customer Premises: The Customer's or User's place(s) of business, residence or other location for the origination or termination of Service.

DEFINITIONS (Cont'd)

Customer-Premises Equipment ("CPE"): Equipment owned or leased by the Customer or Authorized User at a Location and connected to the Network on the Customer's or Authorized User's side of a Network Termination Point. CPE also includes Customer-Provided Equipment.

Customer-Provided Equipment: Facilities, equipment, software or wiring supplied by the Customer or User in connection with Service.

Demarcation Point: The point at which the Company Facilities are interconnected with Customer-Provided Equipment.

Dollars: United States Dollars

Due Date: The date that has been established for completion of the installation, change or disconnect of a service component

Economy Period: 11:00 p.m. to 7:00 a.m. local time at the originating point of a communication.

Entity: Any corporation, public limited company, limited company, partnership, trust or other legal entity.

FCC: Federal Communications Commission.

In Case – In the event of a particular occurrence.

Joint User: A person, firm or corporation that is designated by the Customer as a user of services furnished to the Customer by NAC and to whom a portion of the charges for the service will be billed under a joint user arrangement as specified herein.

Kbps: Kilobits per second, denotes thousands of bits per second.

Location: The premises owned or occupied by the Customer (or any Authorized User) that forms one end of a Location-Pair and at which a Network Termination Point is located.

Local Access and Transport Area (LATA): A geographic area established for the provision and administration of communications services. LATA locations can be found in NECA Tariff F.C.C. No. 4 as filed with the Federal Communications Commission in Washington, DC.

Mbps: Megabits per second, denotes millions of bits per second.

Minimum Service Period: The minimum period that a Customer may subscribe to Service.

Monthly Charge: A flat charge assessed the Customer each month for the use of the Company's Service.

Network Interface Specifications: The specifications relating to the interface between the Network and any Customer-Premises Equipment attached to the Network.

DEFINITIONS (Cont'd)

Network Termination Point: A point representing the physical and management boundary between the Network and Customer Premises Equipment. The Network Termination Point is on the Network side of the Customer Premises Equipment.

Operational Service Date: The date when any Service, or any part of it, is first made available to the Customer by the Company or the date when the Customer first starts to use such Service (or any part of it), whichever date is the earlier.

Other Facilities Supplier: An entity other than the Company that provides facilities or services in connection with the Service furnished by the Company under this Tariff and not as a part of a joint undertaking with the Company to furnish Service under this Tariff.

Outage: A period during which Availability of a Connection has ceased.

Point of Presence (POP): A physical location at which a local access channel, the public telephone network, or other Communications Channel interconnects with Company Facilities for the origination or termination of communications.

Rate Center: The specific geographical location used for determining mileage measurements designated by Vertical and Horizontal coordinates..

Rate Center Area: The area encompassed by the central office codes (NNXs) that are assigned to a rate center.

Recurring Charges: The monthly charges to the Customer for services, facilities and equipment, that continue for the agreed upon duration of the service.

Scheduled Service Date: The date upon which Service is scheduled to commence.

Service: The telecommunications service or services offered by the Company under this Tariff.

Service Interruption: A period of time where a service is interrupted or unavailable for use by the Customer. An interruption or outage scheduled by the Company or beyond the Company's control is not considered a Service Interruption.

Service Order: The written request for Network Services executed by the Customer and the Company in the format devised by the Company. The signing of a Service Order by the Customer and acceptance by the Company initiates the respective obligations of the parties as set forth therein and pursuant to this tariff, but the duration of the service is calculated from the Service Commencement Date.

Service Term: The period that the Customer subscribes to Service. The Service Term may be longer than the Minimum Service Period.

DEFINITIONS (Cont'd)

Shared: A facility or equipment system or subsystem that can be used simultaneously by several Customers.

Subsidiary: Any lower-tiered Entity affiliated with another Entity that (i) holds more than fifty percent of the voting rights, (ii) has the right to appoint or remove a majority of directors or trustees, or (iii) controls, alone or pursuant to an agreement with other shareholders or members, a majority of the beneficial ownership or voting rights of such lower-tiered Entity. Any Subsidiary of an Entity that, in turn, is itself a Subsidiary shall also be a Subsidiary.

Tariff: The Company's Tariff PUC No. 2, Local Exchange Service.

United States: The forty-eight (48) contiguous states and the District of Columbia, Hawaii, Alaska, Puerto Rico, and the U.S. Virgin Islands.

Usage Charge: A charge assessed the Customer for the use of the Company's Service. Usage Charges are assessed per second or minute of use or multiple thereof, as specified in Sections 3.3 and 5 of this Tariff.

User or End User: A Customer, Joint User, or any other person or entity accessing or utilizing the services furnished by the Company to the Customer under this tariff.

Year of Service: The period of twelve (12) months commencing on the Effective Date and, thereafter, each successive period of twelve (12) months from such date.

Section 2: REGULATIONS

2.1 Undertaking of the Company

2.1.1 Scope

The Company undertakes to furnish communications service pursuant to the terms of this tariff in connection with one-way and/or two-way voice transmission between points within the State of Arizona. Service is available only to Customers located in the service areas specified in Section 4 of this tariff.

Customers and users may use services and facilities provided under this tariff to obtain access to services offered by other service providers. The Company is responsible under this tariff only for the services and facilities provided hereunder, and it assumes no responsibility for any service provided by any other entity that purchases access to the Company's network in order to originate or terminate its own services, or to communicate with its own Customers.

2.1.2 Shortage of Equipment or Facilities

A) The Company reserves the right to limit or to allocate the use of existing facilities, or of additional facilities offered by the Company, when necessary because of lack of facilities, or due to some other cause beyond the Company's control.

B) The furnishing of service under this tariff is subject to the availability on a continuing basis of all the necessary facilities and is limited to the capacity of the Company's facilities as well as facilities the Company may obtain from other carriers to furnish service from time to time as required at the sole discretion of the Company.

C) The Company will provide service only in areas and to the extent that service is made available for resale by the underlying facilities-based carrier from whom the Company purchases underlying transmission services. This tariff shall not be construed to require the Company to provide any service for which it is unable to obtain the necessary underlying transmission services.

D) The Company does not provide Customer Premises Equipment under this tariff, although CPE may be used by the Customer in conjunction with the Company's provision of Service.

Manager, Rates and Tariffs
Concert Communications Sales, LLC
11921 Freedom Drive
Reston, Virginia 20190

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.3 Terms and Conditions

A) For the purpose of computing charges in this tariff, a month is considered to have 30 days.

B) Business Customers that do not receive service on month-to-month basis may be required to enter into written service orders which shall contain or reference a specific description of the service ordered, the rates to be charged, the duration of the services, and the terms and conditions in this tariff. Customers will also be required to execute any other documents as may be reasonably requested by the Company.

C) The Company shall notify the Customer of the expiration of the initial term specified in the Service Order. The Customer must then notify the Company orally or in writing whether it will continue to receive service on a month-to-month basis at the existing rates, reenter into a new contractual arrangement or terminate service. Any termination shall not relieve the Customer of its obligation to pay any charges incurred under the service order and this tariff prior to termination. The rights and obligations which by their nature extend beyond the termination of the term of the service order shall survive such termination.

D) Service may be terminated without written notice to the Customer if:

1) the Customer is using the service in violation of this tariff; or

2) the Customer is using the service in violation of the law.

E) Upon suspension of service, the Company shall provide the Customer with a termination notice detailing the termination date and time and how the Customer may have service restored. The termination notice will include a medical emergency restoration notice explaining how Customers with medical emergencies may delay termination of basic service.

F) This tariff shall be interpreted and governed by the laws of the State of Arizona regardless of its choice of laws provision.

G) Notwithstanding the provisions of this Section, the Company will comply with the rules and regulations of the Commission.

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.4 Liability of the Company

A) The liability of the Company for damages arising out of the furnishing of its services, including but not limited to mistakes, omissions, interruptions, delays, or errors, or other defects, representations, or use of these services or arising out of the failure to furnish the service, whether caused by acts or omissions, shall be limited to the extension of allowances for interruption as set forth in Section 2.6. The extension of such allowances for interruption shall be the sole remedy of the Customer and the sole liability of the Company.

B) The Company shall not be liable for any delay or failure of performance or equipment due to causes beyond its control, including but not limited to: acts of God, fire, flood, explosion or other catastrophes; any law, order, regulation, direction, action, or request of the United States Government, or of any other government, including state and local governments having or claiming jurisdiction over the Company, or of any department, agency, commission, bureau, corporation, or other instrumentality of any one or more of these federal, state, or local governments, or of any civil or military authority; national emergencies; insurrections; riots; wars; unavailability of rights-of-way or materials; or strikes, lock-outs, work stoppages, or other labor difficulties.

C) The Company shall not be liable for any act or omission of any entity furnishing to the Company or to the Company's Customers facilities, telecommunications services or equipment used for or with the services the Company offers.

D) The Company shall not be liable for any damages or losses due to the fault or negligence of the Customer or due to the failure or malfunction of Customer-provided equipment or facilities.

E) The Company does not guarantee nor make any warranty with respect to installations it provides for use in an explosive atmosphere. The Customer indemnifies and holds the Company harmless against any and all loss, claims, demands, suits, or other action, or any liability whatsoever, whether suffered, made, instituted, or asserted by any other party or person(s), and for any loss, damage, or destruction of any property, whether owned by the Customer or others, caused or claimed to have been caused directly or indirectly by the installation, operation, failure to operate, maintenance, removal presence, condition, location, or use of any installation so provided. The Company reserves the right to require each Customer to sign an agreement acknowledging acceptance of the provisions of this section 2.1.4(E) as a condition precedent to such installations.

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.4 Liability of the Company (Cont'd)

F) The Company is not liable for any defacement of or damage to Customer premises resulting from the furnishing of services or equipment on such premises or the installation or removal thereof, unless such defacement or damage is caused by negligence or willful misconduct of the Company's agents or employees.

G) The entire liability for any claim, loss, damage or expense from any cause whatsoever shall in no event exceed sums actually paid the Company by the Customer for the specific services giving rise to the claim. Notwithstanding any other provision of this tariff, in no event shall the Company's liability for any claim, loss, damage or expense from any carrier whatsoever exceed the service provider's liability described in the applicable tariffs of Bell Atlantic for the telecommunications services resold by Company. No action or proceeding against the Company shall be commenced more than one year after the service is rendered.

H) Under no circumstances shall this tariff be construed to make the underlying carrier liable to the Customer for any indirect, special, incidental, consequential, or other damages including, but not limited to, harm to business, lost revenues, lost profits, lost savings, or other commercial or economic loss, whether foreseeable or not and regardless of notification of the possibility of such damages.

I) **THE COMPANY MAKES NO WARRANTIES OR REPRESENTATIONS, EXPRESS OR IMPLIED EITHER IN FACT OR BY OPERATION OF LAW, STATUTORY OR OTHERWISE, INCLUDING WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR USE, EXCEPT THOSE EXPRESSLY SET FORTH HEREIN.**

J) The provisions contained in this subsection do not absolve the Company from liability in the event the Company's acts or omissions are determined to be grossly negligent. The remedies available for such liability include monetary damages.

2.1.5 Notification of Service-Affecting Activities

The Company will provide the Customer reasonable notification of service-affecting activities that may occur in the normal operation of its business. Such activities may include, but are not limited to, equipment or facilities additions, removals or rearrangements and routine preventative maintenance. Generally, such activities are not specific to an individual Customer but affect many Customers' services. No specific advance notification period is applicable to all service activities. The Company will work cooperatively with the Customer to determine the reasonable notification requirements. With some emergency or unplanned service-affecting conditions, such as an outage resulting from cable damage, notification to the Customer may not be possible.

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.6 Provision of Equipment and Facilities

A) The Company, either directly, through its agents or underlying carrier, shall use reasonable efforts to make services available to a Customer on or before a particular date, subject to the provisions of and compliance by the Customer with, the regulations contained in this tariff. The Company does not guarantee availability by any such date and shall not be liable for any delays in commencing service to any Customer.

B) The Company shall use reasonable efforts to maintain only the facilities and equipment that it furnishes to the Customer. The Customer may not, nor may the Customer permit others to, rearrange, disconnect, remove, attempt to repair, or otherwise interfere with any of the facilities or equipment installed by the Company, except upon the written consent of the Company.

C) The Company may substitute, change or rearrange any equipment or facility at any time and from time to time, but shall not thereby alter the technical parameters of the service provided the Customer.

D) Equipment the Company provides or installs at the Customer Premises for use in connection with the services the Company offers shall not be used for any purpose other than that for which it was provided by the Company.

E) The Customer shall be responsible for the payment of service charges as set forth herein for visits by the Company's agents or employees to the Premises of the Customer when the service difficulty or trouble report results from the use of equipment or facilities provided by any party other than the Company, including but not limited to the Customer.

F) The Company shall not be responsible for the installation, operation, or maintenance of any Customer-provided communications equipment. Where such equipment is connected to the services furnished pursuant to this tariff, the responsibility of the Company shall be limited to the furnishing of services offered under this tariff and to the maintenance and operation of such services. Subject to this responsibility, the Company shall not be responsible for:

1) the transmission of signals by Customer-provided equipment or for the quality of, or defects in, such transmission; or

2) the reception of signals by Customer-provided equipment.

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.7 Non-routine Installation

At the Customer's request, installation and/or maintenance may be performed outside the Company's regular business hours or in hazardous locations. In such cases, charges based on cost of the actual labor, material, or other costs incurred by or charged to the Company will apply. If installation is started during regular business hours but, at the Customer's request, extends beyond regular business hours into time periods including, but not limited to, weekends, holidays, and/or night hours, additional charges may apply.

2.1.8 Special Construction

Subject to the agreement of the Company and to all of the regulations contained in this tariff, the Company may arrange, on a reasonable effort basis, for the special construction of facilities at the request of the Customer. Special construction is that construction undertaken:

A) where facilities are not presently available, and there is no other requirement for the facilities so constructed;

B) of a type other than that which the Company would normally utilize in the furnishing of its services;

C) over a route other than that which the Company would normally utilize in the furnishing of its services;

D) in a quantity greater than that which the Company would normally provide;

E) on an expedited basis;

F) on a temporary basis until permanent facilities are available;

G) involving abnormal costs; or

H) in advance of its normal construction.

REGULATIONS (Cont'd)

2.1 Undertaking of the Company (Cont'd)

2.1.9 Ownership of Facilities

Title to all facilities provided in accordance with this tariff remains in the Company, its agents or contractors.

2.2 Prohibited Uses

A) The services the Company offers shall not be used for any unlawful purpose or for any use as to which the Customer has not obtained all required governmental approvals, authorizations, licenses, consents and permits.

B) The Company may require applicants for service who intend to use the Company's offerings for resale and/or for shared use to file a letter with the Company confirming that their use of the Company's offerings complies with relevant laws and the regulations, policies, orders, and decisions of the relevant regulatory agency.

C) The Company may require a Customer to immediately shut down its transmission of signals if said transmission is causing interference to others.

D) A Customer, Joint User, or Authorized User may not assign, or transfer in any manner, the service or any rights associated with the service without the written consent of the Company. The Company will permit a Customer to transfer its existing service to another entity if the existing Customer has paid all charges owed to the Company for regulated communications services. Such a transfer will be treated as a disconnection of existing service and installation of new service, and non-recurring installation charges as stated in this tariff will apply.

E) Residential services offered by the Company shall not be used by persons not eligible to subscribe to residential services under the applicable tariffs of the Company's underlying service providers. The Company may require the Customer to provide adequate proof of its compliance with any applicable eligibility criteria.

REGULATIONS (Cont'd)

2.3 Obligations of the Customer

2.3.1 General

The Customer shall be responsible for:

A) the payment of all applicable charges pursuant to this tariff;

B) damage to or loss of the Company's facilities or equipment caused by the acts or omissions of the Customer; or the noncompliance by the Customer, with these regulations; or by fire or theft or other casualty on the Customer Premises, unless caused by the negligence or willful misconduct of the employees or agents of the Company;

C) providing at no charge, as specified from time to time by the Company, any needed personnel, equipment space and power to operate Company facilities and equipment installed on the premises of the Customer, and the level of heating and air conditioning necessary to maintain the proper operating environment on such premises;

D) obtaining, maintaining, and otherwise having full responsibility for all rights-of-way and conduits necessary for installation of fiber optic cable and associated equipment used to provide Communication Services to the Customer from the cable building entrance or property line to the location of the equipment space described in Section 2.3.1(C). Any and all costs associated with obtaining and maintaining the rights-of-way described herein, including the costs of altering the structure to permit installation of the Company-provided facilities, shall be borne entirely by, or may be charged by the Company to, the Customer. The Company may require the Customer to demonstrate its compliance with this section prior to accepting an order for service;

E) providing a safe place to work and complying with all laws and regulations regarding the working conditions on the premises at which Company employees and agents shall be installing or maintaining the Company's facilities and equipment. The Customer may be required to install and maintain Company facilities and equipment within a hazardous area if, in the Company's opinion, injury or damage to the Company's employees or property might result from installation or maintenance by the Company. The Customer shall be responsible for identifying, monitoring, removing and disposing of any hazardous material prior to any construction or installation work;

REGULATIONS (Cont'd)

2.3 Obligations of the Customer (Cont'd)

2.3.1 General (Cont'd)

F) complying with all laws and regulations applicable to, and obtaining all consents, approvals, licenses and permits as may be required with respect to, the location of Company facilities and equipment in any Customer premises or the rights-of-way for which Customer is responsible under Section 2.3.1(D); and granting or obtaining permission for Company agents or employees to enter the premises of the Customer at any time for the purpose of installing, inspecting, maintaining, repairing, or upon termination of service as stated herein, removing the facilities or equipment of the Company;

G) not creating, or allowing to be placed, any liens or other encumbrances on the Company's equipment or facilities; and

H) making Company-provided facilities and equipment available periodically for maintenance purposes at a time agreeable to both the Company and the Customer. No allowance will be made for the period during which service is interrupted for such purposes.

2.3.2 Claims

With respect to any service or facility provided by the Company, Customers shall indemnify, defend and hold harmless the Company from and against all claims, actions, damages, liabilities, costs and expenses for:

A) any loss, destruction or damage to the property of the Company or any third party, or death or injury to persons, including, but not limited to, employees or invitees of either party, to the extent caused by or resulting from the negligent or intentional act or omission of the Customer, its employees, agents, representatives or invitees; or

B) any claim, loss, damage, expense or liability for infringement of any copyright, patent, trade secret, or any proprietary or intellectual property right of any third party, arising from any act or omission by the Customer, including, without limitation, use of the Company's services and facilities in a manner not contemplated by the agreement between the Customer and the Company.

REGULATIONS (Cont'd)

2.4 Customer Equipment and Channels

2.4.1 General

A User may transmit or receive information or signals via the facilities of the Company. The Company's services are designed primarily for the transmission of voice-grade telephonic signals, except as otherwise stated in this tariff. A User may transmit any form of signal that is compatible with the Company's equipment, but the Company does not guarantee that its services will be suitable for purposes other than voice-grade telephonic communication except as specifically stated in this tariff.

2.4.2 Station Equipment

A) Terminal equipment on the User's premises and the electric power consumed by such equipment shall be provided by and maintained at the expense of the User. The User is responsible for the provision of wiring or cable to connect its terminal equipment to the Company Point of Connection.

B) The Customer is responsible for ensuring that Customer-provided equipment connected to Company equipment and facilities is compatible with such equipment and facilities. The magnitude and character of the voltages and currents impressed on Company-provided equipment and wiring by the connection, operation, or maintenance of such equipment and wiring shall be such as not to cause damage to the Company-provided equipment and wiring or injury to the Company's employees or to other persons. Any additional protective equipment required to prevent such damage or injury shall be provided by the Company at the Customer's expense.

REGULATIONS (Cont'd)

2.4 Customer Equipment and Channels (Cont'd)

2.4.3 Interconnection of Facilities

A) Any special interface equipment necessary to achieve compatibility between the facilities and equipment of the Company used for furnishing Communication Services and the channels, facilities, or equipment of others shall be provided at the Customer's expense.

B) Communication Services may be connected to the services or facilities of other communications carriers only when authorized by, and in accordance with, the terms and conditions of the tariffs of the other communications carriers that are applicable to such connections.

C) Facilities furnished under this tariff may be connected to Customer-provided terminal equipment in accordance with the provisions of this tariff. All such terminal equipment shall be registered by the Federal Communications Commission pursuant to Part 68 of Title 47, Code of Federal Regulations; and all User-provided wiring shall be installed and maintained in compliance with those regulations.

D) Users may interconnect communications facilities that are used in whole or in part for interstate communications to services provided under this tariff only to the extent that the user is an "End User" as defined in Section 69.2(m), Title 47, Code of Federal Regulations (1995 edition).

REGULATIONS (Cont'd)

2.4 Customer Equipment and Channels (Cont'd)

2.4.4 Inspections

A) Upon suitable notification to the Customer, and at a reasonable time, the Company or its agent may make such tests and inspections as may be necessary to determine that the Customer is complying with the requirements set forth in Section 2.4.2(B) for the installation, operation, and maintenance of Customer-provided facilities, equipment, and wiring in the connection of Customer-provided facilities and equipment to Company-owned facilities and equipment.

B) If the protective requirements for Customer-provided equipment are not being complied with, the Company or its agents may take such action as it deems necessary to protect its facilities, equipment, and personnel. The Company will notify the Customer promptly if there is any need for further corrective action. Within ten days of receiving this notice, the Customer must take this corrective action and notify the Company of the action taken. If the Customer fails to do this, the Company may take whatever additional action is deemed necessary, including the suspension of service, to protect its facilities, equipment and personnel from harm.

2.5 Payment Arrangements

2.5.1 Payment for Service

The Customer is responsible for the payment of all charges for facilities and services furnished by the Company to the Customer and to all Users authorized by the Customer, regardless of whether those services are used by the Customer itself or are resold to or shared with other persons.

A) Taxes

The Customer is responsible for payment of any sales, use, gross receipts (to be invoiced as a separate line item), gross revenues, excise, access, universal service or other local, state and federal taxes, charges or surcharges (however designated) (excluding taxes on the Company's net income) including the Federal Subscriber Line Charge (SLC) imposed on or based upon the provision, sale or use of Network Services.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont.)

2.5.2 Billing and Collection of Charges

A) Non-recurring charges are due and payable from the Customer within 20 days after receipt of the billing statement, unless otherwise agreed to in advance.

B) The Company shall present invoices for Recurring Charges monthly to the Customer, in advance of the month in which service is provided, and Recurring Charges shall be due and payable 20 days after receipt of the billing statement. When billing is based on Customer usage, charges will be billed monthly for the preceding billing periods.

C) When service does not begin on the first day of the month, or end on the last day of the month, the charge for the fraction of the month in which service was furnished will be calculated on a pro rata basis. For this purpose, every month is considered to have 30 days.

D) Billing of the Customer by the Company will begin on the Service Commencement Date, which is the first day following the date on which the Company notifies the Customer that the service or facility is available for use, except that the Service Commencement Date may be postponed by mutual agreement of the parties, or if the service or facility does not conform to standards set forth in this tariff or the Service Order. Billing accrues through and includes the day that the service, circuit, arrangement or component is discontinued.

E) If any portion of the payment is received by the Company after the date due, or if any portion of the payment is received by the Company in funds that are not immediately available, then a late payment penalty shall be due to the Company. The late payment penalty shall be the portion of the payment not received by the date due, multiplied by a late factor of 1.5% per month.

F) The Customer will be assessed a charge of twenty-five dollars ($25.00) for each check submitted by the Customer to the Company that a financial institution refused to honor.

G) All bills are presumed accurate, and shall be binding on the Customer unless objection is received orally or in writing. In the case of a billing dispute, the Customer may take the following course of action:

1) First, the Customer may request, and the Company will provide, an in-depth review of the disputed amount. (The undisputed portion and subsequent bills must be paid on a timely basis or the service may be subject to disconnection.) Customers with billing inquiries or complaints may reach the Company toll free at (800) XXX-XXXX.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont'd)

2.5.2 Billing and Collection of Charges (Cont'd)

2) Second, if there is still a disagreement about the disputed amount after investigation and review by the Company, the Customer may file an appropriate complaint with the Arizona Public Utilities Commission: The address and phone number of the Commission is:

Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007
(602) 542-4251

H) If service is disconnected by the Company in accordance with Section 2.5.5 following and later restored, restoration of service will be subject to all applicable installation charges.

2.5.3 Advance Payments

To safeguard its interests, the Company may require a Customer to make an advance payment before services and facilities are furnished. The advance payment will not exceed an amount equal to the non-recurring charge(s) and two months' charges for the service or facility. In addition, where special construction is involved, the advance payment may also include an amount equal to the estimated non-recurring charges for the special construction and recurring charges (if any) for a period to be set between the Company and the Customer. The advance payment will be credited to the Customer's initial bill. An advance payment may be required in addition to a deposit.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont'd)

2.5.4 Deposits

A) To safeguard its interests, the Company may require a Customer to make a deposit to be held s a guarantee for the payment of charges. A deposit does not relieve the Customer of the responsibility for the prompt payment of bills on presentation. The deposit will not exceed an amount equal to the estimated charges for two months of service.

B) A deposit may be required in addition to an advance payment.

C) When a service or facility is discontinued, the amount of a deposit, if any, will be applied to the Customer's account and any credit balance remaining will be refunded. Before the service or facility is discontinued, the Company may, at its option, return the deposit or credit it to the Customer's account.

D) Deposits held for more than six months will accrue interest at a rate of 5.6% per annum for residential and business Customers. Interest is credited to the Customer annually or upon termination of service. Interest will not accrue on any deposit after the date on which reasonable effort has been made by the Company to return the deposit to the Customer. Any deposits collected will be maintained in a Arizona bank in compliance with the Commission's rules.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont'd)

2.5.5 Discontinuance of Service

A) Upon nonpayment of any amounts owing to the Company, the Company may suspend service by giving 15 days prior written notice to the Customer. In the event payment is not received within 10 days of the suspension of service, the Company may terminate service without incurring any liability. The Company shall provide a final notice of termination of service 2 days before the proposed discontinuance.

B) Upon violation of any of the other material terms or conditions for furnishing service the Company may, by giving 10 days prior notice in writing to the Customer, discontinue or suspend service without incurring any liability if such violation continues during that period.

C) Service may be discontinued without notice in the event the Customer tampers with equipment furnished or owned by the Company.

D) Upon the Customer's insolvency, assignment for the benefit of creditors, filing for bankruptcy or reorganization, or failing to discharge an involuntary petition within the time permitted by law, the Company may discontinue service with 5 days' written notice if necessary to protect the Company's revenues

E) In the event of unauthorized use of the Company's network, the Company will discontinue service without notice and/or seek legal recourse to recover all costs involved in enforcement of this provision.

F) Upon the Company's discontinuance of service to the Customer under Section 2.5.5(A) or 2.5.5(B), the Company, in addition to all other remedies that may be available to the Company at law or in equity or under any other provision of this tariff, may declare all future monthly and other charges that would have been payable by the Customer during the remainder of the term for which such services would have otherwise been provided to the Customer to be immediately due and payable.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont'd)

2.5.6 Cancellation of Application for Service

A) Applications for service cannot be canceled without the Company's agreement. Where the Company permits a Customer to cancel an application for service prior to the start of service or prior to any special construction, no charges will be imposed except for those specified below.

B) Where, prior to cancellation by the Customer, the Company incurs any expenses in installing the service or in preparing to install the service that it otherwise would not have incurred, a charge equal to the costs incurred by the Company shall apply, but in no case shall this charge exceed the sum of the charge for the minimum period of services ordered, including installation charges, and all charges others levy against the Company that would have been chargeable to the Customer had service commenced.

C) Where the Company incurs any expense in connection with special construction, or where special arrangements of facilities or equipment have begun, before the Company receives a cancellation notice, a charge equal to the costs incurred by the Company applies. In such cases, the charge will be based on such elements as the cost of the equipment, facilities, and material, the cost of installation, engineering, labor, and supervision, general and administrative expense, other disbursements, depreciation, maintenance, taxes, provision for return on investment, and any other costs associated with the special construction or arrangements.

D) The special charges described in Sections 2.5.6(A) through 2.5.6(C) will be calculated and applied on a case-by-case basis.

REGULATIONS (Cont'd)

2.5 Payment Arrangements (Cont'd)

2.5.7 Changes in Service Requested

If the Customer makes or requests material changes in circuit engineering, equipment specifications, service parameters, premises locations, or otherwise materially modifies any provision of the application for service, the Customer's installation fee shall be adjusted accordingly.

2.5.8 Overcharges and Undercharges

A) When a Customer has been overcharged for services because of incorrect application of the rate schedule , inaccurate measuring of services rendered, incorrect calculation of charges or similar reasons, the total overcharge for the period the discrepancy shall be refunded or credited to the Customer.

B) The Company may recover undercharge charges from Customers as a result of incorrect application of the rate schedule, inaccurate measuring of services rendered, incorrect calculation of charges or similar reasons. Unless authorized by the Commission, the Company shall not retroactively bill for undercharges which occurred more than 12 months before the discovery of the error. If the total undercharge is more than 35 percent of the Customer's monthly average monthly bill during the preceding 3 months, the Customer shall be allowed to enter into an installment plan to pay the total retroactive amount.

REGULATIONS (Cont'd)

2.6 Allowances for Interruptions in Service

Interruptions in service that are not due to the negligence of the Customer, or noncompliance with the provisions of this tariff by the Customer, or the operation or malfunction of the facilities, power or equipment provided by the Customer, will be credited to the Customer as set forth in Section 2.6.1 for the part of the service that the interruption affects.

2.6.1 Credit for Interruptions

A) When main service is interrupted for a period of at least 24 hours, the Company, after due notice by the Customer, shall apply the following schedule of allowances except in situations provided for in subsection (2).

1) One-thirtieth of the tariff monthly rate of all services and facilities furnished by the Company rendered inoperative, useless or substantially impaired for each of the first three full 24 hour periods during which the interruption continues after notice by the Customer to the Company if the out-of-service extends beyond a minimum of 24 hours.

2) Two-thirtieths of the tariff monthly rate for each full 24 hour period beyond the first three 24 hour periods. However, in no instance shall the allowance for the out-of-service period exceed the total charges in a billing period for the service and facilities furnished by the Company rendered useless or impaired.

B) When service is interrupted for a period of at least 24 hours due to storms, fires, floods or other conditions beyond the control of the Company, an allowance of one-thirtieth of the tariff monthly rate for all services and facilities furnished by the Company rendered inoperative or substantially impaired shall apply for each full 24 hours during which the interruption continues after notice by the Customer to the Company.

C) The allowance described in this Section shall not be applicable where service is interrupted by the negligence or willful act of the Customer to service or where the Company, pursuant to the terms of the contract for service, suspends or terminates service for non-payment of charges, or for unlawful or improper use of the facilities or service, or for any other reason provided for in the filed and effective tariff.

The preceding Rule applies only when main telephone service to the Rate Demarcation Point is interrupted.

REGULATIONS (Cont'd)

2.7 Use of Customer's Service by Others

2.7.1 Resale and Sharing

Any service provided under this tariff may be resold to or shared with other persons at the option of the Customer, subject to compliance with any applicable laws or Commission regulations governing such resale or sharing. The Customer remains solely responsible for all use of services ordered by it or billed to its telephone number(s) pursuant to this tariff, for payment for such services, for determining who is authorized to use its services, and for notifying the Company of any unauthorized use.

2.7.2 Joint Use Arrangements

Joint use arrangements will be permitted for all services provided under this tariff. From each joint use arrangement, one member will be designated as the Customer responsible for the manner in which the joint use of the service will be allocated. The Company will accept orders to start, rearrange, relocate, or discontinue service only from the designated Customer. Without affecting the Customer's ultimate responsibility for payment of all charges for the service, each Joint User shall be responsible for the payment of the charges billed to it.

REGULATIONS (Cont'd)

2.8 Cancellation of Service

If a Customer cancels a Service Order or terminates services before the completion of the term for any reason whatsoever other than a service interruption (as defined in Section 2.6.1 above), the Customer agrees to pay to the Company termination liability charges, as defined below. These charges shall become due and owing as of the effective date of the cancellation or termination and be payable within the period, set forth in Section 2.5.2.

The Customer's termination liability for cancellation of service shall be equal to:

A) all unpaid Non-Recurring charges and out-of-pocket expenses reasonably expended by the Company to establish service to the Customer; plus

B) any disconnection, early cancellation or termination charges reasonably incurred and paid to third parties by the Company on behalf of the Customer; plus

C) all Recurring Charges specified in the applicable Service Order Tariff for the balance of the then current term; minus

D) a reasonable allowance for costs avoided by the Company as a direct result of the Customer's cancellation.

2.9 Transfers and Assignments

Neither the Company nor the Customer may assign or transfer its rights or duties in connection with the services and facilities provided by the Company without the written consent of the other party, except that the Company may assign its rights and duties:

A) to any subsidiary, parent company or affiliate of the Company; or

B) pursuant to any sale or transfer of substantially all the assets of the Company; or

C) pursuant to any financing, merger or reorganization of the Company.

REGULATIONS (Cont'd)

2.10 Notices and Communications

A) The Customer shall designate on the Service Order an address to which the Company shall mail or deliver all notices and other communications, except that the Customer may also designate a separate address to which the Company's bills for service shall be mailed.

B) The Company shall designate on the Service Order an address to which the Customer shall mail or deliver all notices and other communications, except that Company may designate a separate address on each bill for service to which the Customer shall mail payment on that bill.

C) All notices or other communications required to be given pursuant to this tariff will be in writing. Notices and other communications of either party, and all bills mailed by the Company, shall be presumed to have been delivered to the other party on the third business day following placement of the notice, communication or bill with the U.S. Mail or a private delivery service, prepaid and properly addressed, or when actually received or refused by the addressee, whichever occurs first.

D) The Company or the Customer shall advise the other party of any changes to the addresses designated for notices, other communications or billing, by following the procedures for giving notice set forth herein.

2.11 Incomplete Calls/Wrong Numbers

The Company will not knowingly charge for incomplete calls or wrong numbers. Upon the Customer's request and proper verification, the Company shall promptly adjust and credit the Customer's account for charges or payment for any unanswered call inadvertently billed.

Section 3: APPLICATION OF RATES

3.1 Introduction

The regulations set forth in this section govern the application of rates for services contained in other sections of this tariff.

3.2 Charges Based on Duration of Use

Where charges for a service are specified based on the duration of use, such as the duration of a telephone call, the following rules apply:

A) Calls are measured in durational increments identified for each service. All calls that are fractions of a measurement increment are rounded-up to the next whole unit.

B) Timing on completed calls begins when the call is answered by the called party. Answering is determined by hardware answer supervision in all cases where this signaling is provided by the terminating local carrier and any intermediate carrier(s). Timing for operator service person-to-person calls start with completion of the connection to the person called or an acceptable substitute, or to the PBX station called.

C) Timing terminates on all calls when the calling party hangs up or the Company's network receives an off-hook signal from the terminating carrier.

D) Calls originating in one time period and terminating in another will be billed in proportion to the rates in effect during different segments of the call.

E) All times refer to local time.

APPLICATION OF RATES (Cont'd)

3.3 Rates Based Upon Distance

Where charges for a service are specified based upon distance, the following rules apply:

A) Distance between two points is measured as airline distance between the rate centers of the originating and terminating telephone lines. The rate center is a set of geographic coordinates, as referenced in the Local Exchange Routing Guide issued by Bellcore, associated with each NPA-NXX combination (where NPA is the area code and NXX is the first three digits of a seven-digit telephone number). Where there is no telephone number associated with an access line on the Company's network (such as a dedicated 800 or WATS access line), the Company will apply the rate center of the Customer's main billing telephone number.

B) The airline distance between any two rate centers is determined as follows:

1) Obtain the "V" (vertical) and "H" (horizontal) coordinates for each rate center from the Bellcore Local Exchange Routing guide referenced in Section 3.3(A).

2) Compute the difference between the "V" coordinates of the two rate centers; and the difference between the two "H" coordinates.

3) Square each difference obtained in step (2) above.

4) Add the square of the "V" difference and the square of the "H" difference obtained in step (3) above.

5) Divide the sum of the squares by 10. Round to the next higher whole number if any fraction is obtained.

6) Obtain the square root of the whole number result obtained above. Round to the next higher whole number if any fraction is obtained. This is the airline mileage.

7) FORMULA =

$$\sqrt{\frac{(V1 - V2)^2 + (H1 - H2)^2}{10}}$$

Section 4: SERVICE AREAS

4.1 Local Exchange Service Areas

The Company will provide local exchange services on a resale basis in those areas authorized by the Commission for provision of competitive local services in Arizona.

Section 5: DESCRIPTION OF SERVICES

5.1 Basic Exchange Service

Basic Exchange Service provide a business Customer with a connection to the Company's switching network which enables the Customer to:

a) receive calls from other stations on the public switched telephone network;
b) access the Company's local calling service;
c) access the Company's operators and business office for service related assistance; access toll-free telecommunications service such as 800 NPA; and access 911 service for emergency calling; and
d) access the service of providers of interexchange service. A Customer may presubscribe to such provider's service to originate calls on a direct dialed basis or to receive 800 service from such provider, or may access a provider on an ad hoc basis by dialing the provider's Carrier Identification Code (10XXX).

Basic Exchange Service is provided via one or more channels terminated at the Customer's premises. Each Basic Exchange Service channel corresponds to one or more analog, voice-grade telephonic communications channels that can be used to place or receive one call at a time.

Calls to points within the local exchange area are charged on the basis of the length of completed calls originating from the Customer's service in addition to a base monthly charge.

DESCRIPTION OF SERVICES (Cont'd)

5.1 Basic Exchange Service (Cont'd)

5.1.1 Application of Rates

A) Business rates apply to service furnished:

1) In office buildings, stores, factories and all other places of a business nature;

2) In hotels, apartment houses, clubs and boarding and rooming houses except when service is within the Customer's domestic establishment and no business listings are provided; colleges, hospitals and other institutions; and in churches except when service is provided to an individual of the clergy for personal use only and business service is already established for the church at the same location;

3) At any location when the listing or public advertising indicates a business or a profession;

4) At any location where the service includes an extension which is at a location where business rates apply unless the extension is restricted to incoming calls;

5) At any location where the Customer resells or shares exchange service;

B) The use of business service is restricted to the Customer, agents and representatives of the Customer, and joint users.

DESCRIPTION OF SERVICES (Cont'd)

5.1 Basic Exchange Service (Cont'd)

5.1.2 Basic Exchange Service Options

The following Basic Exchange Service Options are offered:

Basic Business Line Service
Key Line Service
Trunk Service

All Basic Exchange Service may be connected to Customer-provided terminal equipment such as station sets, key systems, PBX systems, or facsimile machines. Service may be arranged for two-way calling, inward calling only or outward calling only.

Connection charges apply to all service on a one-time basis unless waived pursuant to this tariff.

Unless otherwise stated in this tariff, all Business Exchange Services include:

1. Usage Charges
2. Monthly Recurring Charges
3. Nonrecurring Charges

Optional rate elements may also apply as specified in this tariff.

DESCRIPTION OF SERVICES (Cont'd)

5.1 Basic Exchange Service (Cont'd)

5.1.3 Rates

1) Usage Charges, per minute:

	Initial Minute	Ea. Add'l. Minute
Day Rate Period	$0.25	$0.25
Evening Rate Period	$0.20	$0.20
Night/Weekend/Holiday Rate Period	$0.15	$0.15

2) Nonrecurring and Recurring Charges

	Business
Nonrecurring Connection Charge:	$125.00
Monthly Recurring Charges:	$95.00

DESCRIPTION OF SERVICES (Cont'd)

5.1 Basic Exchange Service (Cont'd)

5.1.4 Trunk Service

[Reserved for Future Use]

5.2 Directory Listings

A single main listing is provided free of charge for each customer of record. No charge applies to nonpublished service. Additional listings are billed based upon the charges of underlying carriers.

5.3 Blocking Service

[Reserved for Future Use]

Section 6: SPECIAL ARRANGEMENTS

6.1 Individual Case Basis (ICB) Arrangements

Arrangements will be developed on a case-by-case basis in response to a bona fide request from a Customer or prospective Customer to develop a competitive bid for a service offered under this tariff. Rates quoted in response to such competitive requests may be different than those specified for such services in this tariff. ICB rates will be offered to the Customer in writing and on a nondiscriminatory basis. All ICB Arrangements shall be filed with the Commission in compliance with applicable rules and regulations.

ATTACHMENT C

RESALE AGREEMENT
(SEE APPLICATION)

ATTACHMENT D

NETWORK DESCRIPTION
(NOT APPLICABLE)

ATTACHMENT E

FINANCIAL INFORMATION
FOR
CONCERT COMMUNICATIONS SALES LLC

Concert Communications Sales LLC
Balance Sheet
1999 Calendar Year to Date

ASSETS	
Current assets	
Cash at Bank & in Hand	5000
Accounts Receivable	0
Third Party Debtors	0
Intragroup Investments	0
Total current assets	5000
Fixed assets	
Intangible assets	0
Land, Buildings, Plant & Equip	0
Investments	0
Total fixed assets	0
Other assets	0
Total assets	5000
LIABILITIES	
Current liabilities	
Third Party Payables	0
Intragroup Payables	0
Short Term Loans	0
Other Short Term Borrowings	0
Total current liabilities	0
Long term loans and borrowings	
Third Party LT Loans	0
Intragroup Loans	0
Total long term loans and borrowings	0
EQUITY	
Shareholder equity	
Capital Stock	5000
Additional Paid in Capital	0
Retained Earnings	0
Total capital	5000
Total liability and equity	5000

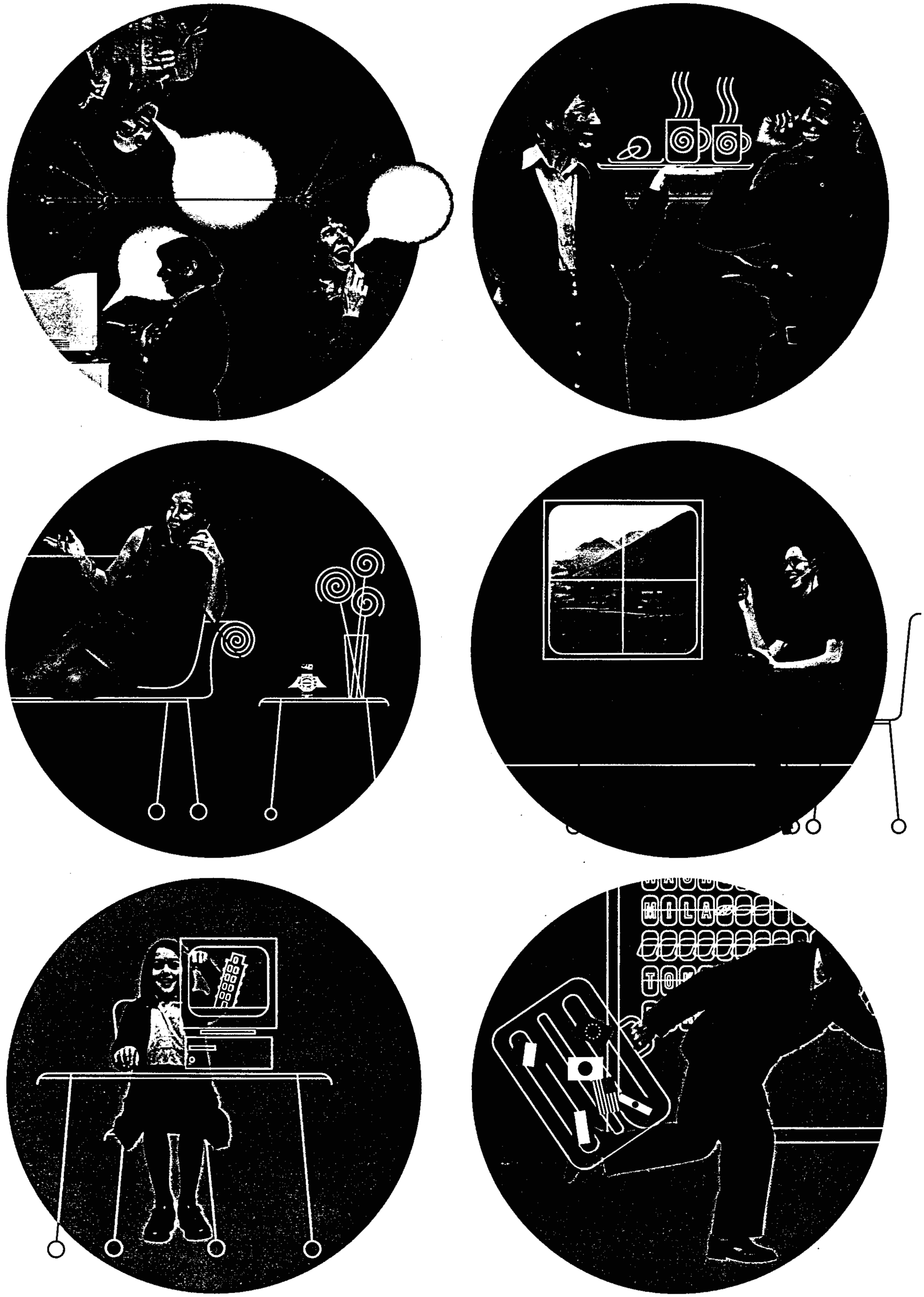
Concert Communications Sales LLC
Profit And Loss Account
1999 Calendar Year to Date

REVENUE	
Third Party	0
Intra-group	0
Total operating income	0
EXPENSES	
Staff Costs	0
Repairs and Maintenance	0
Rents	0
Depreciation	0
Amortization-intangible Assets	0
Payments to Telecom Operators	0
Advertising	0
Intragroup Expenditures	0
Other Deductions	0
Total operating expenses	0
Miscellaneous Income/Expense	
Interest Payable	0
Interest Income	0
Tax Expense	0
Other Gain/Loss	0
Total other income	0
Net income/<loss>	0

Attachment F

Financial Information
for
British Telecommunications PLC

British Telecommunications plc 1998 Annual Report (20-F)
Key Figures from Annual Report in US $$
"Nine Months Results to December 31, 1998" Press Release
Key Figures from Press Release in US $$



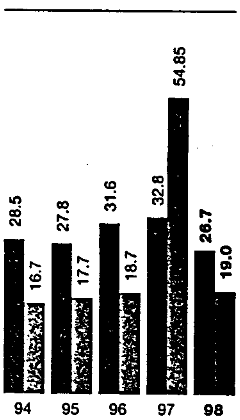
Annual report and accounts 1998

BT

Contents

- **Ten per cent growth in demand for BT's products and services**
- **Prices reduced by over £750 million in the year**
- **£1.5 billion invested in strategic alliances and joint ventures in Europe**
- **Capital expenditure rose to over £3.0 billion**
- **6.4 per cent adjusted increase in ordinary dividends per share**
- **BT incurred £510 million windfall tax and received £238 million merger termination fee, net of expenses**

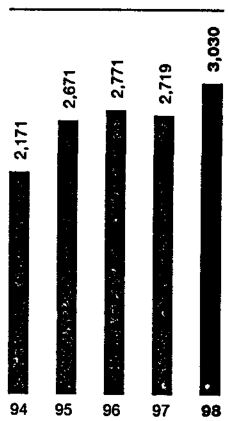
Earnings & dividends per share (pence)



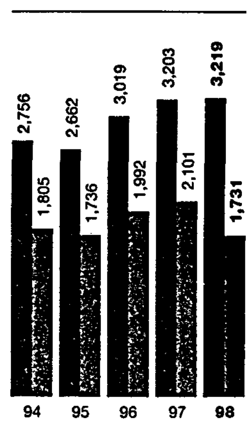
Earnings per share

Dividends per share

Capital expenditure (£m)



Profit before and after tax (£m)



Profit before tax

Profit after tax

The 1997 dividends per share figure included a special dividend of 35 pence per share.

Chairman's statement

The 1998 financial year proved to be a very important chapter in the BT story, even if not quite in the way we anticipated 12 months ago.

This time last year, we expected that there was a good chance that our prospective merger with MCI Communications Corporation would be completed by the end of the calendar year. In the event, of course, this did not happen. WorldCom tabled a considerably higher bid for MCI and we did not feel that it would be in shareholders' best interests to match it.

In our view, the preferable course was to accept the offer WorldCom made for our 20 per cent holding in MCI. On completion of the MCI/WorldCom merger, BT will receive around US$7 billion (more than £4 billion). This, added to the break-up fee and expenses, represents over US$54 per share for a holding we acquired for just over US$32 per share in 1994. As I write, the MCI/WorldCom merger is awaiting regulatory clearance in the USA and Europe.

Nor has the success of Concert Communications Services, our joint venture with MCI, been compromised. Indeed, Concert has continued to lead the world in providing global managed network services to multinational customers. MCI WorldCom will, for a period, have non-exclusive rights to distribute Concert products in the USA. Beyond that, we shall ensure that enduring distribution arrangements are put in place for the longer term.

In other important respects, this has been a good year for your company – both in the UK and in other markets around the world.

Turnover has grown by 4.7 per cent and we have seen strong growth in demand. Customers have benefited from sound quality of service, price cuts worth over £750 million in the year, and a range of new and exciting services. Our Internet-related business is growing fast and we are seeing considerable demand for second lines and ISDN connections. We have also announced a major upgrade to our broadband network to match the ever-increasing volumes of data we are required to carry.

Earnings per share were 26.7 pence and I am pleased to report a final dividend for the year of 11.45 pence per share, which brings the total dividend for the year to 19 pence per share, which is as forecast. This represents an increase of 6.4 per cent on last year, adjusted to take account of the special dividend that we paid in September 1997.

Relations with the new Government have been good. Notwithstanding the so-called "Windfall Tax", which we did not and do not believe was appropriate to BT, the Government's interest in the social and economic benefits that information technology can bring is clear and undiminished. We are proud to support the Government's New Deal welfare-to-work initiative, and have been a key player in developing the "national grid for learning" in the UK.

Outside the UK, liberalisation has been gathering momentum. The World Trade Organisation is committed to opening telecommunications markets; and, in Europe, give or take the odd derogation, there has been full competition in the market since 1 January 1998. BT has now established a presence throughout the European Union, and we are engaged in turning long-awaited opportunities into action, across the world.

Our capacity to address such opportunities and to meet the challenges of change depends to a great extent on the skills and commitment of our employees and I thank all BT people for the continued dedication which they have shown to the company over the year.

In a word, we have the right people, the right strategy and the right positioning for success. And we aim to continue to translate that strategy into long-term shareholder value.

I also wish to pay tribute to those directors who retired from the Board during the year, Birgit Breuel, Yve Newbold, Bert Roberts Jnr, Dr Alan Rudge and Gerald Taylor, each of whom made a much appreciated and distinctive contribution to the company's progress during their term of office.

We are pleased to welcome our new non-executive directors, Helen Alexander and Neville Isdell, to our Board. We also welcome Sir John Weston, who will join the Board in the autumn.

In a break with tradition, I would like to close this Chairman's statement on a personal note. I announced earlier this year that, with effect from 31 July, I will become part-time Chairman, having been fortunate enough to serve as your company's full-time, executive Chairman for over ten years.

BT now has a strong and experienced senior management team in place, under the leadership of Chief Executive, Sir Peter Bonfield. There is no longer a need for two full-time executives at the helm.

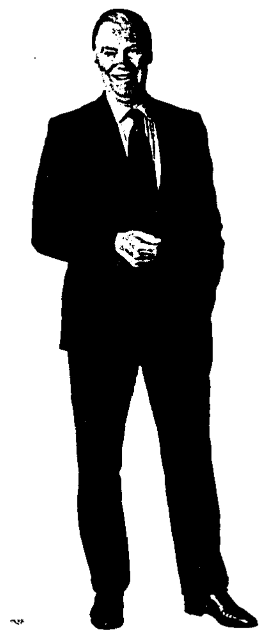
That said, I shall continue to play a full part in the life of the company and I can assure you that my personal commitment to BT and to the industry is undiminished.

Financial highlights

FOR THE YEAR ENDED 31 MARCH 1998

	1998	1997	1996
Turnover	**£15,640m**	£14,935m	£14,446m
MCI break-up fee net of expenses	**£238m**	–	–
Operating profit	**£3,657m**	£3,245m	£3,100m
Profit before taxation	**£3,219m**	£3,203m	£3,019m
Windfall tax charge	**£510m**	–	–
Profit after taxation	**£1,731m**	£2,101m	£1,992m
Earnings per share	**26.7p**	32.8p	31.6p
Earnings per share before exceptional items	**31.7p**	32.8p	31.6p
Dividends per share – ordinary	**19.00p**	19.85p	18.70p
– special	**–**	35.00p	–
Net cash flow from operating activities	**£6,076m**	£6,192m	£5,834m
Capital expenditure	**£3,030m**	£2,719m	£2,771m

Iain Vallance



Sir Iain Vallance
Chairman
26 MAY 1998

An interview with Chief Executive, Sir Peter Bonfield

A lot has been said about BT's strategy over the past year. How would you describe it?

Quite simply, our strategy is to seize the opportunities for growth in the communications market worldwide.

In practice, that means continuing to stimulate and meet growing demand in the UK; moving into new growth markets such as the rest of Europe; and maintaining our world-leading position in serving the needs of multinational companies through Concert Communications Services. Across all of those markets, we will also look to take advantage of the explosive growth in advanced services such as mobility, data, multimedia and the Internet.

Communications technologies are the engines of change and growth in the world's economy at the moment – and that gives us a wealth of opportunities. Our task is to seize those opportunities, deliver excellent value for shareholders and, in doing so, realise our vision of becoming the most successful worldwide telecommunications group.

There's a lot of competition for these opportunities. How can BT make sure it makes the most of them?

BT is uniquely well-positioned. We have proved that we can please a wide range of customers. We are highly experienced in competitive situations. We have significant financial strength and we are already an established global player, with operations in all major markets around the world.

Can there be any growth left in the UK market after over a decade of competition?

Yes there is – even though in the last five years we've steadily increased revenues and call volumes. Usage of residential lines continues to increase. It now stands at more than 11 minutes per line per day, a rise of more than two minutes since 1994. Remember also that UK usage is still only 60 per cent of that in the USA – which shows that there is still considerable room for growth. We're now stimulating the market for phone calls with marketing campaigns and, at the same time, developing a whole new market in advanced services.

What are you doing to take the opportunities for growth in mobility, data and multimedia?

We've taken several steps this year to make sure that mobility is a top priority for the company, and that means all services which help people communicate free from location restraints – including services such as calling cards and messaging as well as mobile telephones. Cellnet – in which we have a 60 per cent stake – has a reputation for innovation. It was the first operator to enable customers to send and receive faxes and data using mobile phones. And, in the last year, it has launched an Internet-linked service, Cellnet Genie, that delivers information such as news, share prices, football scores or job opportunities to your mobile phone. In mainland Europe, we are pioneering the merging of mobile and fixed line services, with one network, one bill and, ultimately, one handset.

The market for data communications is experiencing explosive growth and is set to overtake voice traffic in the next five years. This trend, known as the "datawave", is being driven by developments such as the spectacular growth of the Internet. Already, BT's Internet business is growing faster than 100 per cent per annum. In the UK, we've announced that we will be making a £1.1 billion investment in our networks to meet the demand for data communications and Internet services. In Europe, data revenues are growing very strongly, and Concert offers global companies a choice of data services delivered consistently and reliably around the world.

In the UK, we are also helping the next generation to use data networks by connecting schools to the Net at affordable prices. We're also on the brink of a multimedia innovation that will transform the domestic communications market: digital interactive television. Subject to the necessary regulatory clearances, our joint venture, British Interactive Broadcasting, will enable people to do some shopping, check their bank statement, have an on-line tutorial or buy a CD, all from their homes. They will be able to receive and respond to information via the TV set using a combination of satellite transmission and the telecommunications network.

How can BT give sufficient attention to both UK and global activities?

We have structured the company to ensure that we can pursue these various opportunities with clarity and determination. I have established a small team to drive group strategy and take an overview of BT's operations in the UK and internationally. BT UK, under Bill Cockburn, is focused on the domestic UK market, with the objectives of achieving sustained growth from the core telephony business and maximising value in growth markets. Meanwhile, BT Global, under Alfred Mockett, is concentrating on investing in, and developing, new markets around the world. The team which handles mobility and multimedia opportunities reports directly into me and provides a strategic focus on two of the major worldwide opportunities.

Europe is providing many growth opportunities at the moment – how would you describe BT's operations there?

"Fast-moving" is the best description. Europe is a huge opportunity – a market which has been open to competition since 1 January 1998. We have joint ventures operating in every major country and they have already won 11 licences for fixed or mobile services. Taken together, our European alliances are expected to have annual revenues of £2.5 billion this year, a rise of around 50 per cent. They expect to recruit 4,000 people in 1998. Our partners are companies with local influence and established infrastructures. They include financial services providers, media conglomerates, transport companies and retailers, and they all supplement BT's technology skills and competitive experience with a deep understanding of their own national markets.

Beyond the UK and Europe, what have been the other highlights of the year?

First, it's been another good year for Concert Communications Services, the joint venture we have operated with MCI since 1994. Concert leads the market for global services used by the top multinationals. It is growing at almost 50 per cent per year, serves 40 per cent of the Fortune 500 top companies and was rated number one global outsourcer in the Yankee Group's survey of customers. Other highlights were winning fixed and mobile licences in Singapore – along with partners, including NTT of Japan; signing a Memorandum of Understanding to co-operate with China Telecom; and announcing that we would be the first European communications company to contribute to a working group including top IT names like Compaq and Microsoft to look at setting standards for new high-speed services.

How do you assess the impact of not merging with MCI?

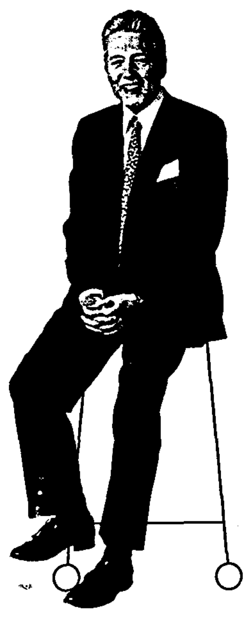
I still believe that merging on the terms which we negotiated would have been a good result for BT and its shareholders, but we decided not to go ahead at a price which would have been uneconomic for BT. Had we chosen to match the rival bid, we believe it would have been against shareholders' interests. As it was, we took action to secure a good return, maintained our services to US customers through Concert Communications Services and kept open our options to pursue new growth opportunities.

So what now in the USA?

We now have two objectives. The first is to make sure we have the most comprehensive possible sales, service and support for customers of Concert Communications Services in the USA. Second – and this is a separate issue – there may still be investment opportunities in growth areas of the US domestic market. It is a valuable market, with over one-third of the world's telecoms revenues. We are looking at all the options but we will only take an opportunity if it will deliver real value for shareholders.

In overall terms, what's your vision for BT?

To be a company that delights customers and shareholders, and is a good place to work. To seize growth opportunities around the world. To help people use communications technology to improve their education, their health, their business. To enable people to use communications to expand their horizons and to get more out of their lives, as employees, as consumers and as citizens.



Sir Peter Bonfield CBE
Chief Executive
26 MAY 1998

Business review

BT is one of the world's leading suppliers of fixed and mobile communications services. In the UK, we support around 27 million customer lines and, through our 60 per cent stake in Cellnet, over three million mobile connections. Our main services are local, national and international calls (with direct dialling to over 230 countries worldwide); and supplying telephone lines, equipment and private circuits for homes and businesses.

Outside the UK, our strategy is to expand in chosen markets by developing a series of alliances and joint venture partnerships, and we have put in place one of the most comprehensive global networks of any operator. In Concert Communications Services, we have the world's leading supplier of global network solutions to multinational customers.

We are also at the forefront of the development and marketing of a comprehensive range of advanced data and interactive multimedia solutions and technologies of the future.

As businesses increasingly operate internationally, and as more and more people are travelling and working abroad, so the demand for international communications grows. In the past ten years, international communications – phone, fax, video, data – have more than doubled from 33 billion minutes a year to 68 billion minutes.

This growth in demand has been complemented by the liberalisation of telecommunications markets around the world. At the beginning of the 1990s, only about 20 per cent of the world's total telecommunications market was open to competition; by the end of the decade, only about ten per cent will *not* be.

We currently have three target geographies – North America, Europe and Asia-Pacific – and our strategy is to work with local partners. We now have a number of key partnerships around the world and significant investment in international services.

The USA

In the USA, the principal news in the year was the announcement by MCI Communications Corporation on 10 November 1997 that it was recommending a merger with WorldCom to form MCI WorldCom and that WorldCom would be buying BT's stake in MCI.
The WorldCom bid for MCI was considerably higher than that made by BT and the BT Board did not feel it would be in shareholders' interests to raise its offer.

WorldCom has agreed to pay BT around US$7 billion (more than £4 billion) for our share in MCI. This, added to the US$465 million break-up fee and partial reimbursement of expenses, represents over US$54 per share for a holding that was acquired for US$32 per share in 1994. At the date of this report, the proposed MCI/WorldCom merger was awaiting the necessary regulatory clearances.

BT is now assessing the options open to the group. We remain committed to securing appropriate distribution channels for the delivery of services to our US customers.

Concert

Through the highly successful Concert Communications Services, BT will continue to deliver global networking solutions to our multinational customers, more than 40 per cent of whom are headquartered in the USA. Concert already has 3,800 major corporate customers in more than 50 countries.

Around 40 per cent of the Fortune Global 500 companies use Concert services, and around 60 per cent of Concert's customers subscribe to more than one service.

Concert has committed future revenues of almost US$1 billion per annum and has been rated the best-positioned global networking outsourcer and top global provider of international voice services in a survey by the Yankee Group, a leading telecommunications consulting firm.

MCI WorldCom will continue to distribute Concert services in the USA, on a non-exclusive basis, for a limited period of time.

Europe

In mainland Europe, it is a time of great opportunity for BT. By 1 January 1998, the major European Union countries had to open their telecoms markets to full competition. Some of Europe's business and mobile markets have been open for some time but now, with just a few exceptions, there is open competition for the business of 300 million residential customers across the continent, in a market that will be worth an estimated £140 billion a year by 2001.

BT's major European alliances

- *France* Cegetel
- *Germany* Viag Interkom
- *Italy* Albacom
- *Netherlands* Telfort
- *Spain* Airtel
- *Sweden* Telenordia
- *Switzerland* Sunrise

Because we believe that in international business it is essential to think global but act local, we have already moved fast in many countries to establish ourselves, with our partners, as the major alternative to the incumbent operators.

We have built partnerships or established distributorships in each of the markets that are opening up. Typically, our partners have not been other telecoms operators but local companies with strong reputations and experience which complements our own. In Germany, our main partner is Viag, a major energy and industrial group with whom we have formed Viag Interkom; in France, we have teamed up with a group headed by Vivendi to form Cegetel. In Italy, we have partnered with energy group ENI, media organisation Mediaset, and Banca Nazionale del Lavoro to form Albacom; and in the Netherlands we have formed Telfort in partnership with the state railway company Nederlandse Spoorwegen.

In total, our ventures cover 85 per cent of the EU market. We have already invested almost £2 billion in European ventures and expect to make further substantial investments over the next few years.

In Germany, France, Italy, the Netherlands, Switzerland, Ireland and Sweden we, alone or in partnership, already have licences to run fixed line services, and we will benefit from mobile network licences in Germany, France, the Netherlands, and Spain too. In other countries, bidding for licences is still in progress.

In February 1998, it was announced that Telfort had won one of two new national Dutch mobile licences, to go with the fixed line licence it already holds. Initial coverage, which will start at the end of this year, will be confined to metropolitan areas, but we aim for 99 per cent national geographic coverage by the end of 1999.

BT's new joint venture in Switzerland, Newtelco, won no fewer than 25,000 customers in the first month when its Sunrise service opened for business in January 1998. Jointly owned by BT, TeleDanmark, Swiss railways, Union Bank of Switzerland and the retail giant Migros, Sunrise means that, for the first time, Swiss customers have a choice of telecoms supplier for some of the calls they make outside Switzerland.

In September 1997, we completed our deal to take a 26 per cent stake in Cegetel, the new French telecommunications group which, in 1997, had revenues of over £1 billion. Cegetel will provide the full range of telecommunications services – both fixed and mobile – and is already positioned to be the main competitor to France Telecom. Cegetel's fixed network service was launched at the beginning of February 1998 and, in the first two months, attracted around 140,000 customers. It also holds a majority stake in SFR, the number two mobile operator in France, with more than 2.5 million customers and a market share of approximately 40 per cent of new subscribers.

In Spain, our fixed line operator – BT Telecomunicaciones – has the second largest data network and has trebled its revenues since it was set up in 1994. And Airtel, in which BT has a 16 per cent stake, has more than a million mobile customers and 40 per cent of the Spanish digital market.

In December 1997, BT and the Electricity Supply Board in the Republic of Ireland announced that they had reached agreement in principle to form a joint venture to offer communications services in Ireland, one of western Europe's fastest growing economies.

Asia-Pacific

The Asia-Pacific telecommunications market is one of the fastest growing in the world, and BT already has offices or ventures in Japan, China, Taiwan, South Korea, Malaysia, Singapore, Indonesia, Thailand, the Philippines, Australia, New Zealand and India.

In April 1997, BT•NIS (a joint venture between BT and Marubeni) began trading in Japan as a Concert distributor, Internet service provider and supplier of advanced voice and data services. In February 1998, BT•NIS announced its intention to apply for a licence to take advantage of the newly-liberalised telecoms market in Japan.

China is one of the most exciting markets in the region and, potentially, one of the largest in the world. For the last few years that market has grown at a rate of about 20 million lines a year.

In March 1998, BT took a further step into this market by signing a Memorandum of Understanding (MoU) with the state-owned operator, China Telecom. Although the MoU does not involve investment, it will foster co-operation and understanding between the two companies, and enable us to swap technology and examine mutually beneficial business opportunities.

And, in Singapore, BT is part of a consortium which has recently won a fixed and a mobile licence, enabling it to compete with Singapore Telecom from April 2000.

In the UK

BT's UK network is one of the most advanced in the world, and we have invested nearly £30 billion since we were privatised in 1984. Investment at this level ensures that we can continue to deliver reliable and innovative services to all our customers.

There are more than 3.5 million kilometres of optical fibre in the UK network, 7,500 local exchanges and 69 main switching units.

Business communications

One of the key growth areas for BT has been the increase in business lines, mainly due to new ISDN lines. These are now also being used in the home for Internet access.

Among our larger business customers, there is a growing realisation that they can gain significant competitive advantage by using a single supplier to provide them with integrated communications solutions. BT's Syncordia Solutions is at the forefront of this rapidly growing outsourcing market.

And, as the value of transactions in the world's capital markets is expected to continue to increase rapidly, BT – through its systems integration business Syntegra – has become the global market leader in the design and provision of dealing rooms and trading systems. Syntegra has a global market share of 25 per cent of dealing boards and our systems are used by 45,000 financial traders around the world.

Currently, only a third of small and medium-sized businesses use electronic mail, compared with two-thirds of large firms; and only a quarter use the Internet, compared with around half of large corporations. But the market for information technology and communications in this sector is expected to grow by around 50 per cent in the next five years and we believe that this is a market of huge importance to BT.

BT and the Confederation of British Industry are jointly sponsoring the Information Society Forum, which focuses in particular on the impact of new technology on the small business market. We are also working closely with the British Chambers of Commerce, offering Internet access to all their members. And, in South Wales, BT and the European Commission are financing the work of the world's first chair of electronic commerce at Cardiff University. The University has become the hub of the South Wales "virtual business community", in which a number of small businesses are discovering how technologies such as the Internet and videoconferencing can help them find new ways to market themselves, cut down on travel costs, get closer to their customers and suppliers, and trade internationally.

We have also teamed up with Comet, a leading UK retailer of consumer electronic equipment, to test a new concept in retailing. Called *I.T. Works*, this is a store dedicated to the information technology and communications needs of smaller businesses. Personal computers, software and peripherals are on sale along with the latest in communications technology. If the trial proves successful, *I.T. Works* stores will be opened across the UK.

Quality of service

BT places great emphasis on quality of service and our customers' satisfaction with the service we provide. We conduct over 22,000 interviews every month with our residential customers and with the general public, as well as over 10,000 interviews with our business customers.

For the period October 1997 to March 1998, 83 per cent of our residential customers and 88 per cent of our business customers said they were satisfied with the services we provide. Satisfaction with inland calls was 95 per cent.

Some residential customers were badly hit by the weather problems in late December and early January – the number of faults cleared in nine working hours or by successful appointment dropped to just under 80 per cent. However, for our business customers, the number of faults cleared in five working hours or by successful appointment increased to over 89 per cent.

Ninety two per cent of customers are satisfied with our Operator Assistance Service (100) and 90 per cent are satisfied with our Directory Assistance Service (192).

BT is investing £84 million in new technology to improve the standards of its directory enquiries service, including an expansion of the database so that, by 2000, it will also be able to provide the numbers for mobile phones, radiopagers and fax machines.

Network reliability remains consistently high – less than one call in 200 fails because of the network, and a customer is unlikely to experience a network fault more than once every seven years on any one of his or her lines.

The number of BT payphones in the UK has grown to just over 138,000.

Regulation

Since August 1997, BT has operated under a price cap formula – agreed with Oftel – of the Retail Price Index (RPI) minus 4.5, covering the services used by those residential customers whose bill size was in the lowest 80 per cent. Under the formula, the price cap applies to less than 20 per cent of BT's total revenues, in contrast to the previous formula of RPI minus 7.5 which ran for the four years until the end of July 1997 and applied to about 50 per cent of revenues.

In March 1998, Oftel instigated a Monopolies and Mergers Commission (MMC) reference on the issue of the pricing of calls made to mobile phones. The enquiry is still underway and will report to Oftel in early September. BT believes that the prices of its services reflect the competitive nature of the UK market and are fully justified. However, we acknowledge the objective approach that an MMC referral will bring and we are co-operating fully with the MMC's investigation.

We are making constructive progress in obtaining regulatory approval for the British Interactive Broadcasting venture, which we are seeking to launch in conjunction with BSkyB, Matsushita and Midland Bank. Scheduled to be launched later in 1998, it will provide a range of services, including home shopping, home banking, home education and information services, as well as Internet, e-mail access and computer games, through a television set-top box.

Internet

The Internet is a key market for BT – our Internet business is currently growing faster than 100 per cent per annum and BT Internet is one of the largest UK Internet service providers.

In March 1998, United News & Media joined BT and News International as an equal partner in LineOne, the Internet-based information and entertainment service for residential customers. LineOne brings customers news, sport, entertainment, business information and home shopping and is the only UK-focused on-line service of its kind.

For businesses, BT WebWorld is a quick, easy and cost-effective web hosting service for creating and operating Internet sites. BT WebWorld offers a full range of web hosting functions, together with web site design packages. Customer support is available seven days a week by e-mail, fax or telephone. Features include high availability systems, regular back-ups and high capacity connections to the Internet.

In addition to the Internet, private corporate intranets have emerged as a source of new business. For example, BT Intranet Complete is a "ready-to-go" solution for companies keen to get started on their own intranet. And BT Intranet Builder offers a "one-stop-shop" for companies wishing to develop their own intranets, providing a comprehensive range of the best components and support services.

Multimedia

In the last 12 months, BT has stepped up its research into, and trials of, interactive multimedia services. Multimedia embraces the Internet, interactive television, and video and audio material delivered over networks to the home or office.

Multimedia is already growing fast, with 10 million e-mails sent each day in the UK and 30 new web pages set up on the Internet every minute. Around five per cent of local call traffic carried by BT is now Internet-related.

Multimedia's popularity is set to increase rapidly. BT trials show that 60 per cent of people would prefer their television service to feature interactivity and the ability to call up videos on demand.

The network

Multimedia's uptake will depend on the capacity of networks to deliver its material and to provide return channels through which consumers can respond to what is broadcast or distributed. BT is therefore working to provide the best possible networks, while keeping costs within affordable limits.

During the year, we announced that we would spend an additional £300 million on upgrading our network to enable it to carry more data at faster speeds. Such an upgrade will help the network support new services such as Home Highway. Home Highway is a new digital communications service that will transform a customer's existing home telephone line into a high-speed Internet and multimedia connection.

Much of our current network investment is focused on the ways that technology can make our existing network investment carry all the latest services by – for example – delivering video services over the existing copper network. This will enable us to provide new services at the most affordable price.

BT is carrying out trials of ADSL (asymmetric digital subscriber loop) technology, which uses compression techniques to increase the capacity of a phone line 30-fold, giving high-speed Internet access, TV-quality video and CD-quality audio.

Variants on this theme are also in development, including the highly economical DSL Lite and the more expensive VDSL (very high-speed digital subscriber loop).

In March 1998, it was announced that BT will be working with Microsoft subsidiary WebTV Networks in a trial of the WebTV service, for which BT will be the Internet service provider.

Mobility solutions

BT is also enhancing and sharpening its focus on the mobile telecommunications market, expanding the way it has traditionally thought of customers' mobility requirements.

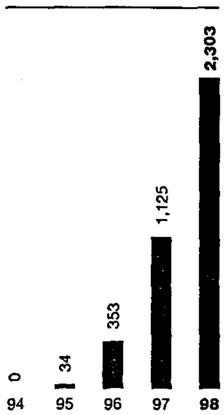
Analysts predict that, within five years, the mobile communications market will account for 30 per cent of all telecommunications revenues, with some 12 to 14 million people in the UK having a mobile phone, compared with nine million today.

Cellnet

BT has a 60 per cent stake in Cellnet, the mobile telecommunications network operator, and – through BT Mobile – offers customers a range of integrated and innovative mobility solutions, enabling them to stay in touch wherever they are.

Cellnet has more than three million customers, the vast majority of whom are connected to the digital GSM network.

Number of Cellnet's digital connections (thousands)



Cellnet was the first UK network to offer a full, two-way digital fax and data service. In effect, a fax number is assigned to an individual rather than a machine. Mobile phone users can now receive and send data securely while on the move in many of the countries with which Cellnet has "roaming" agreements.

September 1997 saw the launch of Cellnet Genie, a world first and one of the UK's most comprehensive free information sources on the Internet. The Genie website brings together the very latest information on news and current affairs, sport, finance, entertainment, travel and careers on one web site. Customers accessing the site can ask for information to be delivered to their mobile phone via text messages or to an e-mail address.

Cellnet plans to launch a radio-on-demand service, allowing people to access personalised news and sports voice reports – beginning with football – at the touch of a button on a Cellnet digital phone.

Card Services

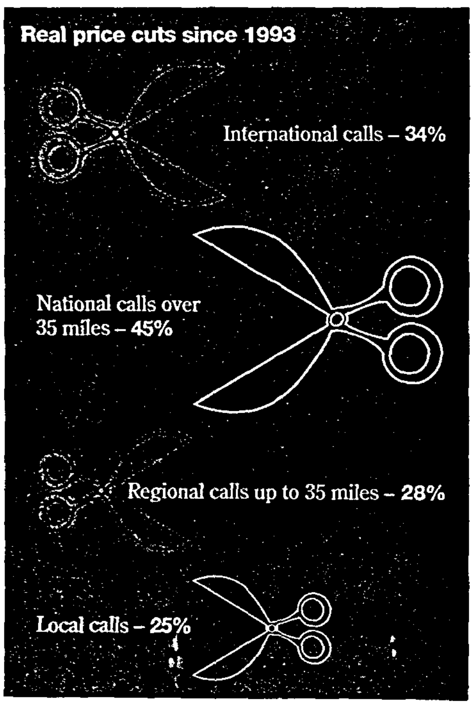
BT's Card Services have developed and launched Concert Card, BT's first truly international calling card for the global marketplace. Launched initially in three European markets in association with our joint venture partners in Italy and Germany, Concert Card combines local tailoring with BT's global capacity to offer a seamless service to international customers outside of the UK. It is positioned specifically to appeal to business travellers from abroad who have a need to call internationally.

Pricing

Since December 1993, BT has cut call prices by more than £2 billion.

At the same time, we have introduced a wide range of flexible optional discount schemes tailored to suit the needs of all our business and residential customers.

BT has a minimum call charge of 5p at basic rates – 3.8p with PremierLine and Friends & Family discounts.



The biggest reduction in the year came in May 1997 when BT cut the price of national daytime calls by ten per cent. At the same time, regional daytime calls were cut by 3.8 per cent.

In September 1997, the pricing structure of BT payphones was simplified. The 10p minimum fee remains unchanged and customers now receive up to 50 per cent more time for their money on UK long-distance daytime calls.

And the cost of calling has continued falling since the year end. On 29 April 1998, the cost of local calls made in the evening and overnight, Monday to Friday, came down by more than ten per cent – from 1.7p a minute to 1.5p.

In December 1997, BT welcomed a High Court decision to lift a temporary injunction preventing us from circulating a report which compared our prices favourably with those of Cable & Wireless Communications.

BT recognises that customers need to compare what each supplier has to offer and assess which is best for them. But, to make a realistic comparison between BT and other suppliers, customers need to be able to compare like with like. In competitors' advertising activity, it is often their best call discounts that are compared with BT's base call rates and no account is taken of our discount packages.

Marketing

Marketing campaigns have played a key role in relaying the message that BT is committed to cutting prices and to changing the way people in the UK regard the telephone.

Thanks to campaigns such as *It's good to talk* and discount packages such as Friends & Family, average residential telephone usage has increased by more than two minutes per day since 1994, to a level which is still only around 60 per cent of that in the USA. Usage per line per day has increased by more than 42 seconds in the past 12 months.

Last year saw the launch of several new marketing campaigns aimed at increasing the number of residential customers connected to BT.

Our Acquisition campaign, involving a mailing to all UK households not benefiting from a telephone service, has resulted in over 45,000 new customers choosing to connect to BT.

Our Reconnection campaign has been even more successful, attracting a further 100,000 customers who had previously given up BT service to reconnect for just £9.99. This campaign includes mailings, telemarketing, a new field marketing operation and television advertising.

Finally, nearly 300,000 BT customers opted for a second line during the year, encouraged by marketing special offers promoting half-price installation and other incentives.

Regional dimension

The regional dimension of UK business is becoming increasingly important and BT is working in close partnership with customers in all regions to aid social and economic development.

Examples include some of the more remote parts of the Scottish Highlands and Islands. Since distance is no obstacle, and location is no longer a constraint, the vast majority of 999 calls on the UK mobile network are handled in Inverness, bringing much needed local employment.

And, in Thurso, BT has recently opened a state-of-the-art call centre which is helping us to build those all-important relationships with our customers, and enabling us to treat them in a more responsive and customer-friendly manner.

In February 1998, the Secretary of State for Northern Ireland opened BT's new £9 million call centre in south west Belfast, a project on which we worked with the Northern Ireland Industrial Development Board.

And, in April 1998, BT announced the creation of 800 new jobs over the next 12 months in a new £6 million call centre in Dundee.

As well as using call centres to contact our customers on a regular basis to tell them about BT's products and services, we are increasingly using them to run telemarketing operations on behalf of other companies. In fact, BT now runs more than 100 call centres in the UK.

BT people

At BT, we understand the link between being our customers' "supplier of choice" and our people's "employer of choice". That is why we have such a deep commitment to our people and why we are backing it up by seeking accreditation as an *Investors in People* company.

By the end of March 1998, around 124,700 people were employed by BT, compared with 227,000 seven years ago. However, during the year, there were increases in certain parts of the business as we have been building on people-intensive activities such as telemarketing and delivering our commitment to world-class quality of service.

We recruited over 500 high-calibre graduates and 500 modern apprentices in the year. BT is a key supporter of the UK Government's New Deal welfare-to-work initiative and plans to help 250 unemployed people get back to work during 1998. We encourage our people to gain appropriate National Vocational Qualifications.

Through our leading-edge policies and programmes, we seek to promote real equality of opportunity throughout the company and actively encourage the employment, training and career development of people with disabilities. We also try to continue to employ any of our people who develop a disability in the course of their career.

In March 1998, BT won top prize in the Opportunity 2000 Awards scheme. These awards recognise UK employers who demonstrate innovative working practices to further women's development at work.

At the 1997 UK Quality Awards, both BT Business Division and BT Northern Ireland were recognised for achievements that led to success for themselves and their customers.

BT is the largest company ever to have won a European Quality Awards prize, and we did so in both 1996 and 1997.

We also run a comprehensive in-house Quality Award scheme. This year's winners included the team which won the bid for the supply and management of an advanced services network for Halifax plc, and the team responsible for a nationwide updating of payphones and phonecard technology.

We conduct a wide-ranging programme of employee opinion research, including an annual company-wide survey. Managers are required to put in place an action plan to address the issues raised by their teams.

The allocation of shares to employees under the BT Employee Share Ownership Scheme amounts to two per cent of annual pre-tax profits.

BT continues to consult and negotiate with recognised unions in the UK as an integral part of our employee relations strategy. We have also set up a European Consultative Council which provides the opportunity for dialogue with representatives from the UK and all our other European operations. The Council is chaired by Chief Executive Sir Peter Bonfield and meets annually.

Corporate citizenship

BT is committed to being a good corporate citizen.

We were a founder member of the Per Cent Club in 1986, and we continue to commit a minimum of 0.5 per cent of our UK pre-tax profits to activities in support of society through our Community Partnership Programme. Our expenditure has grown from £10 million in 1987 to £15 million in 1998, including total donations to charity of £2.6 million. No contributions were made to any political party.

BT's Community Partnership Programme is the largest of its kind in the UK and concentrates its efforts in the areas of health and welfare, education, regeneration, arts and sports, disability, supporting the community activities of BT people, and the environment. We place particular emphasis on education and training, the improvement of communication skills, support for people with disabilities, and the involvement of BT people.

BT is the lead sponsor of the Department for Education and Employment's "out-of-school-hours clubs" project, which was launched in February 1998. Our funding of £150,000 will enable eight consortia of schools, youth and community organisations across England to establish homework clubs, with adult supervision, for disadvantaged children.

And, every year, 50,000 swimmers take part in the UK's largest participative sporting event, the BT Swimathon, which is also our most successful event for generating media coverage. In eight years, it has raised over £10 million for national charities.

In the last year, we have put in place a programme to enable charities and voluntary groups to make more effective use of communications technology. As part of this, we are collaborating with the charity OneWorld On Line to offer training and support for small charities to help them run their own Internet sites.

BT is also bringing the benefits of the new technology it is developing to the people who need it most. For example, BT and the Anchor Trust are developing remote health monitoring systems to help older people continue to live independently. And, as part of the BT Hear for All programme, we have been working with the Royal National Institute for Deaf People to improve deaf people's access to arts venues around the country.

In March 1998, we announced that BT would be one of the corporate sponsors of the Millennium celebrations, not just at the Dome in Greenwich but throughout the country. Because we want to make a contribution that will touch everyone's lives in 2000, we will be launching "Mill-e-Mail" – a free electronic mail address service. This means that everyone in the UK over the age of nine will have his or her own e-mail account.

Education

BT has been a key player in the establishment of a "national grid for learning" in the UK. The aim of the grid is to provide networked access to learning resources for pupils and students of all ages, largely via personal computers located in schools, colleges and libraries.

The development of the grid has been influenced by the Bristol Education Online Network project, in which BT, working with ICL, has been a major participant.

The project, benefiting a group of schools in the Bristol area, has demonstrated the gains which can be made by pupils who are given access to leading-edge computers, servers, software and networks. As well as improvements in academic attainments, the schools reported a decline in vandalism and an increase in parental involvement.

In October 1997, the Prime Minister announced a public/private partnership to provide schools with affordable access to the Internet. He said it would mean that, by 2002, all of the UK's 32,000 schools would have "modern computers, education programmes to go on them, teachers skilled to teach on them, pupils skilled to use them, connected to the superhighway for free and with phone bills... as low as £1 per pupil per year."

CampusWorld, BT's Internet-based resource of more than 20,000 pages of educational material, receives more than 100,000 page requests every school day.

BT has one of the most wide-ranging programmes of community support in the education sector and invests around £3 million each year through, amongst other things, award schemes for schools, colleges and universities.

Environment

A company of BT's size inevitably has an impact on the environment through its significant use of energy and other resources, as well as its waste streams. Since an initial review in 1989, we have developed a whole lifecycle approach to environmental management in line with the international environmental management system standard (ISO14001). Targets are set in line with ISO14001 and industry best practice.

Our policy, first published in 1990 and regularly reviewed, covers all significant environmental impacts: procurement, fuel and energy, emissions to air, local impacts, and wastes.

BT now trades electronically with 90 per cent of its largest suppliers, and we have saved at least £10 million as a result. In the majority of these transactions, our supplier does not print or post orders or invoices – everything is done electronically. We aim to expand our electronic trading to include all of our smaller, localised purchasing, covering around 400,000 orders a year and around 1.5 million invoices.

New targets for environmental improvement are set each year and progress is documented in our award-winning Environmental Performance Report.

Later this year, we shall publish a comprehensive set of reports that describe BT's social, environmental and technological interactions with society. Through these reports, we aim to stimulate a wider debate into how BT can contribute to an improved quality of life for all.

Further information

More information about BT and its operations can be found on our Internet site at **http://www.bt.com**

Financial review

Introduction

BT's earnings of 26.7 pence per share for the year ended 31 March 1998 (the 1998 financial year) compare with 32.8 pence for the 1997 financial year and 31.6 pence for the 1996 financial year. Earnings per share for the 1998 financial year were affected by two exceptional items. The first was a receipt of US $465 million from WorldCom, Inc as a result of the termination of the proposed BT/MCI Communications Corporation merger; the second was the one-off windfall tax charge which amounted to £510 million.

Earnings per share for the 1998 financial year before the two exceptional items were 31.7 pence, a decrease of 3.2% on the previous year, reflecting a number of factors. In the 1998 financial year, earnings were affected by initial expenditure incurred by the group's new European associates as they become established; a charge of £120 million was incurred as compensation to employee share option holders for the special dividend paid in September 1997 and an additional charge for interest of approximately £100 million was incurred from the payment of this special dividend; BT was also affected by its £63 million share of a special charge made by MCI in September 1997.

	1998 £m	1997 £m	1996 £m
Turnover	**15,640**	14,935	14,446
Other operating income	**372**	106	103
Operating costs before redundancy costs	**(12,249)**	(11,429)	(11,028)
Redundancy costs	**(106)**	(367)	(421)
Operating profit	**3,657**	3,245	3,100
Group's share of profits (losses) of associated undertakings	**(252)**	139	82
Profit on sale of group undertakings	**63**	8	7
Net interest and premium payable	**(249)**	(189)	(170)
Profit before taxation	**3,219**	3,203	3,019
Taxation – ordinary	**(978)**	(1,102)	(1,027)
– windfall	**(510)**	–	–
Profit after taxation	**1,731**	2,101	1,992
Minority interests	**(25)**	(24)	(6)
Profit for the financial year	**1,706**	2,077	1,986
Earnings per share	**26.7p**	32.8p	31.6p
Earnings per share before exceptional items	**31.7p**	32.8p	31.6p

The results for the 1998 financial year have benefited from the strong growth in demand for the group's products and services and the buoyant UK economy. BT, however, continued to be affected by the tight regulatory regime in the UK and growing competition. Price reductions, including those imposed by the price control formulae, totalled over £750 million following reductions of over £800 million in the 1997 financial year and £480 million in the 1996 financial year. The 1998 financial year also included lower redundancy costs as a consequence of the surplus disclosed by the latest actuarial valuation of the group's main pension scheme.

The 1998 financial year saw the group increasing its level of investment in continental Europe to address the opportunities presented by the full liberalisation of the telecommunications market from 1 January 1998. Other features of the year included the break-up of the proposed BT/MCI merger, the payment of a £2.2 billion special dividend and the UK Government's imposition of a windfall tax on BT and other privatised companies.

The results for the 1997 financial year were adversely affected by significant redundancy costs of £367 million and a £60 million premium paid on repurchase of bonds. The 1996 financial year's results were also affected by significant redundancy costs of £421 million and a £73 million share of another MCI special charge.

Regulation and prices

The period to 31 July 1997 was the last in which the majority of BT's main UK services were subject to price regulation. Under the price controls which were in force up to that date, BT had to reduce its overall prices for its main UK services, principally inland and outgoing international call services and exchange line rentals, under the RPI minus 7.5 formula. In the two final price control years under this formula, BT reduced its prices by about 5% and 2% in the years to 31 July 1997 and 1996, respectively.

From 1 August 1997, a new retail price control came into force under which a cap of RPI minus 4.5 applies to the services used by the lowest 80% of BT's residential customers by bill size. This new retail price control is estimated to have covered services representing about 17% of the group's total turnover for the year to 31 March 1998. In the current price control year to 31 July 1998, BT has already reduced its prices by more than the required reduction of 1.56%.

From 1 October 1997, the basis of determining most interconnect charges with other UK operators has been moved from fully allocated historical costs to long-run incremental costs. Annual determinations have been replaced with a system based on RPI minus price caps. There has been an initial reduction in charges of 10% followed by annual reductions over a four-year period based on a RPI minus 8 price cap.

The regulatory environment in the UK has had, and will continue to have, a significant adverse impact on the group's turnover and operating profit. As the group extends its operations to other countries, BT has to consider the regulatory regimes in those countries. Generally, most countries have regulatory regimes that are currently less liberal than those in the UK and North America.

Competition and the UK economy

BT has a significant market share in its main UK markets for telephone calls and provision of exchange lines. Competition has eroded BT's market share significantly in key market sectors, in particular areas of the UK and for certain products and services. Figures published by Oftel showed that BT had 77% of the market for national calls for the six months ended 30 September 1997, compared with 79% and 81% in the 1997 and 1996 financial years, respectively, and supplied 89% of the exchange lines in the UK at 30 September 1997, compared with 90% and 93% at 31 March 1997 and 1996, respectively. Additionally, BT had 87% of the market for local calls for the six months ended 30 September 1997, compared with 90% and 92% in the 1997 and 1996 financial years, respectively, and 52% of the market for outgoing international calls from the UK for the six months ended 30 September 1997, compared with 61% and 70% in the 1997 and 1996 financial years, respectively.

The growth in networks of cable operators in the UK is having an adverse effect on BT's share of the residential market. In the last three financial years, BT has experienced a small net reduction in residential exchange line connections as a result of increasing competition in certain geographic areas from these cable operators. This reduction is expected to continue as they build out their networks.

In an environment of strong competition, Cellnet had 34% of the market at 31 March 1998, compared with 38% at 31 March 1997 and 41% at 31 March 1996. There has also been a downward pressure on prices. Oftel has referred BT, Cellnet and Vodafone, its direct competitor, to the Monopolies and Mergers Commission (MMC) for investigation into the charges for calls made from BT's fixed network to Cellnet and Vodafone's networks. The MMC is expected to report in autumn 1998. The company believes that the impact of the investigation is not likely to be significant to the group's financial position in view of the continuing reductions in prices.

The group has seen some diversion of demand from its fixed network as a result of the growth of other licenced operators' activities.

For its operations as a whole, BT expects the competitive pressure to persist and it will continue to defend its market share vigorously and fairly.

The strength of the UK economy is an important determinant of BT's business volumes and the gross domestic product grew by 2.9% in the year ended 31 March 1998, compared with 3.0% and 2.0% in the previous two years.

Turnover

Total turnover grew by 4.7% to £15,640 million in the 1998 financial year after growing by 3.4% in the 1997 financial year compared with the 1996 financial year. The strong growth in demand for the group's products and services of approximately 10% in the 1998 financial year and approximately 8% in the 1997 financial year was partially offset by the effect of price reductions which averaged approximately 5% across the business in each of the two years.

The group's turnover is analysed as follows:

	1998 £m	1997 £m	1996 £m
Inland calls	**4,924**	4,874	4,882
International calls	**1,553**	1,809	1,980
Exchange line rentals	**2,957**	2,811	2,685
Private circuits	**1,149**	1,124	1,056
Mobile communications	**1,089**	949	856
Customer premises equipment supply	**896**	914	946
Yellow Pages and other directories	**466**	438	408
Other sales and services	**2,606**	2,016	1,633
Total turnover	**15,640**	14,935	14,446

Price reductions had a major impact on turnover from inland calls made over the fixed network for the fourth year in succession. Innovative marketing programmes included enhancements to the successful Friends & Family package, business discounts and reductions in national and fixed network to mobile call prices. The combined effect of these price changes totalled over £300 million, which was equivalent to a 6% reduction in call prices following falls of 7% in each of the previous two years.

% annual inland call volume growth

In the 1998 financial year, inland call volume growth of 7% was largely offset by the price reduction effect, resulting in total call turnover increasing by 1% in the year to £4,924 million. Fixed network to mobile calls and inbound services, including 0800 numbers, were the main areas of this strong volume growth, together with local and national calls. In the 1997 financial year, call volume growth of 7% almost wholly mitigated the price reduction effect, resulting in total call turnover remaining static compared with the previous year.

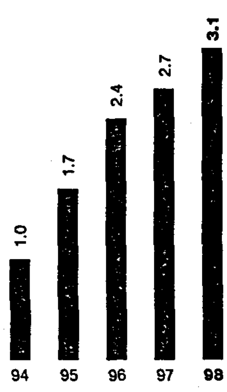
% annual international call volume growth

International-call turnover declined by 14.2% in the 1998 financial year to £1,553 million after declining by 8.6% in the 1997 financial year. This was primarily the result of price reductions averaging 20% and 13% in the two years, respectively, and the impact of the strengthening of sterling, partially offset by strong volume growth of 9% and 7%, respectively. BT is reducing prices substantially on most international routes.

Turnover from the fixed network line rentals grew by 5.2% in the 1998 financial year to £2,957 million after increasing by 4.7% in the 1997 financial year. The increased turnover was the combined result of the growth in business lines and 3% rental price increases in both July 1996 and July 1997. The number of business lines grew by 5.0% in the 1998 financial year and by 5.3% in the 1997 financial year with ISDN services mainly contributing to this growth. The numbers of residential lines declined slightly in both years due to the competition from cable operators. Overall, BT's total fixed network lines were maintained at 27.6 million in the 1998 financial year after growing by 0.9% in the 1997 financial year.

Private circuit turnover rose by 2.2% in the 1998 financial year to £1,149 million after increasing by 6.4% in the 1997 financial year. Demand for digital KiloStream and MegaStream services continued at a high level in both years, supported by a significant migration from analogue circuits.

Cellnet customers (millions)



Mobile communications turnover increased by 14.8% in the 1998 financial year to £1,089 million following growth of 10.9% in the previous financial year. This reflected the

14% and 12.9% growth in Cellnet's customer-base in the two years, respectively, offset by the effect of reductions in mobile call prices. Cellnet had 3.1 million customer connections at 31 March 1998, 75% of which were on its digital GSM network.

The strong growth in BT's sales of its advanced services, including FeatureNet, its Syncordia Solutions operation, incorporating managed data networks, and Syntegra, the group's systems integration business, were the main elements in the increase of 29% in other sales and services in the 1998 financial year to £2,606 million and the 23% growth in the 1997 financial year. Other significant increases in turnover came from BT's overseas operations and interconnect charges.

BT's turnover from its overseas operations grew strongly. Concert services to multinational customers provided much of the growth in the 1998 financial year. Newly-acquired systems integration businesses in Europe accounted for about half of the growth in the 1997 financial year with Concert services providing much of the balance.

Turnover from UK operators for interconnect charges rose from £265 million in the 1996 financial year to £319 million in the 1997 financial year and to £496 million in the 1998 financial year. These increases reflect the growing market share of BT's UK competitors and the increasing level of traffic flowing into BT from their networks. There was also a corresponding increase in the payments made by BT to these operators for traffic passing to their networks.

Other operating income

Under the terms of an agreement among BT, MCI and WorldCom, BT received US $465 million on 12 November 1997 as the break-up fee and partial reimbursement of expenses incurred on the BT/MCI merger agreement. This receipt, net of relevant expenses incurred in the 1998 financial year, has been included as an exceptional profit of £238 million in other operating income in the group's profit and loss account for this year.

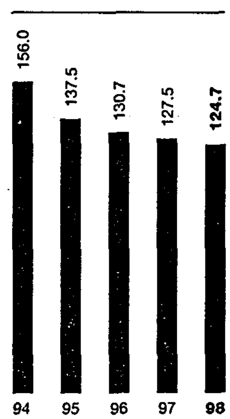
Operating costs

Total operating costs increased by 4.7% in the 1998 financial year to £12,355 million after increasing by 3.0% in the 1997 financial year. As a percentage of turnover, operating costs decreased from 79.3% in the 1996 financial year to 79.0% in the 1997 and 1998 financial years.

	1998 £m	1997 £m	1996 £m
Staff costs	**3,917**	3,778	3,680
Own work capitalised	**(424)**	(399)	(417)
Depreciation	**2,395**	2,265	2,189
Payments to telecommunication operators	**1,600**	1,476	1,383
Other operating costs	**4,761**	4,309	4,193
Total operating costs, before redundancy charges	**12,249**	11,429	11,028
Redundancy charges	**106**	367	421
Total operating costs	**12,355**	11,796	11,449

Staff costs increased by 3.7% in the 1998 financial year to £3,917 million, after rising by 2.7% in the 1997 financial year. The increase in the 1998 financial year was the result of the effects of the annual pay awards and compensation for the special dividend, offset by savings resulting from reduced pension costs. The compensation of £120 million for the special dividend is for those employees holding unexercised rights, mainly under group-wide sharesave schemes, which lost value on the payment of the special dividend in September 1997.

Employees (thousands)



The allocation for the employee share ownership scheme in the 1998 and 1997 financial years was £64 million, representing 2% of pre-tax profit for those years. In the 1996 financial year approximately 1% was allocated. In the 1997 financial year, the increase in staff costs was the result of this higher allocation for the employee share ownership scheme as well as the annual pay awards and staff costs in acquired subsidiaries, offset by savings resulting from staff reductions.

The depreciation charge increased by 5.7% in the 1998 financial year to £2,395 million after increasing by 3.5% in the 1997 financial year, reflecting BT's continuing high level of investment in its networks.

Payments to other telecommunication operators grew by 8.4% in the 1998 financial year to £1,600 million after increasing by 6.7% in the 1997 financial year, primarily as a result of the growing number of calls terminating on UK competitors' networks. Payments to overseas operators for incoming calls terminating in the UK fell significantly in both years as a consequence of falling prices and the strengthening of sterling more than offsetting call volume growth.

Other operating costs, which rose by 10.5% in the 1998 financial year to £4,761 million and by 2.8% in the 1997 financial year, include the maintenance and support of the networks, accommodation and marketing costs, the costs of BT's overseas operations and the cost of sales of customer premises equipment. In the UK's increasingly competitive telecommunications market, BT is spending significantly more on its marketing programmes, including extensive TV advertising, and this has been one of the three main factors behind the increase in costs. The others have been the costs incurred in supporting the recent rapid expansion of Cellnet and Concert.

Redundancy costs of £106 million were incurred in the 1998 financial year, compared with £367 million in the 1997 financial year and £421 million in the 1996 financial year. The significant reduction in costs in the 1998 financial year is a consequence of a surplus arising in BT's main pension scheme. In view of this surplus, described below, and in accordance with BT's accounting policies, redundancy charges for the 1998 financial year do not include the costs of the incremental pension benefits provided to early retirees. In the 1997 and 1996 financial years, redundancy costs included £258 million and £266 million relating to incremental pension benefits, respectively.

Operating profit

Operating profit for the 1998 financial year of £3,657 million was £412 million (12.7%) higher than in the previous year. In the 1997 financial year, operating profit was 4.7% higher than in the 1996 financial year.

Associates

As a consequence of the termination of the BT/MCI merger agreement and BT's agreement with WorldCom to vote in favour of the proposed MCI/WorldCom merger, BT ceased treating MCI as an associate from 1 November 1997. The group's share of its associates' results for the 1998 financial year incorporates a loss of £27 million, representing BT's share of MCI's results up to that date, which include a special charge of £63 million.

Excluding MCI, the group's share of losses of associates totalled £225 million in the 1998 financial year. The principal loss arose in Viag Interkom which is building its initial network to compete in the German market. Smaller losses were incurred by Telfort in the Netherlands and Cegetel in France, which has been an associate since September 1997.

The group's £139 million share of profits of associated undertakings in the 1997 financial year consisted primarily of the company's share of MCI's profits less BT's share of losses in its joint ventures in Germany and Sweden which were commencing establishing their businesses. BT's share of MCI's pre-tax profit for the 1997 financial year amounted to £175 million, under BT's accounting policies, and was significantly higher than the corresponding figure of £101 million for the 1996 financial year which had been adversely affected by a restructuring charge, BT's share of which was £73 million.

BT expects that its associates in Europe as a whole will continue to incur losses for the next two to three financial years.

Interest charge and bond repurchase premium

Following payment of the special dividend in September 1997, described below, the group's borrowings have increased significantly and its interest charge has risen commensurately. Consequently, in the 1998 financial year, the group's net interest charge of £249 million was £120 million higher than the interest charge in the previous year. Interest cover represents 14.7 times operating profit and is expected to continue at a comfortable level.

The net interest charge of £129 million for the 1997 financial year was £41 million lower than the interest charge in the 1996 financial year. The group's strong positive cash flow was the main contributor to this lower charge which was covered 25.2 times by operating profit.

During August 1996, the company took the opportunity to repurchase two of the three then-remaining series of Government held bonds for £422 million, at an effective premium of £60 million which was charged against profit in the 1997 financial year in accordance with UK accounting standards. The last-remaining series was repaid on its maturity in March 1997. The repurchase has reduced the overall effective interest rate on BT's borrowings.

Profit and taxation

The group's profit before taxation for the 1998 financial year was £3,219 million, compared with £3,203 million in the 1997 financial year and £3,019 million in the 1996 financial year.

The tax charge for the 1998 financial year includes BT's £510 million share of the UK Government's windfall tax on certain privatised companies, imposed in July 1997. The first £255 million instalment was paid on 2 December 1997 with the second being payable in December 1998.

The ordinary tax charge of £978 million as a percentage of profit before taxation was 30.4%, compared with 34.4% for the 1997 financial year and 34.0% for the 1996 financial year. The group's ordinary tax charge for the 1998 financial year is an effective 31.5% of pre-tax profit, excluding the MCI merger break-up fee which is effectively subject to a lower tax charge under UK capital gains tax legislation. This effective tax charge reflects the lower 31% rate of corporation tax set for the year, compared with 33% set for the previous two financial years. The higher effective rate in the 1997 financial year was due to the premium on the bond repurchase only being partially deductible for tax purposes.

Earnings and dividends

Earnings per share, based on a profit for the 1998 financial year of £1,706 million, were 26.7 pence. Earnings before the two exceptional items were 31.7 pence per share, in comparison with 32.8 pence for the 1997 financial year and 31.6 pence for the 1996 financial year.

As originally announced in November 1996, the company paid a special dividend of 35 pence per share in September 1997. This dividend absorbed £2,244 million. The Board believed that shareholder value and earnings growth would be enhanced through the introduction of more gearing which was achieved with this payment.

To maintain the yield on the company's shares, the Board has adjusted the level of ongoing annual dividends to take into account the effect of the special dividend. This adjustment was first made for the interim dividend for the year ended 31 March 1998.

The ordinary dividends paid and recommended for the 1998 financial year of 19.0 pence per share represent a 6.4% increase on the previous year, adjusted for the effect of the special dividend, and are covered 1.8 times by earnings, excluding the effect of the windfall tax. These dividends comprise the interim dividend of 7.55 pence per share, which was paid in February 1998, and the proposed final dividend of 11.45 pence per share which, if approved at the annual general meeting, will be paid on 21 September 1998 to shareholders on the register on 7 August 1998. The proposed final dividend is that forecast by the Board in its announcement in October 1997. These ordinary dividends will absorb £1,220 million. For the 1997 and 1996 financial years, ordinary dividends of 19.85 pence and 18.7 pence per share, respectively, were paid or recommended.

Financing

	1998 £m	1997 £m	1996 £m
Net cash inflow from operating activities	**6,076**	6,192	5,834
Net cash outflow for returns on investments and servicing of finance	**(160)**	(220)	(150)
Tax paid	**(1,886)**	(1,045)	(784)
Capital expenditure and financial investment	**(3,108)**	(2,820)	(2,500)
Acquisitions and disposals	**(1,501)**	(252)	(132)
Equity dividends paid	**(3,473)**	(1,217)	(1,138)
Net cash inflow (outflow) before management of liquid resources and financing	**(4,052)**	638	1,130
Management of liquid resources	**2,247**	(504)	(1,317)
Net cash inflow (outflow) from financing	**1,794**	(224)	215
Net increase (decrease) in cash and cash equivalents	**(11)**	(90)	28
Decrease (increase) in net debt	**(3,860)**	849	1,319

Net cash inflow from operating activities of £6,076 million in the 1998 financial year compared with £6,192 million in the 1997 financial year and £5,834 million in the 1996 financial year. The higher net cash inflow in the 1997 financial year than in the 1998 or 1996 financial years reflected a reduction in working capital in the 1997 financial year.

Tax paid in the 1998 financial year totalled £1,886 million. It was particularly high because of £561 million advance corporation tax paid in October 1997 in respect of the special dividend and £255 million paid in December 1997 as the first windfall tax instalment. This advance corporation tax will reduce the group's overall tax payment in the 1999 financial year. The tax paid in the 1997 financial year, principally relating to the prior year's profit, amounted to £1,045 million and the increase of £261 million on the previous year was mainly due to the higher level of profit made in the 1996 financial year compared with the prior year.

The UK Government is changing the pattern of corporation tax payments from April 1999 by requiring companies to pay tax in quarterly instalments starting at the half year stage in each financial year. The changes are being phased in and are in place of the current main single corporation tax payment made nine months after the financial year end and advance corporation tax payments associated with dividends. It is expected that the effect of these accelerated payment arrangements will be to increase the tax payments to be made by the group in the 2000 and 2001 financial years, notwithstanding the reduction in the standard rate of corporation tax to 30% announced by the Government for those years.

Net cash outflow of £3,108 million for capital expenditure and financial investment in the 1998 financial year mainly comprises expenditure on plant, equipment and property and compares with £2,820 million in the 1997 financial year and £2,500 million in the 1996 financial year.

The net cash outflow on acquisitions totalled £1,501 million in the 1998 financial year, the principal part of which was the investment in Cegetel.

Equity dividends paid in the 1998 financial year totalled £3,473 million and included the special dividend of £2,244 million in September 1997. In the two previous financial years dividends of £1,217 million and £1,138 million were paid.

The resulting cash *outflow*, before liquid resources and financing, of £4,052 million in the 1998 financial year was mainly financed by the issue of new loans in the first two months of the year, principally two Eurobonds totalling US $2,500 million, and by using the group's existing short-term investments. In the two previous financial years, the group had positive net cash inflows before financing of £638 million and £1,130 million, respectively.

The cash outflow caused mainly by the special dividend payment and the investment in Cegetel resulted in net debt rising to £3,977 million at 31 March 1998. Balance sheet gearing stood at 36 per cent at that date.

In the 1998 financial year, the group borrowed £1,637 million in long-term loans and long-term debt repaid totalled £338 million. BT issued a US$1.5 billion five-year 6¾% Eurobond in April 1997 and a US$1.0 billion ten-year 7% Eurobond in May 1997 in preparation for the group's cash requirements later in 1997.

The cash dividend payment has been reduced by £18 million as the company's scrip dividend scheme operated for the first time in the 1998 financial year. 3.8 million new shares were issued as a consequence as further described in note 22 to the financial statements.

Treasury policy

The group has a centralised treasury operation. Its primary role is to manage liquidity, funding, investment and the group's financial risk, including risk from volatility in currency and interest rates and counterparty credit risk. The treasury operation is not a profit centre and the objective is to manage risk at optimum cost.

The Board sets the department's policy and its activities are subject to a set of controls commensurate with the magnitude of the investments and borrowings under its management. Counterparty credit risk is closely monitored and managed within controls set by the Board. Derivative instruments including forward foreign exchange contracts are entered into for hedging purposes only.

Capital resources and foreign currency exposure

The directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future and therefore they continue to adopt the going concern basis in preparing the financial statements.

At 31 March 1998, the group had cash and short-term investments of £793 million. At that date, £550 million of short-term debt was outstanding. In addition, the group had unused committed short-term bank facilities, amounting to approximately £786 million at 31 March 1998, in support of a commercial paper programme or other borrowings. The group also has substantial uncommitted short-term bank facilities.

The gearing or ratio of net debt (borrowings net of cash and short-term investments) to shareholders' equity and minority interests was 36.1% at 31 March 1998, compared with 1.6% at 31 March 1997. The group had £3,977 million net debt at 31 March 1998, an increase of £3,801 million in the year. Net debt has increased substantially during the course of the 1998 financial year primarily as a result of the special dividend payment and the investment in Cegetel.

The majority of the group's long-term borrowings has been, and is, subject to fixed interest rates. The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and period for which interest rates are fixed. At 31 March 1998, the group had outstanding interest rate swap agreements with notional principal amounts totalling £1,489 million.

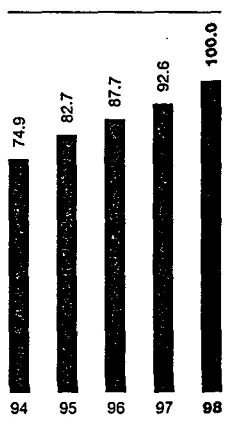
Most of the group's current turnover is invoiced in pounds sterling, and most of its operations and costs arise within the UK. The group's foreign currency borrowings, which totalled £2,316 million at 31 March 1998, are used to finance its UK operations and to finance the groups' overseas investments, including MCI, in order to reduce the currency exposure on the underlying assets. Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investment, interest expense, purchase and sale commitments. The commitments hedged are principally US dollars. As a result of these policies, the group's exposure to foreign currency arises mainly on the residual currency exposure on overseas investments and on any imbalances between the value of outgoing, transit and incoming international calls with overseas telecommunication operators. To date, these imbalances have not been material. As a result, the group's profit has not been materially affected by movements in exchange rates.

The group is not significantly exposed to changes in interest rates. Based upon the composition of net debt at 31 March 1998, a one percentage point change in interest rates would change the group's interest expense by less than £10 million. Apart from the potential proceeds from the sale of the group's holding in MCI, the group is also not significantly exposed to changes in currency rates. Excluding the MCI investment, a 10% change in sterling against major currencies would cause the group's net assets at 31 March 1998 to change by less than £150 million, with insignificant effect on the group's profit. Because the foreign exchange contracts are entered into as a hedge of sales and purchases, a change in the fair value of the hedge is offset by a corresponding change in the value of the underlying sale or purchase.

If market conditions are appropriate, the company will consider making repurchases of its own shares. Authority to purchase up to 10% of the company's issued share capital is to be requested by the directors at the annual general meeting of shareholders to be held in July. Decisions on the amount of cash, if any, to be used in buying back shares and the precise timing will depend in part on market conditions and other opportunities that exist for the deployment of the group's cash resources.

Capital expenditure

% customer lines served by digital exchanges



Capital expenditure on plant, equipment and property totalled £3,030 million in the 1998 financial year, compared with £2,719 million in the 1997 financial year and £2,771 million in the 1996 financial year. There has been an increased emphasis on enhancing the intelligence of the network to enable customers to benefit from advanced services and improving the network's capacity for carrying high-speed data. Additionally, Cellnet has continued expanding its digital cellular GSM network.

The group expects capital expenditure in the 1999 financial year to be at a level similar to that of the 1998 financial year. BT expects that future capital expenditure will be provided from net cash inflows from operating activities supplemented, if appropriate, by external financing.

Acquisitions and joint ventures

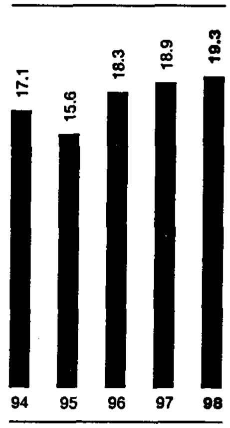
The group has invested over £1,650 million in the 1998 financial year on acquiring interests in associated companies and other investments and providing their further funding. The most significant investment was the completion in September 1997 of the group's acquisition of a 26% interest in Cegetel for a total of £1,029 million. Cegetel, the second French telecommunications operator, has an 80% interest in SFR, a leading mobile provider in France. Over £400 million has been invested in other European telecommunications companies in the year, primarily in Germany, Spain and the Netherlands. The goodwill arising on all of these acquisitions amounted to £869 million out of a total of £937 million, which has been written off to reserves.

In the previous financial year, the group acquired the Rijnhaave group, a Netherlands-based systems integration business in April 1996 and, in March 1997, completed the formation of Telfort, a joint venture with NS, the Dutch railways company, to offer telecommunication services in that country. In February 1997, BT agreed to acquire the 50% interest in its Spanish joint venture it did not already own, thereby obtaining full control; this transaction was completed in July 1997. The goodwill arising on these acquisitions amounted to £166 million; the remaining goodwill taken to reserves in the 1997 financial year of £33 million mainly related to BT's share of goodwill arising on MCI's acquisitions, principally on its joint venture in Mexico.

Return on capital employed

The group made a return of 19.3% on the average capital employed, on a historical cost basis, in its business in the year ended 31 March 1998, compared with returns of 18.9% and 18.3% in the two previous years.

% return on capital employed



Pensions

An actuarial valuation of BT's main pension fund as at 31 December 1996 was completed during the 1998 financial year. This valuation revealed the fund to be in surplus to an amount of approximately £66 million, with assets of the fund at £19,879 million at that date covering just over 100% of the fund's liabilities, in contrast to an asset coverage of 97% at 31 December 1993. The improvement in the funding position principally arose from the strong return on the fund's assets in the three intervening years more than outweighing the impact of redundancies on the fund. The actuarial valuation took into account the effect of the Government's measures in July 1997 to end pension funds' ability to reclaim the tax credit associated with UK companies' dividends. Without this measure the surplus in the fund would have been significantly higher.

From 1 April 1997, the annual pension charge was based on the December 1996 valuation and was £114 million lower than the charge of £291 million in the 1997 financial year. This revised charge took into account the amount of the pension provision which had been established over recent years in the group's accounts and which stood at £1,224 million at 31 March 1998. Additionally, under UK accounting standards, the cost of providing incremental pension benefits for early leavers has no longer been charged against the profit in the period in which people leave, since the latest actuarial valuation of the pension fund indicates a surplus.

The actuarial valuation confirmed that the group's contribution into the fund should continue at 9.5% of employees' pensionable pay.

The number of retired members and other current beneficiaries in the pension fund has been increasing in recent years and, at 31 December 1997, was approximately 45% higher than the number of active members. Consequently, BT's future pension costs and contributions will depend to a large extent on the investment returns of the pension fund and could fluctuate in the medium term.

MCI/WorldCom merger

On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed BT/MCI merger. Following an improved offer from WorldCom in November 1997, BT agreed that it would support the proposed merger of MCI with WorldCom to which the MCI board had agreed on the same day. Consequently, the proposed merger between BT and MCI, originally announced in November 1996, was terminated.

Under the WorldCom agreement, BT will sell its holding of 136 million Class A common shares in MCI to WorldCom for US$51 per share in cash at the time the MCI/WorldCom merger is completed. WorldCom expects the merger, which is subject to regulatory clearance, to be completed later in 1998. At that time, BT will account for the proceeds of approximately US$7 billion and the consequent profit on the sale of its investment, which will depend on the sterling:US dollar exchange rate.

Also under the WorldCom agreement, BT has agreed to acquire MCI's 24.9% equity interest in the Concert Communications Services joint venture at a price to be negotiated.

Year 2000

The BT Year 2000 Programme deals with all the issues arising from the inability of many computer systems and electronic devices to deal with the year 2000 date change and other critical event-related dates. BT takes the Year 2000 issue very seriously and has established a comprehensive group-wide business programme which is monitored regularly at Board level. BT has estimated the total cost to be in the region of £300 million representing primarily the upgrading of existing software and including internal costs. Current forecasts indicate that the programme is being managed within budget.

The programme has been in place since 1995 and BT aims to achieve compliance with substantially all of its major systems by 31 December 1998. BT recognises, however, its dependence on suppliers with whom it is working closely. Both BT's suppliers and the BT programme have been making progress and the company's intention is that telecommunications services provided by BT in the UK will not be significantly affected and that customers will continue to receive the current levels of service and care. One of BT's current priorities is to build the same level of confidence in international services which are heavily dependent on overseas telecommunications companies. Although BT does not yet have sufficient information to guarantee current levels of service to all international destinations, it has been instrumental in a number of initiatives aimed at improving the global situation and BT will continue to work closely with government, international bodies and with the companies themselves.

BT is also working actively with its customers, suppliers and UK organisations to secure appropriate contingency plans, both internally and at a national level.

Impact of inflation

In accordance with a requirement of BT's main licence, the group's annual accounts for the 1997 financial year prepared on a current cost basis were published in September 1997. These accounts showed that the group's current cost profit before tax was £2,419 million, compared with £3,203 million under the historical cost convention. The group's current cost total assets at 31 March 1997 were £29,225 million, compared with £25,062 million under its historical cost accounts. The current cost accounts for the 1998 financial year are to be published by 30 September 1998.

Environment

When removing old analogue exchange equipment from buildings, BT recycles the metal content and takes special care to ensure that any hazardous materials are properly disposed. Although BT receives proceeds from the sale of recovered materials, this is more than offset by the cost of dealing with hazardous materials, contracting and planning their removal and preparing the released site for further development. BT believes that the total cost of dealing with these hazardous materials will not be significant.

Goodwill and intangibles

From the 1999 financial year, BT will be adopting the new UK accounting standard on goodwill and intangibles (FRS10). Under this standard, all goodwill arising on acquisitions made after 1 April 1998 will be capitalised and amortised over its useful economic life.

The net impact on the group's accounts of this change will depend on the extent of any acquisitions which may be made and the level of goodwill involved.

Segmented information

BT essentially operates as a unitary business, providing an integrated range of telecommunications products and services. Accordingly, BT does not publish separately the operating profit for the various sources of turnover described above. In the 1998 financial year, approximately 96% of the group's turnover was generated by operations in the UK, compared with 97% in the 1997 financial year and 98% in the 1996 financial year.

BT is required under its main licence to publish disaggregated financial information for various activities of the group, which have been used as the basis of charges paid by other telecommunication operators in the UK for the use of BT's network. The activities presented separately in the regulatory financial statements do not necessarily correspond with any businesses separately managed, funded or operated within the group. The results set out in these statements for the 1997, 1996 and 1995 financial years showed that the group's operating profit is derived predominantly from local, national and international calls, after taking account of an operating deficit arising on the provision of exchange lines.

For its 1999 financial year, BT will be providing disaggregated financial information in accordance with the requirements of the US SFAS No 131 which requires such information to be analysed in a similar manner to that used by management in managing the business.

US GAAP

The group's net income and earnings per share for the three financial years ended 31 March 1998 and shareholders' equity at 31 March 1998 and 1997 under US Generally Accepted Accounting Principles (US GAAP) are shown in note 30 to the financial statements. Differences between UK GAAP and US GAAP include results of the differing accounting treatment of pension costs, redundancy costs, intangible assets, goodwill, deferred taxation, capitalisation of interest and dividends. The earnings per share under US GAAP are calculated in accordance with SFAS 128 for the first time. Prior year figures have been restated. However, there are no significant differences in earnings to those determined under the previous method. Cash flow information under the US GAAP presentation is also shown in note 30.

Board of directors

EXECUTIVE DIRECTORS

Sir Iain Vallance *Chairman (d)* 1
Sir Iain was appointed a director in 1984. He served as Chief Executive from 1986 to the end of 1995 and has been Chairman since 1987. Sir Iain will become part-time Chairman from 31 July 1998. He is also a non-executive vice-chairman of Royal Bank of Scotland, a non-executive director of Mobil Corporation and Scottish Enterprise, vice-chairman of the European advisory committee of The New York Stock Exchange and chairman of the Princess Royal Trust for Carers. Aged 55.

Sir Peter Bonfield CBE *Chief Executive (a)* 2
Sir Peter was appointed to the Board on 1 January 1996 as Chief Executive. He chairs the *Group Executive Committee*. Sir Peter is a fellow of the Royal Academy of Engineering and the Institution of Electrical Engineers. From 1981 to 1995, he worked for ICL, latterly as chairman and chief executive. He is currently non-executive deputy chairman of ICL, a non-executive director of MCI Communications Corporation and Zeneca, and vice president of the British Quality Foundation. Aged 53.

Robert P Brace FCA *Group Finance Director (a) (e)* 3
Robert Brace joined the company in 1989 and was appointed to the Board in 1993 as Group Finance Director. A career-long finance professional, he started with Peat Marwick Mitchell (KPMG) in 1971 and subsequently held senior finance roles with Unipart and Black & Decker. Robert Brace is also a non-executive director of MCI Communications Corporation. Aged 48.

Bill Cockburn CBE, TD *Group Managing Director, BT UK (a)* 4
Bill Cockburn joined the company on 1 October 1997 as Group Managing Director of BT's UK business and was appointed to the Board with effect from 1 April 1998. After a career in the Post Office, he became chief executive in 1992. In November 1995, Bill Cockburn joined WH Smith as a director, becoming chief executive in 1996. He is a non-executive director of Centrica and Lex Service, a member of the Business in the Community board and a trustee of the Princess Royal Trust for Carers. Aged 55.

NON-EXECUTIVE DIRECTORS

Sir Colin Marshall *Deputy Chairman (b) (c) (d)* * 5
Sir Colin was appointed to the Board in 1995 and became Deputy Chairman in January 1996. He is chairman of British Airways. Sir Colin is also chairman of Inchcape, deputy chairman of Siebe, a non-executive director of HSBC Holdings and The New York Stock Exchange, and president of the Confederation of British Industry. Aged 64.

Helen Alexander * 7
Helen Alexander will join the Board on 1 June 1998. She has been chief executive of The Economist Group since January 1997. Helen Alexander joined The Economist in 1984 and was managing director of The Economist Intelligence Unit from 1993 to the end of 1996. She is also a non-executive director of Northern Foods, a member of the Final Selection Board for the British Home Civil and

1 2 3 4 5

Diplomatic Service, and a member of the ethics committee of the University College London Hospitals. Aged 41.

Dr Iain Anderson *(b) (c) (d) (e)* * 6

Dr Anderson was appointed to the Board in 1995. He is the strategy and technology director of Unilever, for whom he has worked since 1965. Dr Anderson joined the Unilever board in 1988. He has post-doctorate qualifications in microbiology from both Glasgow and Massachusetts Universities. Aged 59.

Malcolm Argent CBE *(b) (d) (e) (f)* 9

Company Secretary from 1984 to 1994, Malcolm Argent was appointed to the Board in 1989, retiring to a non-executive role in 1994. He is deputy chairman of the Civil Aviation Authority, chairman of National Air Traffic Services and a non-executive director of Clerical Medical Investment Group and Westminster Health Care Holdings. Aged 62.

Sir Ewen Fergusson GCMG, GCVO *(c) (d)* * 10

Sir Ewen was appointed a director in 1993, having retired as HM Ambassador to France after a 36-year career in the Diplomatic Service. He is non-executive chairman of Coutts & Co and The Savoy Hotel. Aged 65.

Neville Isdell Ireland * 8

Neville Isdell will join the Board on 1 July 1998. Formerly president of The Coca-Cola Group's greater Europe group, he is currently managing Coca-Cola Amatil's European operations before assuming the position of chairman and chief executive of Coca-Cola Beverages, a new European bottling company. Neville Isdell joined Coca-Cola in 1968 and has held a number of posts managing Coca-Cola's businesses in various parts of the world. He has served on the boards of the publicly-quoted Coca-Cola Enterprises US and Coca-Cola Amatil Australia. Aged 54.

Keith Oates *(b) (c) (d)* * 11

Keith Oates was appointed to the Board in 1994. He is deputy chairman and managing director of Marks and Spencer and a non-executive director of Diageo. Keith Oates' international experience includes working for IBM and Black & Decker. He is a member of the Financial Services Authority and the English Sports Council and a former governor of the BBC. Aged 55.

COMPANY SECRETARY

Colin R Green *(a)*

Colin Green, a solicitor, was appointed Secretary and Chief Legal Adviser in 1994. Aged 49.

Key to membership of principal Board committees:

(a) Group Executive Committee

(b) Audit Committee

(c) Remuneration Committee

(d) Nominating Committee

(e) Pensions Committee

(f) Community Affairs Committee

* *Indicates that the director is considered independent of the management of the company*

6 7 8 9 10 11

Report of the directors

The directors submit their report and the audited financial statements of the company, British Telecommunications plc, and the group, which includes its subsidiary undertakings, for the year ended 31 March 1998.

Introduction

The business review on pages 6 to 14, the financial review on pages 15 to 25, the discussion on corporate governance on pages 30 to 32 and the report on directors' remuneration on pages 33 to 40 form part of this report. The audited financial statements are presented on pages 45 to 79.

Principal activity

The group's principal activity is the supply of telecommunication services and equipment. In the year, 96% of group turnover arose from operations in the United Kingdom.

Directors

The names and biographical details of the directors of the company are given on pages 26 and 27. All served throughout the financial year, with the exception of Bill Cockburn who was appointed to the Board as from 1 April 1998 and Helen Alexander and Neville Isdell who will join the Board on 1 June 1998 and 1 July 1998, respectively.

In addition, Yve M Newbold, Dr Alan W Rudge CBE, Gerald H Taylor, Bert C Roberts Jnr and Birgit Breuel served on the Board until their retirement as directors on 30 June 1997, 31 October 1997, 9 November 1997, 17 March 1998, and 31 March 1998, respectively.

In accordance with the articles of association, Bill Cockburn, Helen Alexander and Neville Isdell, having been appointed to the Board since the last annual general meeting, retire at the forthcoming annual general meeting and will be proposed for election. Sir Colin Marshall and Malcolm Argent retire by rotation and will be proposed for re-election. Details of these directors' service contracts or contracts of appointment are included in the report on directors' remuneration on page 36 and the discussion on corporate governance on page 30, respectively.

On 22 May 1998, BT announced that Sir John Weston, who retires as Britain's Ambassador to the United Nations at the end of June, is to join the Board as a non-executive director on 1 October 1998.

Substantial shareholdings

At 26 May 1998, the company had received a notification from the Prudential Corporation group of companies under Part VI of the Companies Act 1985 in respect of a holding of 247 million shares representing 3.9% of the company's issued ordinary share capital.

Policy on the payment of suppliers

BT's policy is to use its purchasing power fairly and to pay promptly and as agreed.

BT has a variety of payment terms with its suppliers. The terms for payments for purchases under major contracts are settled when agreeing the other terms negotiated with the individual suppliers. It is BT's policy to make payments for other purchases within thirty working days of the invoice date, provided that the relevant invoice is presented to the company in a timely fashion and is complete. BT's payment terms are printed on the company's standard purchase order forms or, where appropriate, specified in individual contracts agreed with suppliers. The ratio, expressed in days, between the amounts invoiced to the company by its suppliers in the year ended 31 March 1998 and the amounts owed to its trade creditors at the end of the year was 29 days.

Auditors

A resolution to reappoint Coopers & Lybrand as the company's auditors and authorise the directors to settle their remuneration will be proposed at the annual general meeting.

Annual general meeting resolutions

The resolutions to be proposed at the annual general meeting to be held on 15 July 1998, together with explanatory notes, appear in the separate *Notice of 1998 Annual General Meeting* sent to all shareholders.

By order of the Board

C R Green
Secretary and Chief Legal Adviser
26 MAY 1998
Registered office: 81 Newgate Street, London EC1A 7AJ
Registered in England: No 1800000

Auditors' report on corporate governance matters

TO BRITISH TELECOMMUNICATIONS plc

In addition to our audit of the financial statements, we have reviewed the directors' statements on pages 21, 30 and 31 concerning the company's compliance with the paragraphs of the Cadbury Code of Best Practice specified for our review by the London Stock Exchange's Listing Rules and their adoption of the going concern basis in preparing the financial statements. The objective of our review is to draw attention to non-compliance with paragraphs 12.43(j) and 12.43(v) of the Listing Rules.

Basis of opinion

We carried out our review in accordance with guidance issued by the Auditing Practices Board. That guidance does not require us to perform the additional work necessary to, and we do not, express any opinion on the effectiveness of either the group's system of internal financial control or its corporate governance procedures nor on the ability of the group and company to continue in operational existence.

Opinion

With respect to the directors' statements on internal financial control on page 31 and going concern on page 21, in our opinion the directors have provided the disclosures required by the Listing Rules referred to above and such statements are not inconsistent with the information of which we are aware from our audit work on the financial statements.

Based on enquiry of certain directors and officers of the company, and examination of relevant documents, in our opinion the directors' statement on page 30 appropriately reflects the company's compliance with the other aspects of the Code specified for our review by paragraph 12.43(j) of the Listing Rules.

Coopers & Lybrand
Chartered Accountants
London
26 MAY 1998

Corporate governance

The directors consider that throughout the year BT has fully complied with the *Code of Best Practice* published by the *Committee on the Financial Aspects of Corporate Governance* (the "Cadbury Committee") and Section A of the best practice provisions of the Stock Exchange Listing Rules introduced following the publication of *Directors' Remuneration – Report of a Study Group chaired by Sir Richard Greenbury* (the "Greenbury Report"), except in respect of non-executive directors' remuneration. This is explained on page 36.

The Board

The Board meets every month, except August. Its principal focus is the overall direction and control of the group. Key matters, such as the group's strategic plans, annual operating plan and budget and the company's operating and financial performance, are reserved for the Board to approve or monitor.

BT aims to have the Board comprise approximately two-thirds non-executive directors. Four of the current non-executive directors are independent of the management of BT either being free from any business or other relationship which could materially interfere with the exercise of their judgement or not previously involved in the management of BT. The three new non-executive directors joining the Board are all independent. Between them the non-executive directors bring experience at a senior level of international business operations, marketing, doing business in the key markets in which the group now operates and international affairs.

The non-executive directors provide a strong independent element on the Board, with Sir Colin Marshall, Deputy Chairman, as the senior independent member. However, the Board operates as a single team.

Non-executive directors are normally appointed initially for three years. Towards the end of that period the Board will consider whether to continue the appointment, which will then become terminable on twelve months' notice from either BT or the director. Appointments will be reviewed again by the Board before the end of the sixth year. Normally, appointments will be for a maximum of ten years. The Deputy Chairman's contract was renewed for a second three-year term from 1 April 1998. It may be terminated on twelve months' notice. Malcolm Argent's contract is for a one-year term ending on 31 December 1998. Helen Alexander's, Neville Isdell's and Sir John Weston's contracts will be for an initial three-year term.

All directors are required by the company's articles of association to be elected by shareholders at the first annual general meeting after their appointment. One-third of other directors must seek re-election by the shareholders each year. In effect, this means directors are re-elected every three years.

The executive directors have service agreements which are reviewed by the *Remuneration Committee.* Information about the periods of these contracts is in the report on directors' remuneration.

The Board has agreed and established a procedure for directors, in furtherance of their duties, to take independent professional advice if necessary, at the company's expense. In addition, all directors have access to the advice and services of the Company Secretary, the removal of whom would be a matter for the whole Board. He advises the Board on appropriate procedures for the management of its meetings and duties and the implementation of corporate governance and compliance in the group.

On appointment, directors receive appropriate information about BT, such as a description of the Board's role and the powers which have been delegated to the company's senior managers and management committees and latest financial information about the group. This is supplemented by meetings with members of the *Group Executive Committee* and other key senior executives, such as the head of the department which manages and advises on BT's regulatory obligations. Throughout their period in office this information is up-dated as BT's business, management structure or the regulatory environment in which it operates changes. This can include further meetings with senior BT executives. Directors are also advised on appointment of their legal and other obligations as a director of a listed company, both in writing and, if they wish, through face-to-face meetings with the Company Secretary. They are reminded of these obligations each year.

Procedures exist to ensure directors receive information at least four working days before each Board meeting. Papers must comply with guidelines about content and presentation.

Principal Board committees

The *Group Executive Committee* is chaired by the Chief Executive, Sir Peter Bonfield. The other members are the Group Finance Director, the Group Managing Director

BT UK, the President and Chief Executive Officer BT Global, the heads of BT UK's customer-facing divisions and the network and systems division, the Secretary and Chief Legal Adviser, the Group Personnel Director, the executive responsible for developing the group's strategy and plans and the head of the group's corporate communications team. The Committee develops the group's strategy, for Board approval, and oversees its implementation. It also finalises, before Board approval, annual plans and budgets, reviews operational activities and agrees and monitors group-wide policies, where these are not reserved to the Board.

The *Nominating Committee* of the Chairman, Deputy Chairman and four other non-executive directors ensures the Board has an appropriate balance of expertise and ability among the non-executive directors. For this purpose it has agreed, and regularly reviews, a profile of the required skills and attributes. This profile is used to assess the suitability as non-executive directors of candidates put forward by the directors and outside consultants. Candidates short-listed for appointment are met by the Committee before it recommends an appointment to the Board.

The Committee also assesses candidates for executive directorships before it recommends an appointment.

The *Audit Committee*, consisting solely of non-executive directors, is chaired by Sir Colin Marshall. Its terms of reference include reviewing BT's internal controls and published financial reports for statutory compliance and against standards of best practice, and recommending appropriate disclosure to the Board. It also reviews annually the services and performance of the company's auditors, monitors their non-audit work to ensure that an objective and professional relationship is maintained and recommends to the Board their fees. The Group Finance Director and the Secretary and Chief Legal Adviser attend these meetings. Each year, the Committee sets aside time to seek the views of the company's auditors in the absence of executives.

The *Remuneration Committee* consists solely of independent non-executive directors and is chaired by Sir Colin Marshall. Further details about the Committee are included in the report on directors' remuneration.

Internal financial control

The directors are responsible for the group's systems of internal financial control. Such systems can provide only reasonable and not absolute assurance against material financial misstatement or loss. Key elements are:

- Formal policies and procedures are in place, including the documentation of key systems and rules relating to the delegation of authorities, which allow the monitoring of controls and restrict the unauthorised use of the group's assets.
- Experienced and suitably qualified staff take responsibility for important business functions. Annual appraisal procedures have been established to maintain standards of performance.
- Forecasts and budgets are prepared which allow management to monitor the key business and financial activities and risks and the progress towards financial objectives set for the year and the medium term; monthly management accounts are prepared promptly providing relevant, reliable and up-to-date financial and other information; significant variances from budget are investigated as appropriate.
- All investment projects are subject to formal authorisation procedures. The Board considers major investment projects, with other projects being approved by the *Group Investment Committee* (a sub-committee of the *Group Executive Committee*) or senior management within delegated authorities approved and reviewed by the Board.
- The *Audit Committee* reviews reports from management, from the internal auditors and from the external auditors, to provide reasonable assurance that control procedures are in place and are being followed.
- Formal procedures have been established for instituting appropriate action to correct weaknesses identified from the above reports.

The *Audit Committee* has reviewed the effectiveness of the systems of internal financial control in existence in the group for the year ended 31 March 1998 and for the period up to the date of approval of the financial statements.

Relations with shareholders

Senior executives, led by the Chief Executive and Group Finance Director, hold meetings with the company's principal institutional shareholders to discuss the company's strategy, financial performance and, as and when necessary, its senior executive remuneration policies and plans. Contact with institutional shareholders (and financial analysts, brokers and the press) is controlled by written guidelines to ensure the protection of share price sensitive information which has not already been made available generally to the company's shareholders.

The company's policy is to give shareholders the opportunity to vote on every substantially different issue by proposing a separate resolution for each issue. The Board's opinion is that the re-election and fees of the auditors are inter-related issues and should therefore be dealt with by one resolution. Changes to the articles of association are being proposed this year. These are being dealt with in a single resolution as changes to the company's constitution are a single issue.

It is our policy for all directors to attend the AGM. Whilst, because of ill health or other pressing reasons, this may not always be achievable, in normal circumstances this means the chairman of the *Audit* and *Remuneration Committees* is at the AGM and is available to answer questions referred to him by the Chairman.

BT's practice is to post the Annual Report and Notice of AGM, given the large number of shareholders, in the most cost-effective manner. We aim to give as much notice as possible and at least 21 days, as required by our articles of association.

Statement of BT Business Practice

BT's policy is to achieve best practice in our standards of business integrity for all of our activities around the world. To reinforce our determination to live up to these standards BT has adopted a *Statement of Business Practice* which sets out the principles the group will observe. A copy is available to every employee. We also require our agents and contractors to apply these principles when representing BT.

Pension fund

BT's main pension fund – the BT Pension Scheme – is not controlled by the Board, but by trustees, who are company and union nominees, with an independent chairman. The trustees look after the assets of the pension fund, which are held separately from those of the company. The pension scheme funds can only be used in accordance with its rules and for no other purpose.

Reporting

A statement by the directors of their responsibilities for preparing the financial statements is included on page 41.

A report to the company by the auditors, Coopers & Lybrand, on corporate governance matters is set out on page 29.

Report on directors' remuneration

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

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

Dr Iain Anderson
Sir Ewen Fergusson
Keith Oates

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

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

Remuneration policy

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

Packages

The remuneration package for executive directors comprises:

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

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

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

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

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

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

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

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

As Bill Cockburn joined the company too late in the year to participate in the 1997 operation of the LTRP, he has been granted an award of shares under the BT Performance Share Plan ('PSP') to the value of £150,000 at the date of the award.

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

The future

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

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

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

To increase the linkage with longer-term performance, the LTRP has been modified, and will now be called the Executive Share Plan. In previous years, part of the award was performance-linked only on grant and not also on vesting. This year and in the future all the awards will be subject to performance criteria over a five-year period, which will continue to be TSR. The level of the awards granted will continue to be based on the individual performance of the executives during the preceding year thereby ensuring that both the grant and vesting of awards will be performance-linked. Awards will be between 20% and 100% of salary and will not exceed the level possible under the previous LTRP arrangement. From and including this year, the optional personal investment and the associated matching grant under the plan will no longer be made available.

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

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

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

- **Pensions**
For executive directors and other senior executives the policy is to provide pension benefits of one thirtieth of final salary for each year of service with a two-thirds surviving spouse's pension. The executive directors and certain other senior executives have undertakings of pension benefits of two-thirds of final salary at normal retirement age with a two-thirds surviving spouse's pension. On death in service a lump sum equal to four times annual salary is payable together with a surviving spouse's pension of two-thirds of the director's prospective pension. Pensions are based on salary alone – bonuses, other benefits and long-term incentives are excluded.

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

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

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

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

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

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

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

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

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

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

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

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

Service agreements

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

Outside appointments

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

Non-executive directors' remuneration

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

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

Directors' remuneration

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

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

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

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

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

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

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

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

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

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

Directors' interests

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sir Colin Marshall

Deputy Chairman and Chairman of Remuneration Committee

26 MAY 1998

Statement of directors' responsibility

FOR PREPARING THE FINANCIAL STATEMENTS

The directors are required by law to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and the group as at the end of the financial year and of the profit or loss, total recognised gains or losses and cash flows of the group for that period.

The directors consider that, in preparing the financial statements for the year ended 31 March 1998 on pages 45 to 79, the company has used appropriate accounting policies, consistently applied and supported by reasonable and prudent judgements and estimates. The directors also consider that all applicable accounting standards have been followed and confirm that the financial statements have been prepared on the going concern basis.

The directors are responsible for ensuring that the company keeps accounting records which disclose with reasonable accuracy at any time the financial position of the company and which enable them to ensure that the financial statements comply with the Companies Act 1985.

The directors are also responsible for taking such steps that are reasonably open to them to safeguard the assets of the group and to prevent and detect fraud and other irregularities.

The auditors' responsibilities are stated in their report to the shareholders.

Report of the auditors

TO THE SHAREHOLDERS OF BRITISH TELECOMMUNICATIONS plc

We have audited the financial statements on page 45 to 79. We have also examined the amounts disclosed relating to the directors' remuneration, share options and pension entitlements on pages 35 to 40.

Respective responsibilities of directors and auditors

As described in the statement of directors' responsibility, the company's directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those financial statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board which are substantially the same as auditing standards generally accepted in the United States. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements referred to above:

- give a true and fair view of the state of affairs of the company and the group at 31 March 1998 and of the profit, total recognised gains and cash flows of the group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.
- present fairly, in all material respects, the consolidated financial position of the group as at 31 March 1998 and 31 March 1997 and the results of their operations, total recognised gains and their cash flows for the years ended 31 March 1998, 31 March 1997 and 31 March 1996 in conformity with accounting principles generally accepted in the United Kingdom. The principles differ in certain respects from accounting principles generally accepted in the United States. The effect of the differences in the determination of net income, shareholders' equity and cash flows is shown in note 30 to the financial statements.

Coopers & Lybrand
Chartered Accountants and Registered Auditors
London
26 MAY 1998

Five year financial summary

YEARS ENDED 31 MARCH

	1994 £m	1995 £m	1996 £m	1997 £m	**1998 £m**
Profit and loss account					
Turnover	13,675	13,893	14,446	14,935	**15,640**
Other operating income *(a)*	53	129	103	106	**372**
Operating profit *(b)*	2,982	2,663	3,100	3,245	**3,657**
Group's share of profits (losses) of associated undertakings	18	92	82	139	**(252)**
Profit (loss) on sale of group undertakings	(14)	241	7	8	**63**
Net interest payable	(230)	(259)	(170)	(129)	**(249)**
Premium on repurchase of bonds	–	(75)	–	(60)	**–**
Profit on ordinary activities before taxation	2,756	2,662	3,019	3,203	**3,219**
Tax on profit on ordinary activities:					
Corporation and similar taxes	(951)	(926)	(1,027)	(1,102)	**(978)**
Windfall tax	–	–	–	–	**(510)**
Profit on ordinary activities after taxation	1,805	1,736	1,992	2,101	**1,731**
Minority interests	(38)	(5)	(6)	(24)	**(25)**
Profit for the financial year	1,767	1,731	1,986	2,077	**1,706**
Earnings per share	28.5p	27.8p	31.6p	32.8p	**26.7p**
Earnings per share before exceptional items	28.5p	27.8p	31.6p	32.8p	**31.7p**
Fully diluted earnings per share	27.9p	27.2p	31.0p	32.2p	**26.3p**
Fully diluted earnings per share before exceptional items	27.9p	27.2p	31.0p	32.2p	**31.2p**
Dividends per share (including 1997 special dividend of 35p)	16.7p	17.7p	18.7p	54.85p	**19.0p**
(a) Including MCI merger break-up fee net of expenses	–	–	–	–	**238**
(b) Including redundancy charges	517	820	421	367	**106**

	1994 £m	1995 £m	1996 £m	1997 £m	**1998 £m**
Cash flow statement					
Cash flow from operating activities	4,917	5,119	5,834	6,192	**6,076**
Returns on investments and servicing of finance	(202)	(348)	(150)	(220)	**(160)**
Taxation	(605)	(1,175)	(784)	(1,045)	**(1,886)**
Capital expenditure and financial investment	(2,123)	(2,535)	(2,500)	(2,820)	**(3,108)**
Acquisitions and disposals	(482)	(2,260)	(132)	(252)	**(1,501)**
Equity dividends paid	(999)	(1,065)	(1,138)	(1,217)	**(3,473)**
Cash inflow (outflow) before management of liquid resources and financing	506	(2,264)	1,130	638	**(4,052)**
Management of liquid resources	(797)	2,557	(1,317)	(504)	**2,247**
Financing	273	(207)	215	(224)	**1,794**
Increase (decrease) in cash for the year	(18)	86	28	(90)	**(11)**
Decrease (increase) in net debt for the year	563	(2,146)	1,319	849	**(3,860)**

Five year financial summary (continued)

AT 31 MARCH

	1994 £m	1995 £m	1996 £m	1997 £m	**1998 £m**
Balance sheet					
Tangible fixed assets	15,584	16,012	16,496	16,802	**17,252**
Fixed asset investments	1,312	1,082	1,057	1,273	**1,708**
Net current assets (liabilities)	125	(725)	(106)	(2,667)	**(2,637)**
Total assets less current liabilities	17,021	16,369	17,447	15,408	**16,323**
Loans and other borrowings falling due after one year	(3,199)	(3,361)	(3,322)	(2,693)	**(3,889)**
Provisions for liabilities and charges	(701)	(879)	(1,267)	(1,391)	**(1,426)**
Minority interests	(95)	(132)	(180)	(208)	**(223)**
Total assets less liabilities	13,026	11,997	12,678	11,116	**10,785**
Total equity shareholders' funds	13,026	11,997	12,678	11,116	**10,785**
Total assets	22,565	21,459	23,536	25,062	**23,285**

US GAAP

YEARS ENDED 31 MARCH

	1994	1995	1996	1997	**1998**
Income before taxes	2,333	2,580	2,774	3,326	**2,796**
Net income	1,476	1,744	1,806	2,149	**1,451**
Basic earnings per ordinary share	23.8p	28.0p	28.8p	33.9p	**22.7p**
Diluted earnings per ordinary share	23.4p	27.6p	28.4p	33.6p	**22.4p**
Basic earnings per ADS	£2.38	£2.80	£2.88	£3.39	**£2.27**
Diluted earnings per ADS	£2.34	£2.76	£2.84	£3.36	**£2.24**

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Total assets	23,181	23,879	26,183	27,239	**27,951**
Ordinary shareholders' equity	11,511	12,185	13,010	11,588	**12,615**

Accounting policies

I Basis of preparation of the financial statements

The financial statements are prepared under the historical cost convention and in accordance with applicable accounting standards. The group financial statements consolidate those of the company and all of its subsidiary undertakings. Where the financial statements of subsidiary and associated undertakings do not conform with the group's accounting policies, appropriate adjustments are made on consolidation in order to present the group financial statements on a consistent basis. The principal subsidiary undertakings' financial years are all coterminous with those of the company.

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenditure during the reporting period. Actual results could differ from those estimates. Estimates are used principally when accounting for income, provision for doubtful debts, payments to telecommunication operators, depreciation, employee pension schemes and taxes. Certain comparative figures have been restated to conform with revised presentation and reclassification of figures in the year ended 31 March 1998.

II Turnover

Turnover, which excludes value added tax and other sales taxes, comprises the value of services provided and equipment sales excluding those between group undertakings.

III Research and development

Expenditure on research and development is written off as incurred.

IV Interest

Interest payable, including that related to financing the construction of tangible fixed assets, is written off as incurred. Discounts or premiums and expenses on the issue of debt securities are amortised over the term of the related security and included within interest payable. Premiums payable on early redemptions of debt securities, in lieu of future interest costs, are written off when paid.

V Foreign currencies

On consolidation, assets and liabilities of foreign undertakings are translated into sterling at year-end exchange rates. The results of foreign undertakings are translated into sterling at average rates of exchange for the year.

Exchange differences arising from the retranslation at year-end exchange rates of the net investment in foreign undertakings, less exchange differences on borrowings which finance or provide a hedge against those undertakings, are taken to reserves and are reported in the statement of total recognised gains and losses.

All other exchange gains or losses are dealt with through the profit and loss account.

VI Goodwill

Goodwill, arising from the purchase of subsidiary and associated undertakings, representing the excess of the fair value of the purchase consideration over the fair value of the net assets acquired, is written off on acquisition against group reserves. If an undertaking is subsequently divested, or if there has been a permanent diminution in value, the appropriate goodwill is dealt with through the profit and loss account in the period of disposal as part of the calculation of gain or loss on divestment or in the period of permanent diminution.

VII Tangible fixed assets

Tangible fixed assets are stated at historical cost less depreciation.

(a) Cost

Cost in the case of network services comprises expenditure up to and including the last distribution point and includes contractors' charges and payments on account, materials, direct labour and related overheads.

(b) Depreciation

Depreciation is provided on tangible fixed assets on a straight line basis from the time they are available for use, so as to write off their costs over their estimated useful lives taking into account any expected residual values. No depreciation is provided on freehold land.

The lives assigned to other significant tangible fixed assets are:

Freehold buildings –	40 years
Leasehold land and buildings –	Unexpired portion of lease or 40 years, whichever is the shorter
Transmission equipment:	
duct –	25 years
cable –	3 to 25 years
radio and repeater equipment –	2 to 25 years
Digital telephone exchange equipment –	2 to 13 years
Computers and office equipment –	2 to 7 years
Payphones, other network equipment, motor vehicles and cableships –	3 to 20 years

VIII Fixed asset investments

Investments in subsidiary and associated undertakings are stated in the balance sheet of the company at cost less amounts written off. Amounts denominated in foreign currency are translated into sterling at year-end exchange rates.

Investments in associated undertakings are stated in the group balance sheet at the group's share of their net assets.

The group's share of profits less losses of associated undertakings is included in the group profit and loss account.

Investments in other participating interests and other investments are stated at cost less amounts written off.

IX Stocks

Stocks mainly comprise items of equipment, held for sale or rental, consumable items and work in progress on long-term contracts.

Equipment held and consumable items are stated at the lower of cost and estimated net realisable value, after provisions for obsolescence.

Work in progress on long-term contracts is stated at cost, after deducting payments on account, less provisions for any foreseeable losses.

X Redundancy costs

Redundancy costs arising from periodic reviews of staff levels are charged against profit in the year in which employees leave the group.

If the most recent actuarial valuation of the group's pension scheme shows a deficit, the estimated cost of providing incremental pension benefits in respect of employees leaving the group is charged against profit in the year in which the employees leave the group, within redundancy charges.

XI Pension scheme

The group operates a defined benefit pension scheme, which is independent of the group's finances, for the substantial majority of its employees. Actuarial valuations of the scheme are carried out as determined by the trustees at intervals of not more than three years, the rates of contribution payable and the pension cost being determined on the advice of the actuaries, having regard to the results of these valuations. In any intervening years, the actuaries review the continuing appropriateness of the contribution rates.

The cost of providing pensions is charged against profits over employees' working lives with the group using the projected unit method. Variations from this regular cost are allocated over the average remaining service lives of current employees to the extent that these variations do not relate to the estimated cost of providing incremental pension benefits in the circumstances described in X above.

Interest is accounted for on the provision in the balance sheet which results from differences between amounts recognised as pension costs and amounts funded. The regular pension cost, variations from the regular pension cost, described above, and interest are all charged within staff costs.

XII Taxation

The charge for taxation is based on the profit for the year and takes into account deferred taxation. Provision is made for deferred taxation only to the extent that timing differences are expected to reverse in the foreseeable future, with the exception of timing differences arising on pension costs where full provision is made irrespective of whether they are expected to reverse in the foreseeable future.

XIII Financial instruments

(a) Debt instruments

Debt instruments are stated at the amount of net proceeds adjusted to amortise any discount evenly over the term of the debt.

(b) Derivative financial instruments

The group uses derivative financial instruments to reduce exposure to foreign exchange risks and interest rate movements. The group does not hold or issue derivative financial instruments for financial trading purposes.

Criteria to qualify for hedge accounting

The group considers its derivative financial instruments to be hedges when certain criteria are met. For foreign currency derivatives, the instrument must be related to actual foreign currency assets or liabilities or a probable commitment and whose characteristics have been identified. It must involve the same currency or similar currencies as the hedged item and must also reduce the risk of foreign currency exchange movements on the group's operations. For interest rate derivatives, the instrument must be related to assets or liabilities or a probable commitment and must also change the nature of the interest rate by converting a fixed rate to a variable rate or vice versa.

(b) Derivative financial instruments (continued)

Accounting for derivative financial instruments

Principal amounts underlying currency swaps are revalued at exchange rates ruling at the date of the group balance sheet and are included in debtors or creditors.

Interest differentials, under interest rate swap agreements used to vary the amounts and periods for which interest rates on borrowings are fixed, are recognised by adjustment of interest payable.

The forward exchange contracts used to change the currency mix of net debt are revalued to balance sheet rates with net unrealised gains and losses being shown as part of debtors or creditors. The difference between spot and forward rate for these contracts is recognised as part of net interest payable over the term of the contract.

The forward exchange contracts hedging transaction exposures are revalued at the prevailing forward rate on the balance sheet date with net unrealised gains and losses being shown as debtors and creditors.

Group profit and loss account

FOR THE YEAR ENDED 31 MARCH 1998

	Notes	1998 £m	1997 £m	1996 £m
Turnover	1	**15,640**	14,935	14,446
Other operating income *(a)*	2	**372**	106	103
Operating costs *(b)*	3	**(12,355)**	(11,796)	(11,449)
Operating profit		**3,657**	3,245	3,100
Group's share of profits (losses) of associated undertakings		**(252)**	139	82
Profit on sale of group undertakings	4	**63**	8	7
Interest receivable	5	**165**	206	201
Interest payable	6	**(414)**	(335)	(371)
Premium on repurchase of bonds	7	**-**	(60)	-
Profit on ordinary activities before taxation		**3,219**	3,203	3,019
Tax on profit on ordinary activities:	8			
Corporation and similar taxes		**(978)**	(1,102)	(1,027)
Windfall tax		**(510)**	-	-
		(1,488)	(1,102)	(1,027)
Profit on ordinary activities after taxation		**1,731**	2,101	1,992
Minority interests		**(25)**	(24)	(6)
Profit for the financial year		**1,706**	2,077	1,986
Dividends:	9			
Ordinary		**(1,220)**	(1,266)	(1,184)
Special		**-**	(2,244)	-
		(1,220)	(3,510)	(1,184)
Retained profit (transfer from reserves) for the financial year	23	**486**	(1,433)	802
Earnings per share	10	**26.7p**	32.8p	31.6p
Earnings per share before exceptional items		**31.7p**	32.8p	31.6p
Fully diluted earnings per share		**26.3p**	32.2p	31.0p
Fully diluted earnings per share before exceptional items		**31.2p**	32.2p	31.0p
(a) Including MCI merger break up fee net of expenses		**238**	-	-
(b) Including redundancy charges		**106**	367	421

Group statement of total recognised gains and losses

FOR THE YEAR ENDED 31 MARCH 1998

	1998 £m	1997 £m	1996 £m
Profit for the financial year	**1,706**	2,077	1,986
Currency movements arising on consolidation of foreign subsidiary and associated undertakings	**(74)**	(76)	42
Total recognised gains and losses	**1,632**	2,001	2,028

Group cash flow statement

FOR THE YEAR ENDED 31 MARCH 1998

	Notes	1998 £m	1997 £m	1996 £m
Net cash inflow from operating activities	*11*	**6,076**	6,192	5,834
Returns on investments and servicing of finance				
Interest received		**168**	196	202
Interest paid, including finance costs		**(328)**	(342)	(332)
Premium paid on repurchase of bonds		**-**	(60)	-
Dividends paid to minorities		**-**	(14)	(20)
Net cash outflow for returns on investments and servicing of finance		**(160)**	(220)	(150)
Taxation				
UK corporation tax paid		**(1,625)**	(1,032)	(738)
Windfall tax paid		**(255)**	-	-
Overseas tax paid		**(6)**	(13)	(46)
Tax paid		**(1,886)**	(1,045)	(784)
Capital expenditure and financial investment				
Purchase of tangible fixed assets		**(3,020)**	(2,823)	(2,547)
Sale of tangible fixed assets		**127**	124	88
Purchase of fixed asset investments		**(265)**	(172)	(85)
Disposal of fixed asset investments		**50**	51	44
Net cash outflow for capital expenditure and financial investment		**(3,108)**	(2,820)	(2,500)
Acquisitions and disposals				
Purchase of subsidiary undertakings, net of £6m (1997 – £2m, 1996 – £1m) cash acquired		**(121)**	(126)	(26)
Purchase of associated undertakings		**(1,380)**	(148)	(122)
Sale of subsidiary undertakings		**-**	11	16
Sale of associated undertakings		**-**	11	-
Net cash outflow for acquisitions and disposals		**(1,501)**	(252)	(132)
Equity dividends paid		**(3,473)**	(1,217)	(1,138)
Cash inflow (outflow) before management of liquid resources and financing		**(4,052)**	638	1,130
Management of liquid resources	*12*	**2,247**	(504)	(1,317)
Financing				
Issue of ordinary share capital		**144**	160	130
Minority shares issued		**48**	51	59
New loans		**1,637**	35	175
Loan repayments		**(338)**	(670)	(133)
Net increase (decrease) in short-term borrowings		**303**	200	(16)
Net cash inflow (outflow) from financing		**1,794**	(224)	215
Increase (decrease) in cash in the year		**(11)**	(90)	28
Decrease (increase) in net debt in the year	*13*	**(3,860)**	849	1,319

Balance sheets

AT 31 MARCH 1998

	Notes	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Fixed assets					
Tangible assets	*14*	**17,252**	16,802	**14,899**	14,493
Investments	*15*	**1,708**	1,273	**7,808**	6,599
Total fixed assets		**18,960**	18,075	**22,707**	21,092
Current assets					
Stocks		**145**	180	**124**	159
Debtors	*16*	**3,387**	3,807	**4,918**	4,013
Investments	*17*	**731**	2,974	**15**	2,909
Cash at bank and in hand		**62**	26	**1**	–
Total current assets		**4,325**	6,987	**5,058**	7,081
Creditors: amounts falling due within one year					
Loans and other borrowings	*18*	**881**	483	**3,282**	2,316
Other creditors	*20*	**6,081**	9,171	**6,043**	9,005
Total creditors: amounts falling due within one year		**6,962**	9,654	**9,325**	11,321
Net current liabilities		**(2,637)**	(2,667)	**(4,267)**	(4,240)
Total assets less current liabilities		**16,323**	15,408	**18,440**	16,852
Creditors: amounts falling due after more than one year					
Loans and other borrowings	*18*	**3,889**	2,693	**4,126**	3,493
Provisions for liabilities and charges	*21*	**1,426**	1,391	**1,269**	1,341
Minority interests		**223**	208	**–**	–
Capital and reserves					
Called up share capital	*22*	**1,603**	1,589	**1,603**	1,589
Share premium account	*23*	**892**	675	**892**	675
Other reserves	*23*	**776**	777	**749**	750
Profit and loss account	*23*	**7,514**	8,075	**9,801**	9,004
Total equity shareholders' funds	*23*	**10,785**	11,116	**13,045**	12,018
		16,323	15,408	**18,440**	16,852

Debtors include amounts receivable after more than one year: group £97m (1997 – £546m) and company £213m (1997 – £741m).

The financial statements on pages 45 to 79 were approved by the board of directors on 26 May 1998 and were signed on its behalf by

Sir Iain Vallance *Chairman*

Sir Peter Bonfield CBE *Chief Executive*

R P Brace *Group Finance Director*

Notes to the financial statements

1. Turnover	**1998 £m**	1997 £m	1996 £m
Inland calls	**4,924**	4,874	4,882
International calls	**1,553**	1,809	1,980
Exchange line rentals	**2,957**	2,811	2,685
Private circuits	**1,149**	1,124	1,056
Mobile communications	**1,089**	949	856
Customer premises equipment supply	**896**	914	946
Yellow Pages and other directories	**466**	438	408
Other sales and services	**2,606**	2,016	1,633
Total turnover	**15,640**	14,935	14,446

The group provides telecommunication services, principally in the United Kingdom, essentially operating as a unitary business. Its main services and products are local and national telephone calls in the United Kingdom, the provision of telephone exchange lines to homes and businesses, international telephone calls made to and from the United Kingdom, the provision of private circuits to businesses, the supply of mobile communication services and equipment to businesses and individuals and the supply of telecommunication equipment for customers' premises.

Turnover included income from UK and overseas telecommunications operators of £1,269m (1997 – £1,165m, 1996 – £1,166m). Approximately 4% (1997 – 3%, 1996 – 2%) of total operating revenues arose from operations outside the United Kingdom. There were no discontinued operations or acquisitions in the years ended 31 March 1996, 1997 and 1998 that require disclosure under Financial Reporting Standard 3.

Unaudited information concerning the group's classified directory business in the UK is shown on page 83 of this annual report.

2. Other operating income	**1998 £m**	1997 £m	1996 £m
Merger agreement break up fee *(a)*	**273**	–	–
Merger expenses written off	**(35)**	–	–
Other	**134**	106	103
Total other operating income	**372**	106	103

(a) The company received US$465 million on 12 November 1997 from WorldCom, Inc as a break up fee and partial reimbursement of expenses ("the MCI merger break up fee") following the termination of the BT/MCI merger agreement on 9 November 1997 (note 15 *(b)*).

3. Operating costs	1998 £m	1997 £m	1996 £m
Staff costs:			
Wages and salaries	**3,290**	3,161	3,105
Social security costs	**266**	262	261
Pension costs *(note 25)*	**177**	291	284
Employee share ownership scheme *(a)*	**64**	64	30
Employee share option scheme compensation for special dividend *(b)*	**120**	–	–
Total staff costs	**3,917**	3,778	3,680
Own work capitalised	**(424)**	(399)	(417)
Depreciation *(note 14)*	**2,395**	2,265	2,189
Payments to telecommunication operators	**1,600**	1,476	1,383
Redundancy charges *(c)*	**106**	367	421
Other operating costs	**4,761**	4,309	4,193
Total operating costs	**12,355**	11,796	11,449
Operating costs included the following:			
Research and development	**307**	291	282
Rental costs relating to operating leases, including plant and equipment hire £19m (1997 – £10m, 1996 – £23m)	**192**	215	250

(a) Amount set aside for the year for allocation of ordinary shares in the company to eligible employees.

(b) Compensation for employees holding share options on 15 August 1997 in respect of the September 1997 special dividend.

(c) Redundancy charges for the year ended 31 March 1997 included £258m (1996 – £266m) being the cost of providing incremental pension benefits for employees taking early retirement. No charge for these pension benefits was made in the year ended 31 March 1998 in view of the surplus in the BT pension scheme disclosed by the most recent actuarial valuation as at 31 December 1996; the previous valuation had shown a deficit.

The directors believe that the nature of the group's business is such that the analysis of operating costs required by the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adapted the prescribed format so that operating costs are disclosed in a manner appropriate to the group's principal activity. Other operating income, previously presented within operating costs, is now shown separately on the face of the group profit and loss account because of its greater materiality in the year ended 31 March 1998.

4. Profit on sale of group undertakings

In the years ended 31 March 1998, 31 March 1997 and 31 March 1996 the subsidiary undertakings disposed of had a negligible effect on the group's operating profit and cash flows and their net assets were immaterial to the group's financial position.

5. Interest receivable	1998 £m	1997 £m	1996 £m
Income from listed investments	**11**	12	29
Other interest receivable	**154**	194	172
Total interest receivable	**165**	206	201

6. Interest payable	1998 £m	1997 £m	1996 £m
Interest payable and similar charges in respect of:			
Bank loans and overdrafts	**80**	76	74
Other borrowings	**334**	259	297
Total interest payable	**414**	335	371

7. Premium on repurchase of bonds

In August 1996, the company repurchased two of the three series of HM Government held bonds then outstanding for £422m at an effective premium of £60m. The final bond series with a face value of £140m was repaid on maturity on 31 March 1997.

8. Tax on profit on ordinary activities	1998 £m	1997 £m	1996 £m
United Kingdom:			
Corporation tax at 31% (1997 – 33%, 1996 – 33%)	**985**	1,135	1,000
Deferred taxation charge (credit) at 30% (1997 – 33%, 1996 – 33%)	**17**	(100)	(20)
Taxation on the group's share of results of associated undertakings	**1**	–	1
Deferred taxation provision released due to reduction in corporation tax rate	**(25)**	–	–
Prior year adjustments	**(2)**	1	(1)
Total UK taxation, excluding windfall tax	**976**	1,036	980
Overseas taxation:			
Current	**6**	17	8
Taxation charge (credit) on the group's share of results of associated undertakings	**(4)**	49	39
Total corporation and similar taxes	**978**	1,102	1,027
Windfall tax	**510**	–	–
Total tax on profit on ordinary activities	**1,488**	1,102	1,027

The company's charge to the UK windfall tax, imposed on certain privatised companies on 2 July 1997, is payable in two equal instalments, the first of which was paid on 2 December 1997. The second instalment is payable on 1 December 1998. The charge is based on the group's profit for the financial years ended 31 March 1986 to 31 March 1989.

Total tax on profit on ordinary activities, excluding the windfall tax, varied from the amount computed by applying the corporation tax rate to profit on ordinary activities before taxation. The differences were attributable to the following factors:

	1998 %	1997 %	1996 %
UK corporation tax rate	**31.0**	33.0	33.0
Non-deductible depreciation	**0.6**	0.8	1.3
Non-deductible overseas losses	**1.1**	1.0	0.9
Unprovided deferred taxes on excess capital allowances	**(0.9)**	(0.9)	(1.0)
Effect of reduction in UK corporation tax rate on deferred tax provision	**(0.8)**	–	–
Lower effective tax on MCI merger break up fee	**(0.7)**	–	–
Non-deductible premium on bonds repurchased from HM Government	**–**	0.4	–
Other	**0.1**	0.1	(0.2)
Effective corporation tax rate	**30.4**	34.4	34.0

Deferred taxation of £30m (1997 – £28m, 1996 – £30m) arising on excess capital allowances and £nil (1997 – £19m, 1996 – £11m) on profits of associated undertakings was not provided in the year ended 31 March 1998.

8. Tax on profit on ordinary activities (continued)

The deferred taxation charge (credit) was mainly the result of the tax effect of timing differences as follows:

	1998 £m	1997 £m	1996 £m
Excess capital allowances	**24**	62	76
Pension provisions	**20**	(103)	(29)
Other timing differences	**(27)**	(59)	(67)
	17	(100)	(20)
Release due to reduction in corporation tax rate	**(25)**	–	–
Prior year adjustments *(a)*	**(14)**	21	116
Total deferred taxation charge (credit)	**(22)**	(79)	96

(a) Reclassification between deferred and current taxation on the profit on ordinary activities for prior years.

9. Dividends	**1998 pence per share**	1997 pence per share	1996 pence per share	**1998 £m**	1997 £m	1996 £m
Interim dividend paid	**7.55**	7.90	7.45	**483**	502	469
Proposed final dividend	**11.45**	11.95	11.25	**737**	764	715
Total ordinary dividends	**19.00**	19.85	18.70	**1,220**	1,266	1,184
Special dividend	**–**	35.00	–	**–**	2,244	–
Total dividends	**19.00**	54.85	18.70	**1,220**	3,510	1,184

10. Earnings per share

Earnings per share are calculated by dividing the profit for the financial year ended 31 March 1998, amounting to £1,706m (1997 – £2,077m, 1996 – £1,986m), by 6,394 million shares, the weighted average number of shares in issue during the financial year (1997 – 6,336 million, 1996 – 6,283 million). The fully diluted earnings per share are based on share options outstanding.

The exceptional items in the calculation of the earnings per share before exceptional items in the year ended 31 March 1998 and the individual earnings per share effects are:

	Pence per share	**£m**
MCI merger break up fee received less expenses		**238**
Less tax charge attributable to the MCI merger break up fee		**(50)**
Net merger break up fee after tax	**3.0**	**188**
Windfall tax charge	**(8.0)**	**(510)**
Net charge	**(5.0)**	**(322)**

11. Reconciliation of operating profit to operating cash flows	**1998 £m**	1997 £m	1996 £m
Operating profit, including share of results of associated undertakings	**3,405**	3,384	3,182
Depreciation	**2,395**	2,265	2,189
Share of losses (profits) of associated undertakings net of dividends received £5m (1997 – £7m, 1996 – £5m)	**257**	(132)	(77)
Decrease in stocks	**36**	31	36
Increase in debtors	**(29)**	(168)	(335)
Increase in creditors	**44**	478	493
Increase (decrease) in provisions	**(47)**	321	309
Other	**15**	13	37
Net cash inflow from operating activities	**6,076**	6,192	5,834

12. Management of liquid resources	1998 £m	1997 £m	1996 £m
Purchase of short-term investments and payments into short-term deposits over 3 months	**(1,103)**	(2,242)	(2,520)
Sale of short-term investments and withdrawals from short-term deposits over 3 months	**1,334**	2,790	1,996
Net movement of short-term investments and short-term deposits under 3 months not repayable on demand	**2,016**	(1,052)	(793)
Net cash inflow (outflow) from management of liquid resources	**2,247**	(504)	(1,317)

Movements in all short-term investments and deposits not repayable on demand are reported under the heading of management of liquid resources.

13. Net debt	At 1 April 1997 £m	Cash flow £m	Other non-cash changes £m	Currency movement £m	At 31 March 1998 £m
Analysis of net debt					
Cash in hand and at bank	26	36	–	–	**62**
Overnight deposits	30	(16)	–	–	**14**
Bank overdrafts	(11)	(31)	–	–	**(42)**
	45	(11)	–	–	**34**
Other current asset investments	2,944	(2,247)	(1)	21	**717**
Short-term investments and cash, less bank overdrafts	**2,989**	**(2,258)**	**(1)**	**21**	**751**
Debt due within one year, excluding bank overdrafts	(472)	(35)	(334)	2	**(839)**
Debt due after one year	(2,693)	(1,567)	315	56	**(3,889)**
Total debt, excluding bank overdrafts	**(3,165)**	**(1,602)**	**(19)**	**58**	**(4,728)**
Net debt	**(176)**	**(3,860)**	**(20)**	**79**	**(3,977)**

Reconciliation of net cash flow to movement in net debt	1998 £m	1997 £m	1996 £m
Increase (decrease) in cash in the year	**(11)**	(90)	28
Cash (inflow) outflow from (increase) decrease in debt	**(1,602)**	435	(26)
Cash (inflow) outflow from (decrease) increase in liquid resources	**(2,247)**	504	1,317
Decrease (increase) in net debt resulting from cash flows	**(3,860)**	849	1,319
Currency and translation movements	**79**	(47)	(60)
Other non-cash movements	**(20)**	(30)	(54)
Decrease (increase) in net debt in the year	**(3,801)**	772	1,205
Net debt at 1 April	**(176)**	(948)	(2,153)
Net debt at 31 March	**(3,977)**	(176)	(948)

14. Tangible fixed assets	Land and buildings *(a)* £m	Plant and equipment £m	Assets in course of construction £m	Total £m
Group				
Cost				
Balances at 1 April 1997	2,801	29,206	979	32,986
Acquisitions of subsidiary undertakings	–	5	–	5
Additions	24	1,058	1,964	3,046
Transfers	148	1,786	(1,934)	–
Disposals and adjustments	(111)	(3,376)	(35)	(3,522)
Total cost at 31 March 1998	**2,862**	**28,679**	**974**	**32,515**
Depreciation				
Balances at 1 April 1997	1,316	14,952	–	16,268
Acquisitions of subsidiary undertakings	–	1	–	1
Charge for the year	95	2,300	–	2,395
Disposals and adjustments	(82)	(3,251)	–	(3,333)
Total depreciation at 31 March 1998	**1,329**	**14,002**	**–**	**15,331**
Net book value at 31 March 1998	1,533	14,677	974	17,184
Engineering stores	–	–	68	68
Total tangible fixed assets at 31 March 1998	**1,533**	**14,677**	**1,042**	**17,252**
Net book value at 31 March 1997	1,485	14,254	979	16,718
Engineering stores	–	–	84	84
Total tangible fixed assets at 31 March 1997	1,485	14,254	1,063	16,802
Company				
Cost				
Balances at 1 April 1997	796	27,354	773	28,923
Additions	17	647	1,978	2,642
Transfers	102	1,782	(1,884)	–
Disposals and adjustments	(14)	(3,257)	(46)	(3,317)
Total cost at 31 March 1998	**901**	**26,526**	**821**	**28,248**
Depreciation				
Balances at 1 April 1997	391	14,122	–	14,513
Charge for the year	23	2,087	–	2,110
Disposals and adjustments	(18)	(3,188)	–	(3,206)
Total depreciation at 31 March 1998	**396**	**13,021**	**–**	**13,417**
Net book value at 31 March 1998	**505**	**13,505**	**821**	**14,831**
Engineering stores	–	–	68	68
Total tangible fixed assets at 31 March 1998	**505**	**13,505**	**889**	**14,899**
Net book value at 31 March 1997	405	13,232	773	14,410
Engineering stores	–	–	83	83
Total tangible fixed assets at 31 March 1997	405	13,232	856	14,493

14. Tangible fixed assets (continued)	Group **1998 £m**	Group 1997 £m	Company **1998 £m**	Company 1997 £m
(a) The net book value of land and buildings comprised:				
Freehold	**1,281**	1,317	**312**	239
Long leases (over 50 years unexpired)	**92**	53	**73**	53
Short leases	**160**	115	**120**	113
Total net book value of land and buildings	**1,533**	1,485	**505**	405

(b) Expenditure on tangible fixed assets comprised:	Group **1998 £m**	Group 1997 £m
Plant and equipment:		
Transmission equipment	**1,219**	1,131
Exchange equipment	**512**	445
Other network equipment	**502**	503
Computers and office equipment	**372**	350
Motor vehicles and other	**230**	175
Land and buildings	**211**	143
Decrease in engineering stores	**(16)**	(28)
Total expenditure on tangible fixed assets	**3,030**	2,719

15. Fixed asset investments	Interests in associated undertakings *(a) (c)* Shares £m	Loans £m	Share of post acquisition profits (losses) £m	Other participating interests £m	Other investments *(d)* £m	Total £m
Group						
Cost						
Balances at 1 April 1997	3,100	20	197	140	155	3,612
Additions	1,281	135	–	70	196	1,682
Transfer of investment in MCI Communications Corporation *(b)*	(2,808)	–	(218)	–	3,026	–
Share of losses less retained profits for the year	–	–	(254)	–	–	(254)
Repayments, disposals and other transfers	22	1	(23)	(46)	24	(22)
Currency movements	(62)	(5)	12	–	(20)	(75)
Balances at 31 March 1998	**1,533**	**151**	**(286)**	**164**	**3,381**	**4,943**
Provisions and amounts written off						
Balances at 1 April 1997	(2,333)	–	–	–	(6)	(2,339)
Goodwill	(928)	–	–	–	–	(928)
Transfer of investment in MCI Communications Corporation *(b)*	2,214	–	–	–	(2,214)	–
Decrease (increase) in the year	42	–	–	–	(10)	32
Balances at 31 March 1998	**(1,005)**	**–**	**–**	**–**	**(2,230)**	**(3,235)**
Net book value at 31 March 1998	**528**	**151**	**(286)**	**164**	**1,151**	**1,708**
Net book value at 31 March 1997	767	20	197	140	149	1,273

	Subsidiary undertakings *(a)* Shares £m	Loans £m	Associated undertakings *(a)* £m	Other participating interests £m	Other investments *(d)* £m	Total £m
Company						
Cost						
Balances at 1 April 1997	4,140	11	2,723	140	176	7,190
Additions	2,586	–	18	70	31	2,705
Transfer of investment in MCI Communications Corporation *(b)*	–	–	(2,613)	–	2,613	–
Repayments, disposals and other transfers	(68)	–	(16)	(46)	(1,212)	(1,342)
Currency movements	–	(1)	(80)	–	–	(81)
Balances at 31 March 1998	**6,658**	**10**	**32**	**164**	**1,608**	**8,472**
Provisions and amounts written off						
Balances at 1 April 1997	(411)	–	(27)	–	(153)	(591)
Increase in the year	(64)	–	–	–	(10)	(74)
Disposals and transfers	–	–	12	–	(11)	1
Balances at 31 March 1998	**(475)**	**–**	**(15)**	**–**	**(174)**	**(664)**
Net book value at 31 March 1998	**6,183**	**10**	**17**	**164**	**1,434**	**7,808**
Net book value at 31 March 1997	3,729	11	2,696	140	23	6,599

15. Fixed asset investments (continued)

(a) Subsidiary and associated undertakings

Details of the principal operating subsidiary and associated undertakings are set out on pages 78 and 79.

(b) MCI Communications Corporation

In September 1994, the company completed the acquisition of a 20% equity interest in MCI (the second largest carrier of long-distance telecommunications services in the USA) represented by a holding of 136 million Class A common shares, whereupon MCI became the group's most significant associated undertaking. On 3 November 1996, the company entered into a merger agreement with MCI whereby the group would acquire the entire share capital of MCI, not already owned. On 21 August 1997, the terms of the merger agreement were modified. On 1 October 1997, WorldCom announced its intention to offer shares in its company to MCI shareholders as an alternative to the proposed merger and, following an improved offer from WorldCom on 9 November 1997, the company agreed that it would support the proposed merger with WorldCom to which the MCI board had agreed on the same day. On 11 March 1998, both MCI's and WorldCom's shareholders approved their merger.

The company has agreed with WorldCom and MCI to sell the group's holding of 136 million unlisted Class A common shares in MCI to WorldCom for US$51 per share in cash at the time the MCI/WorldCom merger is completed. The potential consideration of US$6,936m was equivalent to £4,137m at the exchange rate ruling on 31 March 1998. The completion of the merger is subject to regulatory clearance. The group also holds 0.7 million listed common shares in MCI, most of which were purchased in November 1995. These shares will be exchanged for WorldCom common shares on completion of the merger. If fully listed, the market value of the MCI shares held by the group at 31 March 1998 would have been £4,048m.

As a consequence of the termination of the company's merger agreement with MCI and the company's agreement with WorldCom and MCI, the group ceased treating MCI as an associate from 1 November 1997. The group's share of its associates' results includes a loss before tax of £27m for its share of MCI's results up to that date (1997 – £175m profit, 1996 – £101m profit).

At 31 March 1998, the group's investment in MCI is stated at £813m (1997 – £834m). Goodwill amounting to £2,214m has been written off to group reserves in prior years in respect of this investment and this goodwill will be accounted for at the completion of the MCI/WorldCom merger in determining the profit on the sale of the shares which the group will recognise.

In the period 1 April 1997 to 31 October 1997, the group's turnover with MCI amounted to £108m (1997 – £134m, 1996 – £92m) and the group purchased £56m in the same period (1997 – £87m, 1996 – £77m) in services and products from MCI.

(c) Cegetel

On 24 September 1997, the group completed its acquisition of a 26% interest in Cegetel, a leading French telecommunications company. Of the cost of the investment in the associated undertaking of £1,029m, goodwill arising of £862m has been written off against reserves.

The acquisition of the interest in Cegetel comprised:

	£m
Group share of original book value of net assets	**483**
Fair value adjustment to achieve consistency of accounting policies	**(316)**
Fair value to the group	**167**
Goodwill	**862**
Total cost	**1,029**

(d) Other investments

Other investments include ordinary shares of the company, with a net book value of £29m (1997 – £20m) and a market value of £68m (1997 – £28m), held in trust for the Long Term Remuneration Plan and the Performance Share Plan (note 28). Also, in the group balance sheet at 31 March 1998, listed investments were held with a book value of £117m (1997 – £72m) and a market value of £154m (1997 – £61m).

(e) Subsidiary company acquisition

In February 1997, the group entered into an agreement to purchase from Banco Santander SA its 50% holding in the share capital of BT Telecomunicaciones SA, a joint venture between a wholly-owned subsidiary of the company and Banco Santander SA, for the equivalent of £76m. The transaction was completed in July 1997.

(f) Other related party transactions with associates

In the year ended 31 March 1998, the group's turnover with its other associated undertakings amounted to £74m (1997 – £23m) and the group purchased £9m (1997 – £30m) in services and products from these undertakings.

16. Debtors	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Trade debtors *(a)*	**1,801**	1,757	**1,679**	1,552
Amounts owed by subsidiary undertakings	**–**	–	**1,649**	438
Amounts owed by associated undertakings	**118**	72	**57**	29
Other debtors	**249**	304	**201**	190
Advance corporation tax recoverable *(b)*	**–**	456	**116**	651
Accrued income	**1,046**	1,084	**1,014**	1,055
Prepayments	**173**	134	**202**	98
Total debtors	**3,387**	3,807	**4,918**	4,013
Total debtors included amounts receivable after more than one year:				
Advance corporation tax recoverable *(b)*	**–**	456	**116**	651
Accrued income	**97**	80	**97**	80
Prepayments	**–**	10	**–**	10
Total	**97**	546	**213**	741

(a) The group's trade debtors are stated after deducting £227m (1997 – £163m) for doubtful debts. The amount charged to the group profit and loss account for doubtful debts for the year ended 31 March 1998 was £218m (1997 – £188m, 1996 – £179m).

(b) Advance corporation tax recoverable

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Advance corporation tax on proposed final dividend and, in 1997, on special dividend	**184**	752	**184**	752
Amount offset against deferred tax provision *(note 21)*	**(184)**	(296)	**(68)**	(101)
Balance included within debtors	**–**	456	**116**	651

17. Current asset investments	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Listed investments	**150**	115	**5**	16
Other short-term deposits and investments	**581**	2,859	**10**	2,893
Total current asset investments	**731**	2,974	**15**	2,909
Market value of listed investments	**150**	115	**5**	16

18. Loans and other borrowings	Average effective interest rates *(a)* %	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
US dollar 6½% guaranteed notes 1997	7.7	-	230	-	-
US dollar 9⅜% guaranteed bonds 1998	6.7	**149**	153	-	-
US dollar 9⅜% guaranteed notes 1999	9.6	**179**	184	-	-
US dollar 8¾% guaranteed bonds 1999	8.8	**119**	123	-	-
Zero coupon bonds 2000					
(less unamortised discount £38m (1997 – £55m))	6.6	**162**	145	**162**	145
US dollar 6¾% notes 2002 (less unamortised discount £9m)	7.1	**886**	–	**886**	–
12¼% bonds 2003	12.3	**180**	180	**180**	180
7⅛% bonds 2003 (less unamortised discount £3m (1997 – £4m))	7.3	**497**	496	**497**	496
12¼% bonds 2006	12.3	**229**	229	**229**	229
US dollar 7% notes 2007 (less unamortised discount £3m)	7.1	**593**	–	**593**	–
US dollar 9⅝% guaranteed debentures 2019	9.8	**119**	122	-	–
8⅝% bonds 2020 (less unamortised discount £5m (1997 – £5m))	8.8	**295**	295	**295**	295
Total listed bonds, debentures and notes		**3,408**	2,157	**2,842**	1,345
Lease finance		**10**	2	**2**	2
Bank loans due 1999-2009	9.0	**792**	796	-	–
Other loans	11.0	**10**	–	-	–
Bank overdrafts and other short-term borrowings	7.1	**74**	11	**1,237**	1,597
Commercial paper	7.1	**476**	210	**476**	210
Loans from subsidiary undertakings		-	–	**2,851**	2,655
Total loans and other borrowings		**4,770**	3,176	**7,408**	5,809

Apart from the lease finance, all borrowings are unsecured. Lease finance is repayable by instalments.

	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Repayments fall due as follows:				
Within one year, or on demand	**881**	483	**3,282**	2,316
Between one and two years	**459**	338	**432**	331
Between two and three years	**12**	418	**280**	450
Between three and four years	**2**	–	**1**	774
Between four and five years	**1,143**	–	**1,141**	1
After five years	**2,273**	1,937	**2,272**	1,937
Total due for repayment after more than one year	**3,889**	2,693	**4,126**	3,493
Total loans and other borrowings	**4,770**	3,176	**7,408**	5,809

The group has an option to redeem the US dollar 9⅝% guaranteed debentures 2019 exercisable from February 1999 at a maximum premium of 105%.

18. Loans and other borrowings (continued)

(a) Average effective interest rates
The average interest rates on page 61 take into account the effect of interest rate swaps. The interest basis of interest rate swap agreements used, the notional amounts, their average maturities and weighted average interest rates are shown below:

	Average maturity	Notional amount £m	Average interest receivable rate %	Average interest payable rate %
Pay fixed interest and receive variable interest	Over 5 years	1,124	6.2	8.5
Pay variable interest and receive fixed interest	Under 5 years	365	9.5	7.4

The rates of the variable rate portion of the swaps are based on quoted rates. In calculating the average variable rates, the latest rates agreed with the counterparty on each swap have been used. Changes in interest rates will affect the variable-rate information disclosed above.

(b) Unused committed lines of credit for short-term financing available at 31 March 1998 totalled approximately £786m, which was in support of a commercial paper programme or other borrowings. These lines of credit are normally available for up to one year.

19. Financial instruments and risk management

The group uses derivative financial instruments primarily to manage its exposure to market risks from changes in interest and foreign exchange rates. There has been no change in the risk profile between the year end and the date of these financial statements.

The notional amounts of derivatives summarised below do not necessarily represent amounts exchanged by the parties and, thus, are not a measure of the exposure of the group through its use of derivatives. The amounts exchanged are calculated on the notional amounts and other terms of the derivatives which relate to interest and exchange rates.

(a) Interest rate risk management
The group has entered into interest rate swap agreements with commercial banks and other institutions to vary the amounts and periods for which interest rates on borrowings are fixed. By swapping fixed rates on long-term borrowings into floating rates, the group has obtained lower floating-rate borrowings than those available if borrowing directly at a floating rate. Under interest rate swaps, the group agrees with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts calculated by reference to an agreed notional principal amount.

At 31 March 1998, the group had outstanding interest rate swap agreements having a total notional principal amount of £1,489m (1997 – £1,247m).

(b) Foreign exchange risk management
Cross currency swaps and forward foreign exchange contracts have been entered into to reduce the foreign currency exposure on the group's operations and the group's net assets. The group also enters into forward foreign exchange contracts to hedge investments, interest expense and purchase and sale commitments denominated in foreign currencies (principally US dollars). The terms of the currency swaps are up to 20 years and the terms of currency forward exchange contracts are typically less than one year. The purpose of the group's foreign currency hedging activities is to protect the group from the risk that the eventual net inflows and net outflows will be adversely affected by changes in exchange rates.

At 31 March 1998, the group had outstanding foreign currency swap agreements and forward exchange contracts having a total notional principal amount of £4,476m (1997 – £2,541m).

The fair values of foreign currency contracts at 31 March 1998 were £3,037m (1997 – £1,071m) for purchases of currency and £892m (1997 – £683m) for sales of currency. These fair values have been estimated by calculating their present values using the market discount rates, appropriate to the terms of the contracts, in effect at the balance sheet dates.

At 31 March 1998, the group had deferred unrealised gains of £nil (1997 – £21m) and losses of £36m (1997 – £7m), based on dealer-quoted prices, from hedging purchase and sale commitments. At 31 March 1998, the group also had deferred realised net losses of £12m (1997 – £36m net losses). These are included in the profit and loss account as part of the purchase or sale transaction when it is recognised, or as gains or losses when a hedged transaction is no longer expected to occur.

19. Financial instruments and risk management (continued)

(c) Concentrations of credit risk and credit exposures of financial instruments
The group considers that it is not exposed to major concentrations of credit risk. The group, however, is exposed to credit-related losses in the event of non-performance by counterparties to financial instruments, but does not expect any counterparties to fail to meet their obligations. Based on interest and exchange rates in effect at 31 March 1998, the group had a maximum credit exposure of £118m (1997 – £113m) to one counterparty under foreign currency and interest rate swap agreements. The group limits the amount of credit exposure to any one counterparty. The group does not normally see the need to seek collateral or other security.

(d) Fair value of financial instruments
The following table shows the carrying amounts and fair values of the group's financial instruments at 31 March 1998 and 1997. The carrying amounts are included in the group balance sheet under the indicated headings, with the exception of derivative amounts related to borrowings, which are included in debtors or other creditors as appropriate. The fair values of the financial instruments are the amount at which the instruments could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale.

	Carrying amount		Fair value	
	1998 £m	1997 £m	**1998 £m**	1997 £m
Non-derivatives:				
Assets				
Cash at bank and in hand	**62**	26	**62**	26
Short-term investments *(i)*	**731**	2,974	**731**	2,974
Liabilities				
Short-term borrowings *(ii)*	**550**	221	**550**	221
Long-term borrowings, excluding finance leases *(iii)*	**4,210**	2,953	**4,665**	3,168
Derivatives relating to investments and borrowings (net) *(iv)*:				
Assets	**48**	79	**–**	11
Liabilities	**–**	–	**114**	–

(i) The fair values of listed short-term investments were estimated based on quoted market prices for those investments. The carrying amount of the other short-term deposits and investments approximated to their fair values due to the short maturity of the instruments held.

(ii) The fair value of short-term borrowings approximated to carrying value due to the short maturity of the instruments.

(iii) The fair value of the group's bonds, debentures, notes and other long-term borrowings has been estimated on the basis of quoted market prices for the same or similar issues with the same maturities where they existed, and on calculations of the present value of future cash flows using the appropriate discount rates in effect at the balance sheet dates, where market prices of similar issues did not exist.

(iv) The fair value of the group's outstanding foreign currency and interest rate swap agreements was estimated by calculating the present value, using appropriate discount rates in effect at the balance sheet dates, of affected future cash flows translated, where appropriate, into pounds sterling at the market rates in effect at the balance sheet dates.

20. Other creditors	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Trade creditors	**1,971**	1,858	**1,550**	1,483
Amounts owed to subsidiary undertakings	**–**	–	**870**	898
Amounts owed to associated undertakings	**39**	46	**–**	–
Corporation and windfall taxes	**833**	1,774	**589**	1,503
Other taxation and social security	**309**	332	**308**	321
Other creditors	**1,055**	1,134	**952**	931
Accrued expenses	**392**	313	**302**	203
Deferred income	**745**	706	**735**	658
Dividends *(a)*	**737**	3,008	**737**	3,008
Total other creditors	**6,081**	9,171	**6,043**	9,005
Total other creditors included amounts due after more than one year:				
Deferred income	**–**	13	**–**	13

(a) The 1997 figures include the special dividend of £2,244m, paid in September 1997.

21. Provisions for liabilities and charges	Deferred taxation *(a)* £m	Pension provisions £m	Other provisions £m	Total £m
Group				
Balances at 1 April 1997	296	1,291	100	1,687
Charged (credited) against profit for the year	(22)	177	25	180
Utilised in the year	–	(244)	(13)	(257)
	274	1,224	112	1,610
Advance corporation tax recoverable	(184)	–	–	(184)
Total provisions at 31 March 1998	**90**	**1,224**	**112**	**1,426**
Company				
Balances at 1 April 1997	101	1,291	50	1,442
Charged (credited) against profit for the year	(33)	171	(5)	133
Utilised in the year	–	(238)	–	(238)
	68	1,224	45	1,337
Advance corporation tax recoverable	(68)	–	–	(68)
Total provisions at 31 March 1998	**–**	**1,224**	**45**	**1,269**

21. Provisions for liabilities and charges (continued)

(a) Deferred taxation

The elements of deferred taxation provided in the accounts at 31 March were as follows:	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Tax effect of timing differences due to:				
Excess capital allowances	**712**	763	**598**	669
Pension provisions	**(367)**	(426)	**(367)**	(426)
Other	**(71)**	(41)	**(163)**	(142)
Total deferred taxation provided	**274**	296	**68**	101
Advance corporation tax recoverable	**(184)**	(296)	**(68)**	(101)
Total provision for deferred taxation	**90**	–	**–**	–

The total potential liability to deferred taxation at 31 March was as follows:

Tax effect of timing differences due to:	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Excess capital allowances	**2,576**	2,781	**2,463**	2,687
Pension provisions	**(367)**	(426)	**(367)**	(426)
Other	**(71)**	(41)	**(163)**	(142)
Total	**2,138**	2,314	**1,933**	2,119
Advance corporation tax recoverable	**(184)**	(752)	**(184)**	(752)
Total potential liability for deferred taxation	**1,954**	1,562	**1,749**	1,367

22. Called up share capital

The authorised share capital of the company throughout the year ended 31 March 1998 was £2,625,000,001 divided into one special rights redeemable preference share of £1 and 10,500,000,000 ordinary shares of 25p each.

The allotted, called up and fully paid share capital of the company was £1,603m at 31 March 1998 (1997 – £1,589m), representing 6,411,214,670 ordinary shares (1997 – 6,355,115,816 ordinary shares and one special rights redeemable preference share).

Certain special rights, set out in the company's articles of association, were attached to the special rights redeemable preference share issued to HM Government. The share, which carried no right to capital or profits beyond its nominal value, was redeemed at par by HM Government on 10 September 1997.

Of the authorised but unissued share capital at 31 March 1998, 261 million ordinary shares were reserved to meet options granted under the employee share option schemes described in note 28.

Ordinary shares allotted during the year were as follows:

	Number	Nominal value £	Consideration*(a)* £
Savings related schemes	45,762,406	11,440,602	122,602,122
Other share option schemes	6,554,498	1,638,625	21,454,362
Scrip dividend	3,781,950	945,487	–
Totals for the year ended 31 March 1998	**56,098,854**	**14,024,714**	**144,056,484**

(a) Consideration excludes contributions from group undertakings as described in note 23*(d)*.

During the year ended 31 March 1998 a number of shareholders elected to take all or part of their interim dividend in shares at a value of £18m. The nominal value of the shares issued has been funded out of the capital redemption reserve and the amount of the dividend has been added back to the profit and loss reserve.

23. Reconciliation of movement in shareholders' funds	Share capital £m	Share premium account(a) £m	Capital redemption reserve £m	Other reserves £m	Profit and loss account £m	Total £m
Group						
Balances at 31 March 1995	1,559	415	750	18	9,255	11,997
Goodwill, arising on acquisition of subsidiary and associated undertakings *(b)*	–	–	–	–	(302)	(302)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	12	12
Employee share option schemes – 57 million shares issued *(note 28)*	14	116	–	–	–	130
Currency movements (including £29 million net losses in respect of foreign currency borrowings) *(c)*	–	–	–	–	42	42
Transfer to other reserves	–	–	–	9	(9)	–
Profit for the financial year	–	–	–	–	1,986	1,986
Dividends (18.7p net per ordinary share)	–	–	–	–	(1,184)	(1,184)
Other movements	–	–	–	–	(3)	(3)
Balances at 31 March 1996	1,573	531	750	27	9,797	12,678
Goodwill, arising on acquisition of subsidiary and associated undertakings *(b)*	–	–	–	–	(199)	(199)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	5	5
Employee share option schemes – 64 million shares issued *(note 28)*	16	144	–	–	–	160
Currency movements (including £29 million net gains in respect of foreign currency borrowings) *(c)*	–	–	–	–	(76)	(76)
Profit for the financial year	–	–	–	–	2,077	2,077
Dividends (54.85p net per ordinary share)	–	–	–	–	(3,510)	(3,510)
Other movements	–	–	–	–	(19)	(19)
Balances at 31 March 1997	1,589	675	750	27	8,075	11,116
Goodwill, arising on acquisition of subsidiary and associated undertakings *(b)*	–	–	–	–	(937)	(937)
Goodwill, previously written off to reserves, taken back to the profit and loss account	–	–	–	–	5	5
Employee share option schemes – 52 million shares issued *(d)* *(note 28)*	13	217	–	–	–	230
Movement relating to BT's employee share ownership trust *(d)*	–	–	–	–	(85)	(85)
Currency movements (including £31 million net gains in respect of foreign currency borrowings) *(c)*	–	–	–	–	(74)	(74)
Profit for the financial year	–	–	–	–	1,706	1,706
Dividends (19.0p net per ordinary share)	–	–	–	–	(1,220)	(1,220)
Scrip dividend – 4 million shares issued *(note 22)*	1	–	(1)	–	18	18
Other movements	–	–	–	–	26	26
Balances at 31 March 1998	**1,603**	**892**	**749**	**27**	**7,514**	**10,785**

23. Reconciliation of movement in shareholders' funds (continued)

	Share capital £m	Share premium account *(a)* £m	Capital redemption reserve £m	Profit and loss account £m	Total £m
Company					
Balances at 31 March 1995	1,559	415	750	9,890	12,614
Employee share option schemes – 57 million shares issued *(note 28)*	14	116	–	–	130
Profit for the financial year *(e)*	–	–	–	2,339	2,339
Dividends (18.7p net per ordinary share)	–	–	–	(1,184)	(1,184)
Currency movements (including £28m net losses in respect of foreign currency borrowings)	–	–	–	149	149
Balances at 31 March 1996	1,573	531	750	11,194	14,048
Employee share option schemes – 64 million shares issued *(note 28)*	16	144	–	–	160
Profit for the financial year *(e)*	–	–	–	1,475	1,475
Dividends (54.85p net per ordinary share)	–	–	–	(3,510)	(3,510)
Currency movements (including £29m net gain in respect of foreign currency borrowings)	–	–	–	(155)	(155)
Balances at 31 March 1997	1,589	675	750	9,004	12,018
Employee share option schemes – 52 million shares issued *(d) (note 28)*	13	217	–	–	230
Movement relating to BT's employee share ownership trust *(d)*	–	–	–	(85)	(85)
Profit for the financial year *(e)*	–	–	–	2,150	2,150
Dividends (19.0p net per ordinary share)	–	–	–	(1,220)	(1,220)
Scrip dividend – 4 million shares issued *(note 22)*	1	–	(1)	18	18
Currency movements (including £31m net gain in respect of foreign currency borrowings)	–	–	–	(66)	(66)
Balances at 31 March 1998	**1,603**	**892**	**749**	**9,801**	**13,045**

(a) The share premium account, representing the premium on allotment of shares and the capital redemption reserve are not available for distribution.

(b) Aggregate goodwill at 31 March 1998 in respect of acquisitions in the current and earlier years of £3,603m (1997 – £2,671m, 1996 – £2,477m) has been written off against retained earnings. The goodwill written off in the year ended 31 March 1998 mainly arose in connection with the acquisition of the interest in Cegetel; that written off in the year ended 31 March 1997 mainly arose in connection with the acquisition of shares not already owned in BT Telecomunicaciones SA and the acquisition of Syntegra Groep BV; that written off in the year ended 31 March 1996 mainly arose in connection with an acquisition made by MCI.

(c) The cumulative foreign currency translation adjustment, which decreased retained earnings at 31 March 1998, was £130 million (1997 – £56m decrease, 1996 – £20m increase).

(d) During the year ended 31 March 1998 the company issued shares at a market value of £203m in respect of the exercise of options awarded under its principal savings-related share option scheme. Employees paid £118m to the group for the issue of these shares and the balance of £85m comprised contributions to the qualifying employee share ownership trust from group undertakings.

(e) The profit for the financial year, dealt with in the profit and loss account of the company and after taking into account dividends from subsidiary undertakings, was £2,150m (1997 – £1,475m, 1996 – £2,339m). As permitted by Section 230 of the Companies Act 1985, no profit and loss account of the company is presented.

24. Financial commitments and contingent liabilities	Group 1998 £m	Group 1997 £m	Company 1998 £m	Company 1997 £m
Contracts placed for capital expenditure not provided for in the accounts	**1,047**	1,125	**965**	1,008
Operating lease payments payable within one year of the balance sheet date were in respect of leases expiring:				
Within one year	**9**	10	**3**	6
Between one and five years	**39**	32	**21**	19
After five years	**135**	131	**94**	92
Total payable within one year	**183**	173	**118**	117

Future minimum operating lease payments for the group at 31 March 1998 were as follows:
Payable in the year ending 31 March:

	1998 £m
1999	**183**
2000	**167**
2001	**127**
2002	**122**
2003	**118**
Thereafter	**1,265**
Total future minimum operating lease payments	**1,982**

Operating lease commitments were mainly in respect of leases of land and buildings.

At 31 March 1998, there were no contingent liabilities or guarantees other than those arising in the ordinary course of the group's business and on these no material losses are anticipated. The group has insurance cover to certain limits for major risks on property and major claims in connection with legal liabilities arising in the course of its operations. Otherwise, the group generally carries its own risks.

The company has guaranteed certain borrowings of subsidiary undertakings amounting to £1,330m (1997 – £1,577m).

Satellite consortia, in which the company has participating interests, are organisations without limited liability. At 31 March 1998, the company's share of the aggregate borrowings of these consortia amounted to £188m (1997 – £179m).

Outstanding at 31 March 1998 and 1997 were warrants entitling the holders to subscribe in 1999 for US dollar 8.765% guaranteed bonds at par, repayable in 2009, to be issued by the group with a total principal value equivalent to £119m (1997 – £123m).

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.

As explained in note 15(b), the company's merger agreement with MCI (the BT/MCI merger) was terminated on 9 November 1997. Individuals purporting to represent classes of MCI shareholders have now filed seventeen complaints in the Court of Chancery in the State of Delaware (the "Delaware Shareholder Class Actions"), asserting claims in connection with the original and renegotiated terms of the then-proposed BT/MCI merger. MCI and certain of its officers and directors, including officers of the company who served as MCI directors, are named as defendants in all seventeen Delaware Shareholder Class Actions. The company is named as a defendant in fifteen of these cases. The original and amended complaints filed in these fifteen cases collectively allege that the company breached and aided and abetted breaches of fiduciary duties owed to MCI shareholders in connection with the then-proposed BT/MCI merger. In addition, amended complaints in five of the Delaware Shareholder Class Actions assert claims in connection with the pending WorldCom/MCI merger, including challenges to the merger termination fee paid to the company and the company's right to receive cash in exchange for its Class A common shares in MCI. Four of these amended complaints name the company as a defendant. The court, having issued an order consolidating fifteen of the Delaware

24. Financial commitments and contingent liabilities (continued)

Shareholder Class Actions, subsequently directed the plaintiffs to submit a proposed order vacating that consolidation order and to submit a new proposed order of consolidation. The parties have agreed that the defendants are not obligated to respond to the complaints filed in these fifteen cases until the consolidation issue has been resolved and the plaintiffs serve the defendants with a consolidated and amended complaint. In the two Delaware Shareholder Class Actions that were not included in the court's initial consolidation order, neither the company nor its officers who served as MCI directors have been served, and have therefore not responded to the complaints.

In addition, after the renegotiation of the terms of the BT/MCI merger, an MCI shareholder filed a derivative action on behalf of MCI in the Court of Chancery in the State of Delaware. The complaint names the company and certain officers and directors of MCI, including officers of the company who served as MCI directors, as defendants. Among the claims asserted in the complaint is the allegation that the company aided and abetted breaches of fiduciary duty in connection with the proposed BT/MCI merger. The complaint does not take into account the subsequent WorldCom/MCI merger agreement. The parties have agreed that defendants need not respond to the complaint until the plaintiffs serve an amended complaint. No such complaint has yet been served.

In addition, individuals purporting to represent a class of persons who purchased MCI shares during the period 11 July 1997 to 21 August 1997 have filed a consolidated amended class action complaint (the "Complaint") under the caption In Re MCI Communications Corp Securities Litigation, now pending in the federal district court for the District of the District of Columbia. The Complaint supersedes certain earlier federal securities class action complaints. The Complaint alleges that MCI, the company and certain MCI officers and directors, including officers of the company who served as MCI directors, violated the federal securities laws by failing timely to disclose that MCI was renegotiating the terms of the merger with the company.

The company believes that it will prevail in the foregoing actions.

25. Pension costs

The total pension cost of the group expensed within staff costs was £177m (1997 – £291m, 1996 – £284m), of which £169m (1997 – £281m, 1996 – £275m) related to the group's main pension scheme, the BT Pension Scheme (BTPS). The reduction in the cost in the year ended 31 March 1998 was mainly attributable to the greater than assumed return on the BTPS assets in the three year period to 31 December 1996, i.e. between the last two actuarial valuations. The increase in the charge in the year ended 31 March 1997 was mainly attributable to the increase in interest on the pension provisions in the balance sheet which had risen by £311m to £1,291m in the year ended 31 March 1997.

The pension cost for the year ended 31 March 1998 was based on the valuation of the BTPS at 31 December 1996. The pension cost for the years ended 31 March 1996 and 1997 were based on the valuation of the BTPS at 31 December 1993. The valuations, carried out by professionally qualified independent actuaries, used the projected unit method. The valuations were determined using the following long-term assumptions:

	Rates (per annum)	
	1996	1993
	%	%
Return on existing assets, relative to market values	**8.0**	8.6
Return on future investments	**8.4**	9.7
Real equity dividend growth	**0.75**	0.5
Average increase in retail price index	**4.0**	5.0
Average future increases in wages and salaries	**5.8**	6.8

At 31 December 1996, the assets of the BTPS had a market value of £19,879m and were sufficient to cover 100.3% of the benefits that had accrued to members by that date, after allowing for expected future increases in wages and salaries but not taking into account the costs of providing incremental pension benefits for employees taking early retirement under release schemes since that date. This cost, which amounted to £224m in the year ended 31 March 1998, will be taken into account at the next planned actuarial valuation at 31 December 1999. The incremental pension costs of employees taking early retirement in the years ended 31 March 1997 and 1996, £258m and £266m, respectively were included in redundancy costs charged to the profit and loss account in those years.

In the year ended 31 March 1998, the group made regular contributions of £238m (1997 – £232m, 1996 – £234m).

25. Pension costs (continued)

Certain activities of the BTPS are carried out at the company's pension centre, all costs of which are borne by the company. These costs have not been apportioned for accounting purposes between those attributable to the BTPS and those attributable to the company because functions maintained for both entities cannot be meaningfully divided between them. The company occupies eight properties owned by the scheme on which an annual rental of £3m is payable.

The BTPS assets are invested in UK and overseas equities, UK and overseas properties, fixed interest and index linked securities, deposits and short-term investments. At 31 March 1998, the UK equities included 42 million (1997 – 56 million) ordinary shares of the company with a market value of £270m (1997 – £250m).

26. Directors

Directors' emoluments

The emoluments of the directors for the year ended 31 March 1998 and the gains made by them on the exercise of share options were, in summary, as follows:

	1998 £000	1997 £000*(a)*	1996 £000*(a)*
Salaries	**1,578**	1,543	1,471
Performance-related bonus	**882**	636	543
Deferred bonus	**222**	–	–
Other benefits	**114**	94	71
	2,796	2,273	2,085
Payments to non-executive directors *(b)*	**259**	273	381
Total emoluments	**3,055**	2,546	2,466
Gain on the exercise of share options	**857**	93	6

(a) Comparative figures have been restated.

(b) Payments to non-executive directors include fees paid to their principal employer of £38,000 (1997 – £31,000, 1996 – £24,000).

More detailed information concerning directors' remuneration, shareholdings, options and long-term incentive plans is shown in the report on directors' remuneration on pages 33 to 40.

27. People employed	**1998 Year end '000**	**1998 Average '000**	1997 Year end '000	1997 Average '000	1996 Year end '000	1996 Average '000
Number of employees in the group:						
UK	**120.2**	**124.9**	123.3	125.8	127.8	132.6
International	**4.5**	**4.3**	4.2	3.8	2.9	2.6
Total employees	**124.7**	**129.2**	127.5	129.6	130.7	135.2

28. Employee share schemes

The company has a share ownership scheme used for employee share allocations (profit sharing), savings-related share option schemes for its employees and those of participating subsidiaries and further share option schemes for selected group employees. It also has a performance share plan and a long-term remuneration plan.

Share option schemes

The major share option scheme, the BT Employee Sharesave Scheme, is savings related and the share options are normally exercisable on completion of a three or five-year Save As You Earn contract. A similar savings-related scheme exists for group employees overseas. Under the other share option schemes, share options are normally exercisable between the third and tenth anniversaries of the date of grant. Options outstanding under these share option schemes at 31 March, together with their exercise prices and dates, were as follows:

Normal dates of exercise	Option price per share	Number of ordinary shares 1998 millions	Number of ordinary shares 1997 millions
Savings-related schemes:			
1997	265p	**–**	46
1998	320p	**45**	47
1999	341p	**27**	29
1999	300p	**8**	9
2000	404p	**5**	–
2000	306p	**47**	48
2001	267p	**68**	70
2002	359p	**53**	–

Normal dates of exercise	Option price per share	Number of ordinary shares 1998 millions	Number of ordinary shares 1997 millions
Other share option schemes:			
1992–1999	281p	**–**	1
1993–2000	289p	**1**	3
1995–2002	333p	**3**	4
1996–2003	430p	**2**	2
1997–2004	375p	**2**	4
Total options outstanding		**261**	263

During the year ended 31 March 1998, BT granted 60 million options (1997 – 79 million, 1996 – nil) under the employee sharesave schemes. The weighted average fair value of share options granted during the year ended 31 March 1998 has been estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used in that model: an expected life extending one month later than the first exercise date; estimated annualised dividend growth rates of approximately 5%; risk free interest rates of 7% on options exercisable three years after the date of grant and 8% on options exercisable five years after the date of grant; and expected volatility of approximately 18%.

The weighted average fair value of the share options granted in the year ended 31 March 1998 was 80p (1997 – 85p) for options exercisable three years after the date of grant and 120p (1997 – 107p) for options exercisable five years after the date of grant. The total value of share options granted by BT in the year ended 31 March 1998 was £70m (1997 – £83m) . In accordance with UK accounting practices, no compensation expense is recognised for the fair value of options granted. See note 30 for the treatment under US GAAP.

28. Employee share schemes (continued)

Options granted, exercised and lapsed under these share option schemes during the years ended 31 March 1996, 1997 and 1998 and options exercisable at 31 March 1996, 1997 and 1998 were as follows:

	Savings related schemes millions	Other share option schemes millions	Total millions	Exercise price range	Weighted average exercise price
Outstanding, 31 March 1995	303	26	329	210p–460p	283p
Exercised	(50)	(7)	(57)	210p–380p	230p
Lapsed	(15)	–	(15)	210p–430p	305p
Outstanding, 31 March 1996	238	19	257	211p–460p	294p
Granted	79	–	79	267p–300p	271p
Exercised	(61)	(3)	(64)	211p–430p	251p
Lapsed	(7)	(2)	(9)	244p–430p	299p
Outstanding, 31 March 1997	249	14	263	243p–460p	297p
Granted	60	–	60	359p–596p	363p
Exercised	(46)	(6)	(52)	243p–430p	275p
Lapsed	(10)	–	(10)	243p–430p	313p
Outstanding, 31 March 1998	**253**	**8**	**261**	**262p–596p**	**316p**
Exercisable, 31 March 1996	–	13	13	211p–430p	333p
Exercisable, 31 March 1997	–	11	11	243p–460p	337p
Exercisable, 31 March 1998	–	7	7	262p–460p	362p

Long-term remuneration and performance share plans

A long-term remuneration plan (LTRP) and a performance share plan (PSP) were introduced for employees of the group in 1994 and 1995, respectively. Under the plans, company shares are acquired by an employee share ownership trust and are conditionally awarded to participants, although participants will only be entitled to these shares in full at the end of a five-year period under the LTRP and the end of a three-year period, which may be extended to four or five years, under the PSP if, at the end of the applicable period, the company has met the relevant pre-determined corporate performance measure and normally, if the participants are still employed by the group. Awards of shares were granted in each of the years from 1994 to 1997 under the LTRP and from 1995 to 1997 under the PSP. The corporate performance measure assesses the company's overall performance against those top 100 companies listed on the London Stock Exchange, as rated by the Financial Times (the FT-SE 100 index), at the beginning of the relevant performance period.

At 31 March 1998, 5.8 million shares in the company (1997 – 3.5 million) were held in trust for the PSP and 4.6 million shares (1997 – 2.7 million) were held in trust for the LTRP. Dividends earned on the shares during the conditional periods are reinvested in company shares for the potential benefit of the participants. Additional information relating to the plans is as follows:

	PSP		LTRP		Total	
	1998 £m	1997 £m	**1998 £m**	1997 £m	**1998 £m**	1997 £m
Value of range of possible future transfers: nil to	**37.9**	15.6	**29.5**	11.6	**67.4**	27.2
Provision for the costs of the plans charged to the profit and loss account in year	**6.8**	0.1	**2.5**	0.9	**9.3**	1.0
Nominal value of shares held in trust	**1.5**	0.9	**1.1**	0.7	**2.6**	1.6
Market value of shares held in trust	**38.0**	15.6	**30.0**	12.0	**68.0**	27.6

The values of possible future transfers of shares under the plans were based on the company's share price at 31 March 1998 of 650.0p (1997 – 445.5p). The provisions for the costs of the plans were based on best estimates of the company's performance over the plans' performance periods, relating to those portions of the plan performance periods from commencement up to the financial year end.

29. Auditors

The auditors' remuneration for the year ended 31 March 1998 for the group was £2,396,000 (1997 – £2,135,000, 1996 – £2,138,000), including £1,216,000 (1997 – £1,167,000, 1996 – £1,170,000) for the company.

The following fees were paid or are payable to the company's auditors, Coopers & Lybrand, in the UK for the year ended 31 March 1998:

	1998 £000	1997 £000	1996 £000
Audit of the company's statutory accounts	**1,216**	1,167	1,170
Audits of the UK subsidiary undertakings' statutory accounts	**510**	396	349
Other services, including regulatory audits and tax compliance work	**4,724**	4,620	4,004
Total	**6,450**	6,183	5,523

In addition, fees of £1,295,000 (1997 – £1,888,000, 1996 – £1,395,000) were paid or are payable to other members of Coopers & Lybrand International for the year ended 31 March 1998 in respect of audit and other services to the company's overseas subsidiary undertakings and in respect of other services to the group.

30. United States Generally Accepted Accounting Principles

The group's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the UK (UK GAAP), which differ in certain significant respects from those applicable in the US (US GAAP).

Differences between United Kingdom and United States generally accepted accounting principles
The following are the main differences between UK and US GAAP which are relevant to the group's financial statements.

(a) Pension costs
Under UK GAAP, pension costs are accounted for in accordance with UK Statement of Standard Accounting Practice No. 24, costs being charged against profits over employees' working lives. Under US GAAP, pension costs are determined in accordance with the requirements of US Statements of Financial Accounting Standards (SFAS) Nos. 87 and 88. Differences between the UK and US GAAP figures arise from the requirement to use different actuarial methods and assumptions and a different method of amortising surpluses or deficits.

(b) Accounting for redundancies
Under UK GAAP, the group generally charges to profit and loss direct severance costs, primarily severance payments and payments in lieu of notice, in the period in which employees leave the group. The cost of providing incremental pension benefits in respect of workforce reductions are taken into account in determining current and future pension costs, unless the most recent actuarial valuation under UK actuarial conventions shows a deficit. In this case, the costs of providing incremental pension benefits are included in redundancy charges in the year in which the employees leave the group.

Under US GAAP, if employees are encouraged to leave voluntarily by the use of special termination benefits, then the termination benefits, primarily severance payments, payments in lieu of notice and the associated cost of providing incremental pension benefits, are charged against profits in the period in which the termination terms are agreed with the employees. If staff terminations are likely to be enforced, then the termination benefits are charged against profits at the time when the group is committed to the staff terminations and the associated costs can be reasonably estimated.

(c) Capitalisation of interest
Under UK GAAP, the group does not capitalise interest in its financial statements. To comply with US GAAP, the estimated amount of interest incurred whilst constructing major capital projects is included in fixed assets, and depreciated over the lives of the related assets. The amount of interest capitalised is determined by reference to the average interest rates on outstanding borrowings. At 31 March 1998 under US GAAP, gross capitalised interest of £525m (1997 – £722m) with regard to the company and its subsidiary companies was subject to depreciation generally over periods of 3 to 25 years.

(d) Goodwill
Under UK GAAP, the group writes off goodwill arising from the purchase of subsidiary and associated undertakings on acquisition against retained earnings. The goodwill is reflected in the net income of the period of disposal, as part of the calculation of the gain or loss on divestment, or when recognising a permanent diminution in value. Under US GAAP, such goodwill is held as an intangible asset in the balance sheet and amortised over its useful life and only the unamortised portion is included in the gain

30. United States Generally Accepted Accounting Principles (continued)

(d) Goodwill (continued)
or loss recognised at the time of divestment. Gross goodwill under US GAAP at 31 March 1998 of £925m (1997 – £1,986m) was subject to amortisation over periods of 3 to 40 years. Goodwill relating to MCI has been unchanged since 31 October 1997 when the investment ceased to have associated company status. The value of goodwill is reviewed annually and the net asset value is written down if a permanent diminution in value has occurred.

(e) Mobile cellular telephone licences, software and other intangible assets
Certain intangible fixed assets recognised under US GAAP purchase accounting requirements are subsumed within goodwill under UK GAAP. Under US GAAP these separately identified intangible assets are valued and amortised over their useful lives.

(f) Investments
Under UK GAAP, investments are held on the balance sheet at historical cost. Under US GAAP, trading securities and available-for-sale securities are carried at market value with appropriate valuation adjustments recorded in profit and loss and shareholder's equity, respectively. The net unrealised holding gain on available-for-sale securities for the year ended 31 March 1998 which related primarily to the investment in MCI was £1,315m (1997 – £nil, 1996 – £nil).

(g) Deferred taxation
Under UK GAAP, provision for deferred taxation is generally only made for timing differences which are expected to reverse. Under US GAAP, deferred taxation is provided on a full liability basis on all temporary differences, as defined in SFAS No. 109.

At 31 March 1998, the adjustment of £2,095m (1997 – £1,942m) reconciling ordinary shareholders' equity under UK GAAP to the approximate amount under US GAAP included the tax effect of other US GAAP adjustments. This comprised an adjustment decreasing non-current assets by £76m (1997 – £138m decrease); an adjustment increasing current assets by £68m (1997 – £408m decrease); an adjustment decreasing current liabilities by £184m (1997 – £191m decrease); an adjustment decreasing minority interests by £3m (1997 – £nil) and an adjustment increasing non-current deferred tax liabilities by £2,274m (1997 – £1,587m increase).

(h) Dividends
Under UK GAAP, dividends are recorded in the year in respect of which they are declared (in the case of interim or any special dividends) or proposed by the board of directors to the shareholders (in the case of final dividends). Under US GAAP, dividends are recorded in the period in which dividends are declared.

Net income and shareholders' equity reconciliation statements
The following statements summarise the material estimated adjustments, gross of their tax effect, which reconcile net income and shareholders' equity from that reported under UK GAAP to that which would have been reported had US GAAP been applied.

Net income

YEAR ENDED 31 MARCH	**1998 £m**	1997 £m	1996 £m
Net income applicable to shareholders under UK GAAP	**1,706**	2,077	1,986
Adjustments for:			
Pension costs	**(66)**	83	18
Redundancy charges	**(253)**	156	(152)
Capitalisation of interest, net of related depreciation	**(38)**	(23)	(22)
Goodwill amortisation	**(71)**	(73)	(74)
Mobile licences, software and other intangible asset capitalisation and amortisation, net	**42**	77	38
Investments	**5**	–	(2)
Deferred taxation	**163**	(148)	14
Other items	**(37)**	–	–
Net income as adjusted for US GAAP	**1,451**	2,149	1,806
Basic earnings per American Depositary Share as adjusted for US GAAP *(a)*	**£2.27**	£3.39	£2.88
Diluted earnings per American Depositary Share as adjusted for US GAAP *(a)*	**£2.24**	£3.36	£2.84

30. United States Generally Accepted Accounting Principles (continued)

Shareholders' equity

AT 31 MARCH

	1998 £m	1997 £m
Shareholders' equity under UK GAAP	**10,785**	11,116
Adjustments for:		
Pension costs	**(1,347)**	(1,057)
Redundancy costs	**(41)**	(12)
Capitalisation of interest, net of related depreciation	**299**	337
Goodwill, net of accumulated amortisation	**2,118**	2,146
Mobile licences, software and other intangible asset capitalisation and amortisation	**930**	260
Investments	**1,266**	(24)
Deferred taxation	**(2,095)**	(1,942)
Dividend declared after the financial year end	**737**	764
Other items	**(37)**	–
Shareholders' equity as adjusted for US GAAP	**12,615**	11,588

(a) Each American Depositary Share is equivalent to 10 ordinary shares of 25p each.

Minority interests

Under US GAAP, the minority interest charge would have been reduced by £5m (1997 – £nil, 1996 – £nil) after adjusting for goodwill amortisation. Net assets attributable to minority interests would have been £81m higher (1997 – £nil) after adjusting for goodwill, investments and other items.

Accounting for share options

Under UK GAAP, the company does not recognise compensation expense for the fair value, at the date of grant, of share options granted under the employee share option schemes. Under US GAAP, the company adopted the disclosure-only option in SFAS No. 123 "Accounting for Stock-Based Compensation" in the year ended 31 March 1997. Accordingly, the company accounts for share options in accordance with APB Opinion No. 25 "Accounting for Stock Issued to Employees", under which no compensation expense is recognised. Had the group expensed compensation cost for options granted in accordance with SFAS No. 123, the group's pro forma net income, basic earnings per share and diluted earnings per share under US GAAP would have been £1,436m (1997 – £2,126m, 1996 – £1,800m), 22.5p (1997 – 33.6p, 1996 – 28.7p) and 22.1p (1997 – 33.2p, 1996 – 28.4p), respectively. The SFAS No. 123 method of accounting does not apply to share options granted before 1 January 1995, and accordingly, the resulting pro forma compensation costs may not be representative of that to be expected in future years. See note 28 for the SFAS No. 123 disclosures of the fair value of options granted under employee sharesave schemes at date of grant.

Consolidated statements of cash flows

Under UK GAAP, the Consolidated Statements of Cash Flows are presented in accordance with UK Financial Reporting Standard No. 1 (FRS 1). The statements prepared under FRS 1 present substantially the same information as that required under SFAS No. 95.

Under SFAS No. 95 cash and cash equivalents include cash and short-term investments with original maturities of three months or less. Under FRS 1 cash comprises cash in hand and at bank and overnight deposits, net of bank overdrafts.

Under FRS 1, cash flows are presented for operating activities; returns on investments and servicing of finance; taxation; capital expenditure and financial investments; acquisitions and disposals; dividends paid to the company's shareholders; management of liquid resources and financing. SFAS No. 95 requires a classification of cash flows as resulting from operating, investing and financing activities.

30. United States Generally Accepted Accounting Principles (continued)

Cash flows under FRS 1 in respect of interest received, interest paid (net of that capitalised under US GAAP) and taxation would be included within operating activities under SFAS No. 95. Cash flows from purchases, sales and maturities of trading securities, while not separately identified under UK GAAP, would be included within operating activities under US GAAP. Capitalised interest, while not recognised under UK GAAP, would be included in investing activities under US GAAP. Dividends paid would be included within financing activities under US GAAP.

The following statements summarise the statements of cash flows as if they had been presented in accordance with US GAAP, and include the adjustments which reconcile cash and cash equivalents under US GAAP to cash at bank and in hand reported under UK GAAP.

	1998 £m	1997 £m	1996 £m
Net cash provided by operating activities	**3,847**	5,066	5,026
Net cash used in investing activities	**(4,198)**	(2,589)	(3,257)
Net cash used in financing activities	**(1,647)**	(1,517)	(975)
Net increase (decrease) in cash and cash equivalents	**(1,998)**	960	794
Effect of exchange rate changes on cash	**21**	(14)	4
Cash and cash equivalents under US GAAP at beginning of year	**2,343**	1,397	599
Cash and cash equivalents under US GAAP at end of year	**366**	2,343	1,397
Short-term investments with original maturities of less than 3 months	**(304)**	(2,317)	(1,276)
Cash at bank and in hand under UK GAAP at end of year	**62**	26	121

Current asset investments

Under US GAAP, investments in debt securities would be classified as either trading, available for sale or held-to-maturity. Trading investments would be stated at fair values and the unrealised gains and losses would be included in income. Securities classified as available-for-sale would be stated at fair values, with unrealised gains and losses, net of deferred taxes, reported in shareholders' equity. Debt securities classified as held-to-maturity would be stated at amortised cost. The following analyses do not include securities with original maturities of less than three months.

At 31 March 1998, the group held trading investments at a carrying amount of £384m (1997 – £173m) with fair values totalling £389m (1997 – £173m). Held-to-maturity securities at 31 March 1997 and 1998 consisted of the following:

	Amortised cost £m	Estimated fair value £m
UK Government securities and other UK listed investments	25	25
Commercial paper, medium term notes and other investments	18	18
Total at 31 March 1998	**43**	**43**
UK Government securities and other UK listed investments	44	44
Commercial paper, medium term notes and other investments	439	439
Total at 31 March 1997	483	483

The contractual maturities of the held-to-maturity debt securities at 31 March 1998 were as follows:	Cost £m	Fair value £m
Maturing on or before 31 March 1999	18	18
Maturing after 31 March 1999	25	25
Total at 31 March 1998	**43**	**43**

30. United States Generally Accepted Accounting Principles (continued)

Pension costs

The following position for the main pension scheme is computed in accordance with US GAAP pension accounting rules under SFAS No. 87 and SFAS No. 88, the effect of which is shown in the above reconciliation statements.

The pension cost determined under SFAS No. 87 requirements for the year ended 31 March 1998 was calculated by reference to an expected long-term rate of return on scheme assets of 8.2% (1997 – 9.2%, 1996 – 9.6%). The components of the pension cost for the main pension scheme comprised:

	1998 £m	1997 £m	1996 £m
Cost of benefits earned during the year	**327**	268	266
Interest cost on projected benefit obligation	**1,554**	1,645	1,543
Actual return on scheme assets	**(3,494)**	(2,038)	(2,799)
Net amortisation and deferral	**1,846**	323	1,244
Additional cost of termination benefits	**224**	258	266
Pension cost for the year under US GAAP	**457**	456	520

The projected benefit obligation for the main pension scheme was determined using the following assumptions at 1 January 1997 and 1 January 1998:

	1998 per annum %	1997 per annum %
Discount rate	**7.2**	7.7
Rate of future pay increases	**5.8**	5.8

The determination also took into account requirements in the scheme as to future pension increases.

The information required to be disclosed in accordance with SFAS No. 87 concerning the funded status of the main scheme at 31 March 1997 and 31 March 1998, based on the valuations at 1 January 1997 and 1 January 1998, respectively, is given below.

	1998 £m	1997 £m
Actuarial present value of accumulated benefit obligation due to past and present employees (all benefits vested)	**21,299**	18,823
Projected benefit obligation	**23,513**	20,733
Scheme assets at fair value	**22,666**	19,879
Projected benefit obligation in excess of scheme assets	**(847)**	(854)
Unrecognised net obligation at date of initial application of SFAS No. 87 *(a)*	**262**	314
Unrecognised prior service costs *(b)*	**223**	247
Other unrecognised net gains	**(2,199)**	(2,062)
Accrued pension cost under US GAAP	**(2,561)**	(2,355)

(a) The unrecognised net obligation at the date of initial application is being amortised over 15 years from 1 April 1988.

(b) Unrecognised prior service costs on scheme benefit improvements, are being amortised over periods of 15 or 16 years commencing in the years of the introduction of the improvements.

Subsidiary and associated undertakings

Brief details of principal operating subsidiary and associated undertakings at 31 March 1998, all of which were unlisted unless otherwise stated, were as follows:

Subsidiary undertakings	Activity	Group interest in allotted capital *(b)*	Country of operations *(c)*
BT Australasia Pty Limited *(a)*	Communication related services and products provider	100% ordinary 100% preference	Australia
BT (CBP) Limited *(a)*	Financial market telecommunication equipment provider	100% ordinary	International
BT Cableships Limited *(a)*	Cableship owner	100% ordinary	International
BT Communications Management Limited *(a)*	Telecommunication services provider	100% ordinary	International
BT France SNC *(a)*	Communication related services and products provider	100% equity	France
BT Limited *(a)*	Communication related services and products provider	100% ordinary	International
BT (Hong Kong) Limited *(a)*	Communication related services and products provider	100% ordinary 100% preference	Hong Kong
BT Network Information Services Company *(a)*	Communication related services and products provider	51% ordinary	Japan
BT North America Inc *(a)*	Communication related services and products provider	100% common	USA
BT Property Limited *(a)*	Property holding company	100% ordinary	United Kingdom
BT Subsea Cables Limited	Cable maintenance and repair	100% ordinary	United Kingdom
BT Telecomunicaciones SA *(a)*	Communication related services and products provider	100% ordinary	Spain
BT (Worldwide) Limited *(a)*	International telecommunication network systems provider	100% ordinary	International
Call Connections Limited *(a)*	Cellular telecommunication services provider	60% ordinary 60% preference	United Kingdom
Cellnet Group Limited *(a)*	Holding company for the Cellnet group	60% ordinary	United Kingdom
Cellnet Solutions Limited *(a)*	Messaging service provider for cellular telephone systems	60% ordinary	United Kingdom
Concert Communications Company *(a)*	Telecommunication services and network systems provider	75% ordinary	International
Europe Informatique SA *(a)*	Systems integration and application development	100% ordinary	France
First State Computing Unit Trust *(a)*	Systems integration and application development	100% equity	Australia
Manx Telecom Limited *(a)*	Telecommunication services supplier	100% ordinary	Isle of Man
Syntegra Groep BV *(a)*	Systems integration and application development	100% common	Netherlands

Subsidiary undertakings (continued)	Activity	Group interest in allotted capital *(b)*	Country of operations *(c)*
Telecom Securicor Cellular Radio Limited *(a)*	Mobile cellular telephone system provider and operator	60% ordinary	United Kingdom
Westminster Cable Company Limited	Cable television service provider	100% ordinary	United Kingdom
Yellow Pages Sales Limited *(a)*	Yellow Pages sales contractor	100% ordinary	United Kingdom

(a) Held through intermediate holding company.

(b) The proportion of voting rights held corresponds to the aggregate interest percentage held by the holding company and subsidiary undertakings, unless otherwise stated.

(c) All overseas undertakings are incorporated in their country of operations. Subsidiary undertakings operating internationally are all incorporated in England and Wales.

		Share capital		
Associated undertakings	Activity	Issued *(a)*	Percentage owned	Country of operations *(b)*
Albacom SpA	Communication related services and products provider	Lire 1,273 billion	23%	Italy
Bharti Cellular Limited	Mobile cellular telephone system provider and operator	Rs1.05 billion	23%	India
Cegetel SA	Communication related services and products provider	FFr 9.55 billion	26%	France
Clear Communications Limited	Communication related services and products provider	NZ$101m	25%	New Zealand
Newtelco AG	Communication related services and products provider	SFr 19.7m	22%	Switzerland
Springboard Internet Services Limited	Internet service provider	£5.6m	33%	United Kingdom
Telenordia AB	Communication related services and products provider	SKR102m	33%	Sweden
Telfort BV	Communication related services and products provider	NLG 0.1m	50%	Netherlands
Viag Interkom GmbH & Co	Communication related services and products provider	Unincorporated	45%	Germany

(a) Issued share capital comprises ordinary or common shares, unless otherwise stated. All investments are held through intermediate holding companies.

(b) All overseas undertakings are incorporated in their country of operations.

Quarterly analysis of turnover and profit

(UNAUDITED) YEAR ENDED 31 MARCH 1998

Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Turnover	3,798	3,951	3,939	3,952	**15,640**
Other operating income *(a)*	25	26	279	42	**372**
Operating profit *(b)*	891	813	1,149	804	**3,657**
Group's share of profits (losses) of associated undertakings	6	(91)	(90)	(77)	**(252)**
Profit (loss) on sale of group undertakings	20	(2)	45	–	**63**
Interest receivable	59	72	20	14	**165**
Interest payable	(95)	(104)	(105)	(110)	**(414)**
Profit on ordinary activities before taxation	881	688	1,019	631	**3,219**
Tax on profit on ordinary activities:					
Corporation and similar taxes	(278)	(216)	(285)	(199)	**(978)**
Windfall tax	–	(510)	–	–	**(510)**
Profit (loss) on ordinary activities after taxation	603	(38)	734	432	**1,731**
Minority interests	(4)	6	(14)	(13)	**(25)**
Profit (loss) for the financial period	599	(32)	720	419	**1,706**
Earnings (loss) per share	9.4p	(0.5p)	11.2p	6.5p	**26.7p**
Earnings per share before exceptional items	9.4p	7.5p	8.3p	6.5p	**31.7p**
Fully diluted earnings per share	9.2p	n/a	11.0p	6.5p	**26.3p**
Fully diluted earnings per share before exceptional items	9.2p	7.3p	8.2p	6.5p	**31.2p**
(a) Including MCI merger break up fee net of expenses	–	–	238	–	**238**
(b) Including redundancy charges	16	1	15	74	**106**

(UNAUDITED) YEAR ENDED 31 MARCH 1997

Quarters	1st £m	2nd £m	3rd £m	4th £m	**Total £m**
Turnover	3,641	3,725	3,763	3,806	**14,935**
Other operating income	34	17	31	24	**106**
Operating profit *(a)*	870	770	910	695	**3,245**
Group's share of profits of associated undertakings	38	44	27	30	**139**
Profit on sale of group undertakings	4	–	4	–	**8**
Interest receivable	44	60	53	49	**206**
Interest payable	(87)	(84)	(85)	(79)	**(335)**
Premium on repurchase of bonds	–	(60)	–	–	**(60)**
Profit on ordinary activities before taxation	869	730	909	695	**3,203**
Tax on profit on ordinary activities	(296)	(261)	(309)	(236)	**(1,102)**
Profit on ordinary activities after taxation	573	469	600	459	**2,101**
Minority interests	(4)	(8)	(1)	(11)	**(24)**
Profit for the financial period	569	461	599	448	**2,077**
Earnings per share	9.0p	7.3p	9.4p	7.1p	**32.8p**
Fully diluted earnings per share	8.9p	7.2p	9.2p	6.9p	**32.2p**
(a) Including redundancy charges	52	183	39	93	**367**

Financial statistics

Financial ratios

YEAR ENDED 31 MARCH

	1994	1995	1996	1997	**1998**
Earnings per share – pence	28.5	27.8	31.6	32.8	**26.7**
Growth in net dividends per share % *(a)*	7.1	6.0	5.6	6.1	**6.4**
Return on capital employed % *(b)*	17.1	15.6	18.3	18.9	**19.3**
Gearing – net debt to equity % *(c)*	9.3	17.8	7.4	1.6	**36.1**
Interest cover *(d)*	13.0	10.3	18.2	25.2	**14.7**
Dividend cover *(a) (e)*	1.7	1.6	1.7	1.7	**1.8**

(a) 1997 and 1998 figures excluded the effects of the special dividend of 35p per share paid in September 1997.

(b) The ratio is based on profit before tax and interest on long-term borrowings, to average capital employed. Capital employed is represented by total assets less current liabilities, excluding corporate taxes and dividends payable, and provisions other than those for deferred taxation. Year-end figures are used in the computation of the average, except in the case of short-term investments and borrowings where average daily balances are used in their place.

(c) The ratio is based on borrowings net of cash and short-term investments to capital and reserves and minority interests.

(d) The number of times net interest payable is covered by operating profit. In 1995 and 1997, net interest excludes the premiums paid on the repurchase of bonds.

(e) The number of times dividends are covered by earnings. The figure for 1998 excludes the effect of the windfall tax charge.

Expenditure on research and development

YEAR ENDED 31 MARCH

	1994 £m	1995 £m	1996 £m	1997 £m	**1998 £m**
Total expenditure	265	271	282	291	**307**

Expenditure on tangible fixed assets

YEAR ENDED 31 MARCH

	1994	1995	1996	1997	**1998**
Plant and equipment					
Transmission equipment	896	1,060	1,114	1,131	**1,219**
Exchange equipment	493	605	566	445	**512**
Other network equipment	335	378	491	503	**502**
Computers and office equipment	219	343	333	350	**372**
Motor vehicles and other	153	214	195	175	**230**
Land and buildings	51	75	87	143	**211**
Increase (decrease) in engineering stores	24	(4)	(15)	(28)	**(16)**
Total expenditure on tangible fixed assets	2,171	2,671	2,771	2,719	**3,030**
Decrease (increase) in creditors	(10)	(33)	(224)	104	**(10)**
Cash outflow on purchase of tangible fixed assets	2,161	2,638	2,547	2,823	**3,020**

Operational statistics

Call growth

YEAR ENDED 31 MARCH

	1994	1995	1996	1997	**1998**
% growth in fixed network call volumes over the previous year:					
Inland	6	7	6	7	**7**
International *(a)*	6	5	9	7	**9**

(a) Outgoing, incoming and transit.

Exchange line connections

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Business ('000)	6,129	6,459	6,798	7,160	**7,521**
% growth over previous year	3.1	5.4	5.2	5.3	**5.0**
Residential ('000)	20,471	20,613	20,500	20,393	**20,130**
% growth (reduction) over previous year	1.8	0.7	(0.5)	(0.5)	**(1.3)**
Total exchange line connections ('000)	26,600	27,072	27,298	27,553	**27,651**
% growth over previous year	2.1	1.8	0.8	0.9	**0.4**

Network modernisation

AT 31 MARCH

	1994	1995	1996	1997	**1998**
% customer lines served by type of telephone exchange:					
Digital	74.9	82.7	87.7	92.6	**100.0**
Semi-electronic	24.6	17.2	12.3	7.4	**–**
Electro-mechanical	0.5	0.1	–	–	**–**
Total	100.0	100.0	100.0	100.0	**100.0**

Optical fibre

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Fibre – kilometres in the network ('000)	2,577	2,782	3,043	3,302	**3,591**

Cellnet (Cellular telephones in the UK)

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Digital GSM ('000)	–	34	353	1,125	**2,303**
Analogue ('000)	1,019	1,700	2,036	1,573	**774**
Total	1,019	1,734	2,389	2,698	**3,077**

Payphones

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Total public payphones in the UK ('000)	124	129	133	136	**138**

People employed

AT 31 MARCH

	1994	1995	1996	1997	**1998**
Total employees ('000)	156.0	137.5	130.7	127.5	**124.7**

Regulatory statistics and information

Price control

Under the company's licence, there are restrictions on the prices it may charge for its main switched telephone services. The company's performance against this price constraint, which is linked to the annual movement in the retail price index (RPI), is shown below.

YEAR COMMENCING 1 AUGUST	1993	1994	1995	1996	**1997**
% RPI movement for the relevant period *(a)*	1.22	2.62	3.52	2.14	**2.94**
RPI formula in effect *(b)*	(7.50)	(7.50)	(7.50)	(7.50)	**(4.50)**
% required reduction in prices *(c)*	(6.94)	(4.86)	(1.38)	(4.92)	**(1.56)**
% reduction in prices overall	(6.95)	(7.35)	(1.82)	(4.92)	**(1.59)** *(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% 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.

(d) Price changes implemented to 26 May 1998.

Exchange line disconnections for non-payment of bills

YEAR ENDED 31 MARCH 1998

	April	May	June	July	Aug	Sep
Business ('000)	21	18	18	19	15	18
Residential ('000)	96	73	71	84	86	71
Total disconnections ('000)	117	91	89	103	101	89

	Oct	Nov	Dec	Jan	Feb	Mar
Business ('000)	18	17	9	10	13	14
Residential ('000)	72	60	48	57	65	65
Total disconnections ('000)	90	77	57	67	78	79

BT's policy is not to disconnect customers for non-payment of regular bills unless 28 days have elapsed from the dispatch of the relevant bill, except in cases of suspected fraud. Generally, customers who are late in paying receive at least two reminders from BT, one of which is normally given by telephone, before the company considers disconnection. BT takes this action only as a last resort, after restricting the service to incoming calls only and giving customers an opportunity to agree revised payment plans.

Classified directory business in the UK

The company is providing the following information with respect to its classified directory business in the UK in accordance with undertakings made with the Office of Fair Trading in July 1996. For the year ended 31 March 1998, the classified directory business of BT made an operating profit of £179m (1997 – £166m) on turnover of £420m (1997 – £389m) and, at 31 March 1998, it employed net assets of £136m (1997 – £151m). Since the classified directory business is integrated with the company's wider operations, this financial information incorporates the effects of certain apportionments and allocations of expenditures and assets.

BT is required to submit annual audited accounts in respect of the classified directory business to the Director of the Office of Fair Trading within nine months of the company's financial year end. Copies of these accounts, when available, may be obtained free of charge from the *Financial Director, Yellow Pages at Queens Walk, Reading, RG1 7PT.*

Financial, operational and regulatory statistics have been restated where necessary to provide consistency with the presentation of the 1998 figures.

Additional information for shareholders

Analysis of shareholdings

Size of shareholding

AT 31 MARCH 1998	Number of shareholders	Percentage of total	Ordinary shares of 25p each: Number of shares held (millions)	Percentage of total
1 – 399	912,968	44.7	198	3.1
400 – 799	596,978	29.3	322	5.0
800 – 1,599	358,289	17.6	392	6.1
1,600 – 9,999	166,091	8.1	439	6.9
10,000 – 99,999	3,645	0.2	91	1.4
100,000 – 999,999	1,405	0.1	502	7.8
1,000,000 – 4,999,999	429	0.0	934	14.6
5,000,000 and above *(a)(b)(c)*	172	0.0	3,533	55.1
Total	2,039,977	100.0	6,411	100.0*(d)*

(a) Under the BT Long Term Remuneration Plan and the BT Performance Share Plan 10 million shares were held in trust in respect of contingent awards of shares which have been granted to 870 participants in the two plans.

(b) Under the BT Employee Share Ownership Scheme 30 million shares were held in trust on behalf of 131,870 participants who were beneficially entitled to the shares.

(c) Approximately 110 million shares were represented by American Depositary Receipts and a further 12 million shares were held by a nominee of the Tokyo Stock Exchange on behalf of investors. Analysis by size of holding is not available for these holdings.

(d) 20.4% of the shares were in 1,996,319 individual holdings, of which 179,249 were joint holdings, and 79.6% of the shares were in 43,658 institutional holdings.

Listings

BT has a listing on the Stock Exchanges in London, New York and Tokyo.

BT shares are traded on the New York Stock Exchange in the form of American Depositary Shares (ADSs). Each ADS represents ten ordinary shares. Trading on the New York Stock Exchange is under the symbol "BTY".

In Japan, BT shares are traded on the Tokyo Stock Exchange under the code "9484".

CREST: London Stock Exchange settlement system

The company's ordinary shares are settled in CREST, the computerised system for settling sales and purchases of shares. CREST is a voluntary system which enables shareholders, if they wish, to hold and transfer their shareholdings electronically rather than by paper. Shareholders who wish to retain their certificates are able to do so.

Personal equity plans (PEPs)

Details of BT single company PEPs and BT corporate PEPs offered by the Halifax may be obtained from: Halifax Investment Services Limited, Trinity Road, Halifax HX1 2RG, Tel. **Free***fone 0800* **371 769.** Other PEP managers offer similar products.

Results announcements

Expected announcements of results:

1st quarter	29 July 1998
2nd quarter and half year	12 November 1998
3rd quarter and nine months	February 1999
4th quarter and full year	May 1999
1999 annual report and accounts published	June 1999

Dividends

The proposed 1998 final dividend will be paid on 21 September to shareholders on the register on 7 August 1998.

The expected dividend payment dates in 1999 are:

1999 interim dividend payable	February 1999
1999 final dividend payable	September 1999

Dividend mandate

Any shareholder wishing dividends to be paid directly into a bank or building society account should contact the Registrar for a dividend mandate form. Dividends paid in this way will be paid through the Bankers Automated Clearing System (BACS).

Scrip dividends

In the year ended 31 March 1998, the group introduced the BT share dividend plan to allow shareholders to elect to receive additional shares in lieu of a cash dividend. The price per share of the scrip dividend paid on 16 February 1998 was 480.35p. This election for scrip dividends will also be available to ordinary shareholders in respect of the 1998 final dividend to be paid on 21 September 1998. The last date for lodging mandates for the BT share dividend plan in respect of the final dividend is 7 August 1998.

ADR Shareholder Services Programme

Details of the Morgan Guaranty Trust shareholder services programme, including reinvestment of dividends, are available from Morgan Guaranty Trust Co. of New York on 1 800 749 1687 (toll free in the USA) or +1 781 575 4328 (from outside USA), or on written request to the ADR Depositary.

Form 20-F

The company will file its annual report on Form 20-F with the Securities and Exchange Commission in the USA by 30 September 1998.

Regulatory financial statements

The company will publish historical cost Financial Statements for the Businesses and Activities for the year ended 31 March 1998, as required by Oftel, by 31 July 1998. BT will also publish current cost Financial Statements for the Businesses and Activities for the year including long-run incremental cost information for the Network Business by 30 November 1998.

Copies of the Form 20-F, the Financial Statements for the Businesses and Activities, the Current Cost Financial Statements and details of quarterly results announcements, when available, may be obtained on request from the BT Shareholder Helpline provided by the company's Registrar, see page 86 for details.

The Registrar
Lloyds Bank Registrars (450)
The Causeway
Worthing, West Sussex
BN99 6DA, England

BT Shareholder Helpline
Tel **Free***fone 0808* **100 4141**
Fax (01903) 833062
From overseas:
Tel +44 1903 833950
Fax +44 1903 833062

BT North America Inc.,
Investor Relations
40 East 52nd Street
New York, NY 10022,
USA

Tel 1 800 331 4568
(toll free within USA and Canada)
or +1 212 418 7787
(from outside USA and Canada)
Fax +1 212 418 7788

ADR Depositary
Morgan Guaranty Trust Company
of New York
ADR Service Center
P.O. Box 8205
Boston, MA 02266-8205
USA

Tel 1 800 634 8366 (toll free)
or (781) 575 4328

e-mail adr@jpmorgan.com

BT (Japan) KK
ARK Mori Building
12-32 Akasaka 1-Chome
Minato-Ku, Tokyo 107-6024

Tel (03) 5562 6000

Share Handling Agent in Japan
The Toyo Trust & Banking Co. Ltd.
Tokyo Office:
10-11 Higashisuna 7-Chome
Koto-Ku, Tokyo 137-8081
(Corporate Agency Department)

Tel (03) 5683 5111

Osaka Office:
6-3 Fushimi-machi 3-Chome
Chuo-Ku, Osaka 541-8502
(Corporate Agency Department)

Tel (06) 222 3111

Shareholder enquiries
Lloyds Bank Registrars maintain BT's share register and the separate BT Employee Share Ownership Scheme register. They also provide a BT Shareholder Helpline service.

Shareholders should contact the Registrar (details above) if they have any enquiries about their shareholding.

General enquiries
British Telecommunications plc
BT Centre
81 Newgate Street
London EC1A 7AJ
England

Tel (0171) 356 5000
Fax (0171) 356 5520
From overseas:
Tel +44 171 356 5000
Fax +44 171 356 5520

Internet
This report is available on the BT web site at **http://www.bt.com/world/corpfin/shareholder/index.htm**

A full list of BT contacts, and an electronic feedback facility, is available at **http://www.bt.com/talk**

Glossary

Term used in UK report and accounts	US equivalent or definition
Accounts	Financial statements
Advance corporation tax (ACT)	No direct US equivalent. Tax payable on company distributions recoverable from UK taxes due on income
Associated undertakings	Equity investees
Capital allowances	Tax depreciation
Capital redemption reserve	Other additional capital
Creditors	Accounts payable and accrued liabilities
Creditors: amounts falling due within one year	Current liabilities
Creditors: amounts falling due after more than one year	Long-term liabilities
Debtors: amounts falling due after more than one year	Other non-current assets
Employment costs	Payroll costs
Finance lease	Capital lease
Fixed asset investments	Non-current investments
Freehold	Ownership with absolute rights in perpetuity
Inland calls	Local and long-distance calls
Interests in associated undertakings	Securities of equity investees
Loans to associated undertakings	Indebtedness of equity investees not current
Net asset value	Book value
Other debtors	Other current assets
Own work capitalised	Costs of group's employees engaged in the construction of plant and equipment for own use
Profit	Income
Profit and loss account (statement)	Income statement
Profit and loss account (under 'capital and reserves' in balance sheet)	Retained earnings
Profit for financial year	Net income
Profit on sale of fixed assets	Gain on disposal of non-current assets
Provision for doubtful debts	Allowance for uncollectable receivables
Provisions	Long-term liabilities other than debt and specific accounts payable
Redundancy charges	Early release scheme expenses
Reserves	Shareholders' equity other than paid-up capital
Share premium account	Additional paid-in capital or paid-in surplus (not distributable)
Shareholders' funds	Shareholders' equity
Stocks	Inventories
Tangible fixed assets	Property, plant and equipment
Trade debtors	Accounts receivable (net)
Turnover	Revenues

Index

Concert Communications Sales LLC
Exhibit F

Key financial figures from
British Telecommunications plc
"Annual report and accounts 1998"
(conformed to U.S. SEC Form 20-F)

Turnover (Revenues)	$ 25,649,000,000.60
Profit before tax	5,279,000,000.16
Profit after tax	2,838,000,000.84
Earnings per share	0.52
Net dividends	0.31
Capital expenditure	4,969,000,000.20

Exchange rate: £1.00 = $1.64

News release

February 11, 1999

NINE MONTHS RESULTS TO DECEMBER 31, 1998

BT's results for the third quarter and nine months to December 31, 1998 are summarised in the table below.

Sir Iain Vallance, Chairman of BT, said:

> "Demand for our products and services has been buoyant in the quarter, stimulated both by the datawave and strong growth in mobile sales. Our trading performance in the UK has been good and our European ventures are growing fast.
>
> This quarter saw two major investments in mobile companies in Malaysia and The Republic of Korea where we foresee significant growth.
>
> Our balance sheet remains strong with low gearing which gives us flexibility for further development."

THIRD QUARTER AND NINE MONTHS TO DECEMBER 31, 1998

	Third Quarter		Nine Months	
	1998	*1997*	1998	*1997*
	£m	*£m*	£m	*£m*
Turnover, including share of ventures	4,684	*4,083*	13,326	*11,930*
Exceptional income (costs)	(8)	*238*	(42)	*238*
Operating profit	1,012	*1,149*	2,823	*2,853*
Profit on sale of fixed asset investments	-	*45*	1,107	*63*
Profit before taxation	858	*1,019*	3,459	*2,584*
Windfall tax charge	-	-	-	*(510)*
Profit after taxation	592	*734*	2,425	*1,296*
Earnings per share	9.2p	*11.3p*	37.5p	*20.1p*
Earnings per share before exceptional items	9.3p	*8.3p*	25.6p	*25.2p*

Results

Earnings per share for the nine months to December 31, 1998 were 37.5 pence based on a profit before taxation of £3,459 million. Of these earnings, 11.9 pence represented exceptional income mainly relating to the sale of the group's investment in MCI Communications Corporation in September. Earnings before exceptional items, of 25.6 pence per share, compare with an equivalent 25.2 pence in the corresponding period of the prior year.

At the operating level, group profit before exceptional items for the nine months increased by 9.6 per cent over the prior period compared with group turnover growth of 6.7 per cent.

Earnings for the third quarter were 9.2 pence per share net of 0.1 pence exceptional charges. On the same basis, earnings per share were 11.9 per cent higher compared with the corresponding quarter of the prior year and group operating profit was 12.0 per cent higher on group turnover growth of 8.5 per cent.

Turnover

Total turnover, which includes BT's share of its ventures' turnover, grew by 11.7 per cent in the nine months to £13,326 million, and by 14.7 per cent in the third quarter to December 31, 1998. BT's new ventures in Europe and Asia-Pacific accounted for two-fifths of these increases in turnover. Both mobile and fixed network calls in the UK made strong contributions to the growth in the group's activities.

The rapidly expanding use of the internet and a significant increase in calls to mobile phones have been the main factors behind a sharp increase in inland calls over BT's fixed network in the third quarter. Volume growth on a 12-month moving average basis to December 31, 1998 rose to 8 per cent compared with 6 per cent in the 12 months to September 30, 1998. After taking into account the effect of continuing price decreases, inland call turnover grew by 3.5 per cent to £3,838 million for the nine months and by 6.5 per cent in the quarter.

Exchange line turnover increased by 4.8 per cent in the nine months to £2,490 million, reflecting mainly the growth in business lines. ISDN line installations resulted in the number of business line connections growing by 5.8 per cent in the 12 months to December 31, 1998. Residential lines at 20.1 million increased slightly in the quarter helped by the large number of BT customers installing second lines.

International call turnover continues to be adversely affected by competition and significant price reductions. The continuing strong volume growth of 9 per cent on a 12-month moving average basis contrasted with a turnover decrease of 5.8 per cent in the nine months. Transit call volumes continue to be healthy.

Cellnet had an impressive quarter adding 658,000 to its customer base which exceeded 4 million at December 31, 1998. The majority of the additions were "pre-paid" phones, many of which were sold through new channels to market developed by Cellnet in the period. Cellnet's customer base increased by 35 per cent over the 12 months to December 31, 1998 and resulted in BT's mobile communications turnover growing by 23 per cent in the nine months after taking into account significant price reductions.

Receipts from other licensed operators in the UK grew by 19.6 per cent reflecting the growing level of interconnection activity between both fixed and mobile network operators.

Syncordia, Syntegra, multimedia and advanced services were the main contributors to the 34 per cent increase in other UK sales and services to £1,252 million in the nine months. These services mainly consist of outsourcing, data and multimedia products.

BT's share of its ventures' turnover totalling £852 million for the nine months and £410 million for the quarter include for the first time contributions from the group's new investments in Malaysia and The Republic of Korea. The principal contributors in the quarter were Cegetel in France, Airtel in Spain and Viag Interkom in Germany.

Operating costs

Excluding £42 million of exceptional costs (primarily relating to Concert expenses) explained below, operating costs increased by 6.0 per cent to £9,711 million in the nine months to December 31, 1998.

After adjusting for the £120 million one-off charge in 1997 relating to employee compensation for the special dividend, staff costs increased by 1.2 per cent in the nine months. Depreciation rose by 6.2 per cent reflecting the higher level of capital expenditure. Payments to telecommunication operators increased by 23 per cent as a consequence of the growing number of calls made to mobile operators and other fixed networks in the UK. Other operating costs grew by 7.3 per cent, partly due to increased expenditure on computer systems, including work on the Year 2000 issue, and higher costs in mobile communications reflecting the growth in the customer base.

Associates and joint ventures

BT's share of operating losses in our ventures totalled £101 million for the third quarter and £235 million for the nine months in line with expectations. The two main contributors were Viag Interkom and Telfort which launched their new mobile businesses in Germany and the Netherlands, respectively, in Autumn 1998. Goodwill amortisation of £9 million is included in the nine months' results.

MCI Communications Corporation and Concert Communications

Following the completion of the MCI-WorldCom merger on September 15, 1998, BT sold its holding in MCI to WorldCom. As previously reported, the proceeds totalled £4,159 million on which an exceptional pre-tax profit of £1,133 million was realised.

On the same day as the sale of the MCI shares, BT acquired from MCI its 24.9 per cent interest in Concert Communications for £607 million. Now that Concert is wholly owned by BT, work is being undertaken to ensure that the group's business will be fully independent of MCI. The costs involved in this work are estimated at £150 million over the two years to March 2000, of which £42 million has been incurred to December 31, 1998. These costs are shown as exceptional items in the profit and loss account.

The net proceeds from the MCI shares have been invested mainly in US dollar investments on a short-term basis. During the quarter a currency translation gain of £58 million has been made on these investments which has been included in the results as a reduction in other operating costs.

Interest and taxation

The group's net interest charge for the nine months increased by £25 million to £236 million but declined by

£41 million in the third quarter. The increase was mainly as a result of the September 1997 special dividend payment, offset in the third quarter by the interest received on the proceeds from the sale of the MCI shares.

The effective tax rate for the current financial year is expected to be 31.0 per cent of pre-tax profits, excluding the gain on the MCI shares which attracts a slightly lower rate of 28 per cent.

The tax charge for the nine months to December 31, 1997 included BT's full charge for the windfall tax of £510 million. The final instalment of this tax amounting to £255 million was paid in December 1998.

Capital expenditure

Capital expenditure on plant, equipment and property totalled £2,097 million in the nine months, 2.1 per cent higher than in the corresponding period of the previous year. Work continues on enhancing the intelligence of the fixed network to enable customers to benefit from advanced services and improving the capacity for carrying high-speed data. Cellnet has continued improving the quality and capacity of its digital cellular GSM network.

BT has recently announced an agreement with a major supplier for the development and supply of the next generation exchange equipment designed to handle the rapid growth in UK data traffic. The first of these leading edge exchanges is due to be in service by Summer 1999.

Investments in associates and joint ventures

During October 1998, BT made two significant investments in the Asia Pacific region. The first was the acquisition of a 33.3 per cent stake for £269 million in Binariang Bhd, a major Malaysian telecommunications group operating a successful mobile communications business and providing fixed and international gateway services in Malaysia. The second related to the acquisition for £229 million of an interest of just over 23 per cent in LG Telecom, a leading mobile telephone operator in The Republic of Korea.

During the nine months, BT has continued to share in funding the development of its ventures, principally Viag Interkom and Telfort, to a total of £530 million.

Cash flow and net debt

Net cash flow from operations totalled £4,099 million in the nine months. In addition, net cash inflow from investing activities of £2,032 million principally consists of the proceeds of sale from the MCI shares of £4,159 million less the group's expenditure on tangible fixed assets. The net cash outflow on acquisitions totalled £1,710 million, the principal part of which was the purchase of the minority interest in Concert, the equity investments in Binariang Bhd and LG Telecom and the additional funding of ventures, described above. Equity dividends paid in September 1998 totalled £700 million and windfall and other tax paid amounted to £561 million. Virtually all of the resulting cash inflow of £2,908 million, before liquid resources and financing, has been invested and is shown in current asset investments in the balance sheet.

The proceeds of the sale of the investment in MCI caused net debt to fall in the nine months to £937 million at December 31, 1998. Balance sheet gearing was 6 per cent at that date.

Proposed global venture with AT&T

On July 26, 1998, BT and AT&T announced the formation of a 50:50 global venture for their trans-border telecommunication activities to serve the needs of multinational companies and the international calling needs of individuals and businesses. BT will be transferring its cross-border international network, its international traffic, its business with selected multinational customers and its international products for business customers together with Concert into the global venture, the formation of which is subject to, amongst other things, regulatory clearances.

The preliminary announcement of BT's results for the year ending March 31, 1999 is expected to be made on May 19, 1999.

Group profit & loss account (three months)
Group profit & loss account (nine months)
Group cash flow statement
Group balance sheet

*News releases*

Concert Communications Sales LLC
Exhibit F

Key financial figures from
British Telecommunications plc
"Nine Months Results to December 31, 1998"
Press Release Issued February 11, 1999

Turnover (Revenues) including share of ventures	$	22,121,000,000.16
Exceptional income (costs)		(69,000,000.72)
Operating profit		4,686,000,000.18
Profit on sale of fixed asset investments		1,837,000,000.62
Profit before tax		5,741,000,000.94
Windfall tax charge		0.00
Profit after tax		4,025,000,000.50
Earnings per share		0.62
Earnings per share before exceptional items		0.43

Exchange rate: £1.00 = $1.66