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*The 1998 BT Annual Report on Form 20-F has been prepared solely to meet the requirements of US and Canadian law and regulation.*

*Non-North American Readers may only make use of the Report in accordance with the following conditions:*

- *The Report is not intended nor should it be treated as an investment advertisement, but instead exclusively as general background about BT.*
- *Non-North American Readers must not rely upon the fact that anything is included in or omitted from the Report in relation to any decisions to do or refrain from doing anything (including dealing, or refraining from dealing, in any securities) or for any other purpose.*

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**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F**

**ANNUAL REPORT PURSUANT TO SECTION 13  
OF THE SECURITIES EXCHANGE ACT OF 1934**

for the fiscal year ended **March 31, 1998**

Commission file number **1-8819**

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**BRITISH TELECOMMUNICATIONS public limited  
company**

(Exact name of registrant as specified in its charter)

**ENGLAND AND WALES**

(Jurisdiction of incorporation or organization)

**BT CENTRE, 81 NEWGATE STREET, LONDON EC1A 7AJ, ENGLAND**

(Address of principal executive offices)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
<b>American Depositary Shares Ordinary shares of 25p each</b>	<b>New York Stock Exchange New York Stock Exchange*</b>

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\* Not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act:

**None**

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

**None**

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Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the Annual Report.

**6,411,214,670** **Ordinary shares of 25p each**

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

Yes  No

Indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

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## EXCHANGE RATES

### Exchange rates

In this Annual Report, references to “\$” are to United States ( US ) dollars, references to “pounds sterling”, “£”, “pence” or “p” are to United Kingdom (“UK”) currency and references to the “financial year” are to the fiscal year ended 31 March of each year (e.g., “the 1998 financial year” refers to the fiscal year ended 31 March 1998). References to the “company” are to British Telecommunications public limited company, and references to “BT” or the “group” are to the company and its subsidiaries, or any of them, as the context may require.

BT publishes its consolidated financial statements expressed in pounds sterling. The following table sets forth certain information concerning the exchange rates between pounds sterling and US dollars based on the noon buying rate in New York City for cable transfers in pounds sterling as certified for customs purposes by the Federal Reserve Bank of New York (the “Noon Buying Rate”).

Financial year	Period end	Average(a)	High	Low
1994	1.49	1.50	1.59	1.46
1995	1.62	1.57	1.64	1.46
1996	1.53	1.52	1.56	1.50
1997	1.64	1.60	1.71	1.49
1998	1.68	1.65	1.70	1.58

(a)The average of the Noon Buying Rates in effect on the last day of each month during the relevant period.

On 8 June 1998, the Noon Buying Rate was \$1.6324 to £1.00.

For information regarding the effects of currency fluctuations on the market price of the ordinary shares of 25p each in the company (the “Ordinary Shares”) and of its American Depositary Shares (“ADSs”), see “Item 5 – Nature of Trading Market”. For information regarding the effects of currency fluctuations on the group’s results, see the information set forth under the heading “Capital resources and foreign currency exposure” on pages 21 and 22 of the BT Report and Accounts 1998 (the “1998 Report and Accounts”) contained in the company’s Report on Form 6-K dated 9 June 1998 which is incorporated herein by reference, and on the conversion of dividends, see “Item 8 – Selected Financial Data – Dividends”.

## FORWARD LOOKING STATEMENTS

Certain forward looking statements are included in this Form 20-F concerning the telecommunications industry and BT's operations, economic performance and financial condition. These appear in "Item 1 – Description of Business", "Item 3 – Legal Proceedings" and "Item 9 – Management's Discussion and Analysis of Financial Condition and Results of Operations". They include, without limitation:

- A. those concerning (i) possible or assumed future results of operations of BT, (ii) impact of regulatory initiatives on BT's operations, (iii) expectations regarding competition, prices and growth, (iv) adequacy of capital, (v) impact of legal proceedings on BT's financial position and results of operations, and (vi) impact on BT of the proposed MCI/WorldCom merger; and
- B. those preceded by, followed by, or that include the words "believes", "expects", "anticipates" or similar expressions.

Because such statements involve risks and uncertainties, actual results may differ materially from those expressed or implied by such forward-looking statements. Factors that could cause such differences include, but are not limited to, material adverse changes in economic conditions in the markets served by BT; future regulatory actions and conditions in BT's operating areas, including competition from others in the UK, US and other international telecommunications markets; the timing of entry and profitability of BT in certain national markets; and fluctuations in foreign currency exchange rates.

## PART I

### ITEM 1 – DESCRIPTION OF BUSINESS

#### Introduction

BT is one of the world's leading providers of telecommunication services. Its main services and products are local and national calls in the United Kingdom, the provision of exchange lines to homes and businesses, international calls made from and to 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. BT also offers a range of other products and services.

The company was incorporated under the laws of England and Wales on 1 April 1984 as a public limited company wholly owned by Her Majesty's Government of the United Kingdom ("HM Government"). In a series of three offers to the public, HM Government reduced its holding from 100% in December 1984 to less than 1% in July 1993. HM Government now has a residual holding of less than 0.2% of the outstanding Ordinary Shares.

#### *Strategy*

BT's strategy is to become the most successful worldwide telecommunications group by developing and growing new business in the United Kingdom, which BT believes has the most open and competitive telecommunications market in the world; to move into new growth markets such as mainland Europe; to serve the needs of multinational companies; and to expand into high growth services such as mobile, data, multimedia and the Internet.

#### *Recent developments*

Full liberalisation of telecommunications markets took effect throughout most of the European Union/European Economic Area from 1 January 1998. Liberalisation is generally being achieved through the enacting of legislation to remove barriers to competition. This includes the award of additional licences to operate fixed and mobile telecommunication services which will increase customer choice, the setting of rules to guarantee interconnection on non-discriminatory terms, and the establishment of independent regulatory authorities. It is backed up in a growing number of cases through the privatisation of state owned telecommunication companies. In several cases where European Union member states have failed to implement liberalisation measures correctly, the European Commission has initiated legal enforcement proceedings.

BT believes that it is well positioned to penetrate local markets in Europe following liberalisation and it works closely with regulatory and competition authorities to ensure the maximisation of competitive market conditions. It has entered into a number of alliances across Europe in order to gain presence in major European markets. See "Alliances and Joint Ventures – Overseas".

In 1994 BT acquired a 20% holding in MCI Communications Corporation ("MCI"), the second largest of the US long-distance telephone operators and formed with MCI a global joint venture, Concert Communications Company ("Concert Communications"), to pioneer global services and pool technical and marketing resources. See "Alliances and joint ventures – Overseas". On 3 November 1996, the Boards of Directors of BT and MCI announced that they had reached agreement for a merger of the two companies (the "Merger"). Following the announcement of reduced earnings expectations by MCI on 10 July 1997, BT and MCI conducted a joint management review into the prospects of both companies. On 22 August 1997, BT and MCI announced that they had agreed to new terms for the Merger which reflected changes in the marketplace. On 1 October 1997, WorldCom Inc ("WorldCom") announced its intention to offer shares in its company to MCI shareholders as an alternative to the BT/MCI merger. Following an improved offer from WorldCom on 9 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 was terminated. Under the terms of an agreement between BT, MCI and WorldCom (the "WorldCom agreement"), BT received \$465 million on 12 November 1997, as the break-up fee and partial reimbursement of expenses incurred on the BT/MCI merger agreement.

Under the terms of the WorldCom agreement, BT has agreed to sell its holding of 136 million Class A common shares in MCI to WorldCom for \$51 per share in cash at the time the MCI/WorldCom merger is completed. The transaction, which has been approved by MCI and WorldCom shareholders and is awaiting regulatory approvals in the United States and Europe, is expected to close in 1998. Also under the WorldCom agreement BT, which



owns 75.1% of Concert Communications, has agreed to acquire MCI's interest in Concert Communications at a price to be negotiated.

BT is committed to providing comprehensive sales, service and support for customers of Concert Communications. BT believes that there may still be investment opportunities in the US market and continues to consider all of its options.

#### *Competition and regulatory environment*

BT operates in the United Kingdom in an environment of growing competition and extensive regulation. The growing number of providers of telecommunication services is creating an increasingly competitive market for those services. The services that generate a majority of the group's operating revenues, or turnover, are currently regulated through a licence granted by the UK Secretary of State for Trade and Industry (the "Secretary of State") which is enforced by the UK Director General of Telecommunications (the "Director General"), who also has broad supervisory powers and duties under the UK Telecommunications Act 1984 (the "Telecommunications Act"). This licence has been amended frequently. See "Regulation, competition and prices". As BT expands its interests and activities outside the United Kingdom, regulatory regimes elsewhere in the world are becoming an increasingly important feature of its operating environment.

#### **BT's services**

The following table shows the principal components of BT's operating revenues during each of the last five fiscal, or financial, years. In the financial year ended 31 March 1998 (the "1998 financial year"), approximately 96% of BT's total turnover arose from operations in the United Kingdom.

<b>Turnover</b>	<b>Year ended 31 March</b>					<b>1998 % of total</b>
	1994	1995	1996 (in millions)	1997	1998	
UK local and national calls	£ 5,193	£ 4,941	£ 4,882	£ 4,874	<b>£ 4,924</b>	<b>31</b>
International calls	1,960	1,935	1,980	1,809	<b>1,553</b>	<b>10</b>
Exchange line rentals	2,402	2,534	2,685	2,811	<b>2,957</b>	<b>19</b>
Private circuits	992	1,024	1,056	1,124	<b>1,149</b>	<b>7</b>
Mobile communications	459	657	856	949	<b>1,089</b>	<b>7</b>
Customer premises equipment supply	1,003	1,041	946	914	<b>896</b>	<b>6</b>
Yellow Pages and other directories	343	371	408	438	<b>466</b>	<b>3</b>
Other sales and services	1,323	1,390	1,633	2,016	<b>2,606</b>	<b>17</b>
<b>Total turnover</b>	<b>£13,675</b>	<b>£13,893</b>	<b>£14,446</b>	<b>£14,935</b>	<b>£15,640</b>	<b>100</b>

BT essentially operates as a unitary business, providing an integrated range of telecommunication products and services. Management considers that the group's net operating income or operating profit, is derived predominantly from UK local and national and international calls.

#### *UK fixed network*

Within the United Kingdom, the company has more than 27 million customer lines (exchange line connections), comprising approximately 20.1 million residential lines and approximately 7.5 million business lines, over which, on average, approximately 100 million UK local and national calls are made each day. Calls comprise both voice and non-voice traffic, such as facsimile and data transmissions, and include calls to directory assistance services.

The following table shows the estimated growth rates in the volume of BT's UK local and national calls in each of the last five financial years:

	<b>Year ended 31 March</b>				
<b>BT's UK call growth</b>	1994	1995	1996	1997	<b>1998</b>
Estimated growth over previous year in BT's UK call volume (a)	6%	7%	6%	7%	<b>7%</b>

(a) Growth is estimated by reference to revenue growth attributable to UK local and national calls, adjusted to eliminate the effect of price changes.

UK local and national calls accounted for approximately 31% of the group's total turnover in the 1998 financial year.

Call growth in recent years has resulted mainly from the increase in usage of the lines in service, stimulated partly by significant price reductions introduced since December 1993 and partly by the growth in the UK economy.

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

In the 1998 financial year, exchange line rentals accounted for approximately 19% of the group's total turnover. BT's exchange line customers are generally charged a uniform quarterly rental per line, the charge for business lines being higher than for residential lines.

The following table shows, for BT's business and residential exchange lines, the number of connections at the end of each of the last five financial years and the respective percentage growth or decline in the number of connections from the previous year:

	<b>At 31 March</b>				
<b>BT's exchange line connections</b>	1994	1995	1996	1997	<b>1998</b>
(in thousands, except percentage amounts)					
Business	6,129	6,459	6,798	7,160	<b>7,521</b>
Growth	3.1%	5.4%	5.2%	5.3%	<b>5.0%</b>
Residential	20,471	20,613	20,500	20,393	<b>20,130</b>
Growth (decline)	1.8%	0.7%	(0.5)%	(0.5)%	<b>(1.3)%</b>
Total	26,600	27,072	27,298	27,553	<b>27,651</b>
Growth	2.1%	1.8%	0.8%	0.9%	<b>0.4%</b>

Since the beginning of 1995 BT has experienced a small net reduction in residential exchange line connections as a result of the growing competition from cable operators which offer integrated television and telephony services. See "Regulation, competition and prices – Competition – Cable operators" for a discussion of the growth of cable telephony.

BT also undertakes the installation and reconnection of exchange lines. Revenues from these services are included under "Other sales and services".

#### *International calls*

International calls accounted for approximately 10% of the group's total turnover in the 1998 financial year. In the 1998 financial year, the greater part of BT's international call traffic was generated from a limited number of routes and 73% of outgoing call volume was to 15 countries. The United Kingdom is one of the world's principal telecommunication transit centres, enabling calls originating and terminating outside the United Kingdom to be routed through it. International direct dialling from BT's UK network is available to more than 230 countries and other territories, and almost all international calls originating from BT's UK network are direct dialled.

International call revenues are derived from outgoing calls made by customers in the United Kingdom and from receipts from overseas telecommunications operators for incoming calls which use BT's facilities. In turn, BT makes payments to overseas operators for the use of their facilities primarily for terminating calls. The rates for

payments (known as “accounting rates”) are agreed bilaterally under the general auspices of the International Telecommunications Union. BT’s receipts and payments are broadly in balance overall.

The following table shows the estimated growth rates in the volume of BT’s international calls (outgoing, incoming and transit) in each of the last five financial years:

BT’s international call growth	Year ended 31 March				1998
	1994	1995	1996	1997	
Estimated growth over previous year in BT’s international call volume (a)	6%	5%	9%	7%	9%

(a) Growth is estimated by reference to revenue growth attributable to international calls, adjusted to eliminate the effect of changes in prices and in currency exchange rates.

Growth in the volume of international calls over this period has resulted primarily from the increase in the usage of the lines in service. BT believes that the increased usage was partly attributable to significant price reductions.

BT continues to seek reductions in accounting rate levels, which historically have not generally kept pace with reductions in the underlying costs of providing international service other than on the more liberalised routes. However increasing liberalisation, competition and globalisation of the market place – underscored by the World Trade Organisation (“WTO”) agreement on basic telecommunications ratified on 5 February 1998 – is placing increased pressure for rates to be reduced to reflect more closely costs of service, continuing the downward trend in prices. BT expects that accounting rates will start to be replaced by more cost based arrangements. Lower rates increase BT’s flexibility in pricing international calls.

Volume changes for the activities described below have been estimated by adjusting revenues to eliminate the effect of price changes.

#### *Private circuits*

BT provides customers with private circuits, which are lines between fixed points reserved for the exclusive use of a customer, leased at a fixed rate irrespective of usage. There is continuing change from analogue to digital circuits, in part because digital circuits normally have a greater capacity and flexibility of use. Private circuit revenue volumes increased by approximately 5% in the 1998 financial year. Private circuit revenues accounted for approximately 7% of the group’s total turnover in the 1998 financial year.

#### *Mobile communications*

Mobile communication services and products supplied by BT mainly comprise cellular telephony, radiopaging and voice messaging and accounted for approximately 7% of the group’s total turnover in the 1998 financial year. Cellular telephony has continued to grow at a faster pace than other sectors of the telecommunications industry in the United Kingdom and internationally.

The company owns 60% of Cellnet, one of four cellular telephone network operators licensed by HM Government. Cellnet and Vodafone each provide digital and analogue communications networks while Orange and One 2 One provide digital personal communications networks (“PCN”). As a result of the rapid growth of PCN services, the market for mobile services is highly competitive with consequent pressure on prices and Cellnet continues to reduce a number of its charges.

In March 1998, the Director General referred BT, Cellnet and Vodafone to the UK Monopolies and Mergers Commission (the “MMC”) for investigation into BT’s retail charges for calls made from BT’s fixed network to Cellnet and Vodafone’s networks and Cellnet and Vodafone’s charges to BT for terminating such calls. The MMC is expected to report in autumn 1998. BT believes that the impact of the investigation is not likely to be significant to the group’s financial position and results of operations in view of the continuing reduction in prices. See “Regulation, competition and prices – Competition – Mobile services”.

Cellnet provides comprehensive coverage for virtually all of the United Kingdom population. It has operated a digital GSM service since 1994 alongside its analogue system, and approximately 75% of Cellnet’s users are now connected to the digital service. A substantial number of customers have migrated or are migrating from the analogue system to the digital system.

The digital service provides a technology platform for advanced high quality service offerings, including international roaming to 77 countries and across more than 120 networks to date, with the prospect of allowing much larger customer bases to be supported.

The following table shows the number of telephones connected to Cellnet's network at the end of each of the last five financial years:

Cellnet (Cellular telephones in the United Kingdom)	Year ended 31 March				1998
	1994	1995	1996 (in thousands)	1997	
Digital GSM	–	34	353	1,125	<b>2,303</b>
Analogue	1,019	1,700	2,036	1,573	<b>774</b>
<b>Total</b>	<b>1,019</b>	<b>1,734</b>	<b>2,389</b>	<b>2,698</b>	<b>3,077</b>

BT estimates that the total number of mobile telephones connected to the Cellnet and Vodafone networks at 31 March 1998 was 3.1 million and 3.4 million respectively, up from 2.7 million and 2.9 million respectively at 31 March 1997. In addition, Orange had around 1.3 million customers and One 2 One had around 1.2 million customers at 31 March 1998, up from 0.9 million and 0.6 million at 31 March 1997.

Changes were made during the 1998 financial year so that Cellnet now deals direct with the majority of its customers, rather than through service providers. Cellnet now has end-to-end contact with the majority of its customers with the benefits that direct communication will bring. Cellnet also acquired a 40% interest in The Link, part of the Dixons Group plc, in May 1997. The Link is a chain of 123 retail outlets which specialises in providing a complete range of telecommunications products and services.

New radio interface standards are being developed internationally for third generation mobile. Third generation mobile will provide greater bandwidth than current GSM technology for high speed data and multimedia applications to be used whilst on the move. HM Government is expected to auction licences for spectrum for third generation mobile in 1999 with commercial service likely to be available from 2000 onwards. BT expects the group to participate in the auction process.

#### *Customer premises equipment supply*

BT sells and rents a wide range of equipment for customer premises, from telephones for use in the home to advanced private exchange equipment for businesses. These activities accounted for approximately 6% of the group's total turnover in the 1998 financial year.

#### *Yellow Pages*

Yellow Pages is responsible for a portfolio of products including a series of regional classified information directories in the United Kingdom to meet both consumer and business needs. Sales of its products accounted for approximately 3% of the group's total turnover in the 1998 financial year. Revenue from volume growth of advertisements published by Yellow Pages increased by approximately 5% in the 1998 financial year compared with the 1997 financial year.

#### *Other sales and services*

Other sales and services, which accounted for approximately 17% of the group's total turnover in the 1998 financial year, include Syncordia Solutions in the UK and overseas, carrier telecommunication services, charges for exchange line connections, systems integration products and services, advanced services, audio-conferencing, and various other activities.

*Syncordia Solutions* – the end-to-end provision, maintenance and billing of value-added voice and data services. These services are brought to the international market by Concert Communications. Syncordia Solutions also supplies telecommunication outsourcing services for the management of complex international communication needs of organisations for voice and data.

*Carrier telecommunication services* – whereby existing telecommunications operators and new entrants to the UK telecommunications market can utilise BT's network through interconnection to it.

*Systems integration* – the business of enabling business change, by offering a combination of skills and technologies, and the underlying network and service platforms, through Syntegra, BT's systems integration business.

*Advanced services* – BT provides advanced voice services primarily through the FeatureNet service. BT also provides advanced services for data.

*Other services* – BT also provides freephone services, visual communication services, including the distribution of television material for broadcasting organisations, video-conferencing, closed circuit television and internet services.

## **Alliances and joint ventures**

### ***Overseas***

In pursuing its international objectives, BT's approach has focused on providing network-based services to multinational and major national businesses primarily in North America, Europe, and the Asia Pacific region. In particular, this has been achieved through Concert Communications, BT's joint venture with MCI. There are partnerships in many countries with distribution agreements for Concert Communications' services in major business centres worldwide.

*BT's relationship with MCI* – in 1994, BT established a major alliance with MCI, the second largest carrier of long-distance telecommunications services in the United States. This involved the creation of Concert Communications which enabled BT and MCI to combine their international enhanced voice and data service. At about the time of the creation of Concert Communications, BT invested approximately \$4.3 billion (£2.8 billion) to acquire a 20% interest in MCI. BT currently has approximately 19% of MCI's share capital, pending closing of the WorldCom agreement. See "Recent developments". Mr Bert C Roberts, Jr., the chairman of MCI, and Mr Gerald H. Taylor, the chief executive officer of MCI, served as directors of the company during part of the 1998 financial year until they retired as directors of the company on 17 March 1998 and 9 November 1997, respectively.

*Concert Communications* – Concert Communications provides BT with a portfolio of globally managed voice and data related products and services. These services include packet services, frame relay, managed bandwidth and a full array of virtual voice network services and are provided across a global platform. Concert Communications' portfolio of products and services is targeted at meeting the international telecommunications requirements of multinational companies. It has achieved a leading position in the provision of international enhanced voice and data services. Concert Communications has approximately 3,800 corporate customers in more than 50 countries and has committed future revenues of almost \$1 billion per annum. Concert Communications is currently held 75.1% by BT and 24.9% by MCI. Under the WorldCom Agreement, BT has agreed to acquire MCI's interest in Concert Communications at a price to be negotiated, after which MCI will distribute Concert services in the United States on a non-exclusive basis for a limited period of time.

*Europe* – BT believes that it is well positioned to penetrate local markets in Europe following the liberalisation of the telecommunications market throughout most of the European Union on 1 January 1998. BT's alliance partners in Europe include: Viag and Telenor in Germany; Banca Nazionale del Lavoro, Mediaset and ENI in Italy; Vivendi (formerly Compagnie Generale des Eaux), Mannesmann and SBC in France; Nederlandse Spoorwegen (the Dutch state railway) in the Netherlands; Telenor and TeleDanmark in Sweden; TeleDanmark, Swiss Railways, Migros and UBS in Switzerland; and the Electricity Supply Board in the Republic of Ireland.

In September 1997, BT completed a transaction to take a 26% interest in Cegetel, a new French telecommunications group. Cegetel's fixed network services in France were launched at the beginning of February 1998. It holds a majority interest in SFR, the number two mobile operator in France. Viag Interkom, BT's German joint venture, was awarded a licence to offer fixed line services from 1 January 1998 and also has a mobile licence. In February 1998, Telfort, BT's joint venture in the Netherlands, was awarded one of the two new national Dutch mobile licences in addition to the fixed line licence it already held. Albacom, BT's Italian joint venture in which it has an economic interest of 23%, offers telecommunications services in the liberalised Italian market and has a fixed licence. Airtel, the Spanish mobile operator in which BT has a 16% interest, has more than one million mobile customers and approximately 40% of the Spanish digital mobile market.

*Asia Pacific* – BT-NIS, a Japanese joint venture between BT, Marubeni Corporation and others, in which BT owns 51%, began trading as a Concert distributor, Internet service provider and supplier of advanced voice

and data services in April 1997. In March 1997 BT acquired 22.5% of Bharti Cellular Limited, one of two cellular operators in Delhi, India. In April 1998 BT, in a consortium comprising Singapore Technologies Telemedia, Singapore Power and NTT of Japan, was awarded both a fixed and a mobile telecommunications licence in Singapore.

## **UK**

In May 1997, BT announced the proposed formation of an independent company, British Interactive Broadcasting (“BIB”), with British Sky Broadcasting Group, Midland Bank and Matsushita, to deliver digital interactive services to television viewers in the United Kingdom. BIB will enable businesses to offer interactive services, including home shopping, banking, travel, educational, and public information services. In addition, through their televisions, customers will be able to connect to an E-Mail service. These services will be available through an ordinary telephone line connected to a digital satellite set top box that gives access to digital satellite television broadcasts. As part of the regulatory approvals process, which is still ongoing, BT has proposed to divest itself of its existing broadband cable television interests which are not core to the company’s strategy and which are insignificant to the group’s financial position and results of operations.

### **Network modernisation and capital expenditure**

BT has been engaged in an extensive programme of modernising, improving and expanding its telecommunication network. BT completed the replacement of its semi-electronic exchanges in March 1998. The replacement of electro-mechanical exchanges was completed in June 1995. The installation of digital switching and associated transmission equipment throughout BT’s UK long-distance network was completed in 1991. BT is also continuing to install optical fibre cable in the network.

BT’s digital network has improved call quality for customers and provided management with more flexibility and control, and has led to reductions in maintenance manhours. It also makes possible the integration of voice, data and other services into a single Integrated Services Digital Network (“ISDN”).

#### *Capital expenditure*

BT’s capital expenditure over the last five financial years is shown in the table below:

<b>BT’s capital expenditure</b>	<b>Year ended 31 March</b>				
	1994	1995	1996	1997	1998
	(in millions)				
Plant and equipment					
Transmission equipment	£ 896	£1,060	£1,114	£1,131	<b>£1,219</b>
Exchange equipment	493	605	566	445	<b>512</b>
Other network equipment	335	378	491	503	<b>502</b>
Computers and office equipment	219	343	333	350	<b>372</b>
Motor vehicles and other	153	214	195	175	<b>230</b>
Property	51	75	87	143	<b>211</b>
Increase (decrease) in engineering stores	24	(4)	(15)	(28)	<b>(16)</b>
<b>Total expenditure on property, plant and equipment</b>	<b>£2,171</b>	<b>£2,671</b>	<b>£2,771</b>	<b>£2,719</b>	<b>£3,030</b>

The group’s expenditure on transmission equipment, exchange and other network equipment accounted for 74% of the total capital expenditure in the 1998 financial year. In that year there was 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. In addition, Cellnet continued expanding its digital cellular GSM network.

### *UK network*

As a result of the programme of local exchange modernisation in the United Kingdom, 100% of the customer lines in service are now served by digital exchanges. The following table shows the percentage of customer lines in service served by type of exchange at the end of each of the last five financial years:

<b>Network modernisation</b>	<b>At 31 March</b>				
	1994	1995	1996	1997	<b>1998</b>
Customer lines served by type of telephone exchange					
Digital	74.9%	82.7%	87.7%	92.6%	<b>100.0%</b>
Semi-electronic	24.6	17.2	12.3	7.4	–
Electro-mechanical	0.5	0.1	–	–	–
<b>Total</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

This programme of modernisation enables BT to provide virtually all its customers with a range of network services, including call forwarding and reminder calls, the “call minder” service, providing call answering and routing services, and the call return service.

Optical fibre accounts for approximately 93% of the current capacity of BT’s UK national network. In the junction network (connecting local exchanges), optical fibre generally continues to be the most cost-effective method of meeting new capacity requirements. BT also continues to improve and modernise its local network of cables with approximately 60,000 business customer sites served by optical fibre cable.

The following table shows the number of kilometres of optical fibre in BT’s network at the end of each of the last five financial years:

<b>Optical fibre</b>	<b>At 31 March</b>				
	1994	1995	1996	1997	<b>1998</b>
Fibre – kilometres in the network	2,577	2,782	3,043	3,302	<b>3,591</b>

### *International networks*

BT continues to invest in its international digital cable and satellite network infrastructure to support a growing range of advanced communication services between the United Kingdom and the rest of the world. Optical fibre cable links are now available from the United Kingdom to many destinations, including continental Europe. 75% of international public switched call traffic is routed via fibre cable. BT has investments in a number of international consortia which provide and own satellite communication facilities. All of BT’s international telephone calls are switched through digital international exchanges in the United Kingdom.

### *Research and development*

Research and development is a primary mechanism by which BT aims to remain competitive. The major part of BT’s expenditure on research and development, which in the 1998 financial year totalled £307 million, is directed towards the development of new and improved networks and services for customers. Increasingly, resources are being devoted to software systems to provide better managed and more intelligent networks and network services, but work also continues on optical fibre systems, speech and image processing, mobile applications, data, Internet and interactive services.

Continuing development of products and services such as call centres, computer/telephony integration and corporate intranets, feature in BT’s research programme. Also under research are broadband applications, access network evolution, data services, customer handling systems, public warning systems, service management, electronic commerce, user authentication, multimedia services, advanced mobile terminals, healthcare services and education applications.

## Organisation and employees

### *Organisation*

BT is currently organised into two main operations, BTUK and BT Global; and a number of support units in the group's headquarters which provide specialised services. BTUK comprises three divisions, Business Division, Consumer Division and Networks & Systems.

Business customers whose telecommunications requirements fall mainly within the United Kingdom are served by Business Division. Consumer Division provides the primary interface between BT and its residential customers. It also has responsibility for BT's public payphones. Networks & Systems is responsible for the design, operation, maintenance and development of BT's networks and technology. It is also responsible for BT's research and development facility. BT Global serves business customers who require telecommunications services around the world and it is responsible for BT's relationship with joint ventures.

### *Employees*

The following table shows the total number of BT's employees at the end of each of the last five financial years:

	<b>At 31 March</b>				
<b>BT's employees</b>	1994	1995	1996	1997	<b>1998</b>
Number of employees in the group:					
UK	153,900	134,900	127,800	123,300	<b>120,200</b>
International	2,100	2,600	2,900	4,200	<b>4,500</b>
<b>Total employees</b>	<b>156,000</b>	<b>137,500</b>	<b>130,700</b>	<b>127,500</b>	<b>124,700</b>

The number of BT's employees has fallen substantially since 1991 as a result of improvements in operating efficiency, a reduction in layers of management and in directory assistance work, the contracting-out of certain services, and business disposals. At the same time, BT has increased its use of temporary contract personnel, where this has been cost effective, to provide the particular skills and flexibility necessary to meet new and changing workloads in both field engineering and support services. BT expects this trend to continue where it is appropriate in the context of its overall resourcing strategy and the maintenance of positive industrial relations.

An estimated 80% of the company's employees belong to two main trade unions recognised by the company. The pattern of industrial relations in the last few years has been generally stable. The reduction in the number of employees has so far been implemented on a voluntary basis and without significant disruption to BT or its customers. BT completed the last of the company-wide voluntary workforce reduction programmes at the end of September 1996. These have been replaced with smaller, localised or business focused reduction programmes. In line with its continuing drive to improve productivity BT made further reductions in the 1998 financial year and such reductions are expected to continue.

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

## Regulation, competition and prices

### **Regulation**

#### *UK Regulation*

The regime for the regulation of telecommunications activities in the United Kingdom is principally set out in the Telecommunications Act, which confers regulatory functions on the Secretary of State and the Director General. Under this Act, the Secretary of State and the Director General have a duty to exercise their functions to secure the provision, so far as reasonably practicable, throughout the United Kingdom of telecommunication services which satisfy all reasonable demands for them, including certain community services, and to secure the ability of licensed operators to finance the provision of those services. Subject to this duty, they are required, among other things, to promote the interests of consumers, purchasers and other users in respect of prices, variety and quality of telecommunication services and equipment, to maintain and promote effective competition between persons engaged in commercial activities in the UK telecommunications field and to promote efficiency and economy on



the part of such persons. These duties are under review in HM Government's review of utility regulation. See "HM Government's review of utility regulation".

With limited exceptions, a licence under the Telecommunications Act is required for the running of a telecommunication system in the United Kingdom. Responsibility for licensing rests with the Secretary of State after consulting the Director General. The Director General has broad supervisory powers and duties under the Telecommunications Act and licences issued under it. An important factor in the impact on BT of the UK regulatory system is how the Director General and the Secretary of State exercise their powers (many of which allow considerable discretion) and perform their duties.

The Director General is statutorily responsible for enforcing licence conditions, and he may make orders requiring compliance, enforceable in the UK courts, which, if breached, could result in liability for damages to third parties. He also has broad discretionary powers (under the Telecommunications Act and in licences) available to him and is responsible for monitoring the telecommunications market and investigating complaints about telecommunications related matters.

In addition, the Director General may modify licence conditions with the licensee's agreement. Alternatively, he may refer a matter concerning a licence to the MMC. If the MMC recommends modifying conditions of the licence concerned, the Director General is required to make the modifications which he considers necessary to remedy the adverse effects on the public interest identified by the MMC. In either case, the Telecommunications Act requires public consultation before licence condition modifications can be made. Licences may also be modified by legislation including the transposition into UK domestic law of European Union ("EU") directives. HM Government is currently undertaking public consultation on proposals to change the licence modification procedure to remove the need for an MMC reference where only a small percentage of licensees affected by a modification objected to its introduction.

The Director General has concurrent jurisdiction with the Director General of the UK Office of Fair Trading ("OFT") in exercising certain functions under the UK Fair Trading Act 1973 and under the UK Competition Act 1980, but only in so far as they relate to telecommunications. See "General competition law".

A new Competition Bill is currently being considered in the UK Parliament. See "General competition law".

The current Director General is David Edmonds. He was appointed effective 1 April 1998 and his current appointment continues until 31 March 2001. The Director General is supported by the UK Office of Telecommunications ("OfTel"), which has a permanent staff of about 170. The previous Director General was Donald Cruickshank who held office from 1 April 1993 until 31 March 1998.

#### *HM Government's review of utility regulation*

HM Government has initiated a review of utility regulation which is still in its early stages. Public responses to the consultative document were submitted to HM Government at the end of May 1998. HM Government has made a number of proposals for regulatory reform which include a tiered regime with little or no regulation for fully competitive industries, ranging to more close regulation for those industries where competition has not developed sufficiently. In its response, BT took the opportunity to show that, in the company's view, the development of competition in the telecommunications market means that the need for a special telecommunications regulatory regime is rapidly diminishing and that issues such as fair trading should now be overseen by the UK's general competition authorities, such as the MMC and the OFT.

#### *The BT Licence*

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

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

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

The company is required to connect to its system on standard terms and conditions any other system run under a licence which authorises connection to the company's system and which is composed of equipment which meets specified independent approval standards and to install separate wiring for its network and for customers' equipment in customers' premises, so as to enable private systems and equipment to be separate from the company's system.

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

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

The Licence also contains provisions enabling the Director General to monitor the company's activities, including requirements for BT to supply him with information he requests and to maintain segregated accounting records for specified parts of its business. These parts, designated in the Licence for regulatory purposes, include the "systems business" (the activities of running the main UK network, including installation, maintenance and repair of the network and conveyance of telephone calls and other messages); the "supplemental services business" (generally value-added services and data services, including video-conferencing); and the "apparatus supply business" (broadly, the supply of customer premises equipment). In addition, the Licence requires the provision to the Director General and publishing of financial statements in respect of the systems business and apparatus supply business. In part, these financial statements are required to enable the Director General to satisfy himself as to compliance with the prohibition on unfair cross-subsidy discussed above. Where it appears to the Director General that an unfair cross-subsidy exists in relation to specified parts of its business, BT must take such steps as the Director General may direct to remedy the situation.

#### *Domestic obligations in a global market*

A new licence condition was introduced into BT's Licence in October 1997 prohibiting BT from doing anything by act or omission, that would detract materially from its ability during the remainder of the initial 25 year period of the Licence (see "The BT Licence") to meet its licence obligations to provide telecommunication services and any legal obligation to provide such services to a specified standard. BT's directors will be required to submit an annual compliance certificate to the Director General. The Director General may also, not more than once every 12 months, require BT to procure an auditors' report stating whether, in the auditors' opinion, BT has in place and has followed the appropriate systems and processes to enable the directors to form a reasonable opinion as to whether BT is complying with the obligation. The need for compliance certification and the option of an audit report will apply from 1 April 1998 to June 2004, unless extended.

#### *Interconnection under the Licence*

The company must, in accordance with the Licence, permit the interconnection to its system of certain other systems appropriately licensed for the provision of telecommunication services to the public. Prices of interconnection services prior to 1 October 1997 were determined by the Director General. This has been replaced by a network charge control regime running from 1 October 1997 to 30 September 2001 which gives BT the freedom to set charges for its standard interconnection charges. See "Prices – Network charge control." BT is required to publish an interconnection agreement, or an amendment of one, within 28 days of entering into or amending it and to provide a copy to any person who requests it.

#### *Competition and Service (Utilities) Act 1992*

Under the UK Competition and Service (Utilities) Act 1992, the Director General has powers concerning, among other things, service standards and the amount of compensation to be paid to individual customers if such standards are not met; overall performance standards; procedures for handling complaints; and criteria for charging deposits. The Director General's powers apply to BT in relation to a specified range of services, including voice telephony, facsimile and directory information services. In particular, he can set enforceable

performance standards after consultation with BT, but without the agreement of BT and without reference to the MMC. During 1995 the telecommunications industry voluntarily agreed to, and began publication of, comparable performance indicators. To date the Director General has not exercised such powers.

The Secretary of State is also empowered under this Act to make regulations giving the Director General power to resolve billing disputes.

As required by this Act, BT's complaints handling procedures, deposit guidelines and a procedure for resolving disputes about deposits have been formally approved. It is not expected that any other powers contained in this Act will be used in the near future. However, they will remain available and their effect cannot be assessed unless and until they are exercised from time to time. Although this Act contains powers which BT believes may, if implemented, have adverse effects on it, BT does not expect them to be material.

#### *Universal service*

In July 1997, the Director General published a statement setting out the result of his review of the universal service obligations of UK telecommunications operators. The company's unique obligations to provide service are to remain broadly unchanged but it is required to provide a new outgoing calls barred service at a low price targeted at the poorer sections of the UK community. This new service, which was introduced nationally in March 1998, is not expected to have a significant impact on revenues. The Director General will consider in 1999 whether to establish a universal service fund.

#### *Radio spectrum licences*

The use of radio spectrum in the United Kingdom is regulated under the Wireless Telegraphy Acts of 1949, 1963 and 1998. BT's national and international telecommunication networks, including microwave and satellite links, are dependent on licences under the 1949 Act. A comprehensive licence covers most of the company's existing fixed terrestrial and satellite links and the use of maritime radio frequencies. In 1996 the company was granted a separate licence under the Wireless Telegraphy Acts to authorise the use of spectrum for fixed telephony access in remote rural areas (covering about 4% of the UK population). Radiopaging services and Cellnet's cellular network are both licensed separately. Under the Act, wireless telegraphy licences can be revoked or varied at any time, by the Secretary of State.

Historically, the Secretary of State has delegated exclusive management control of some blocks of radio spectrum to BT. However, in 1991, HM Government stated that ultimately BT would lose management control of all its blocks with some specific exceptions. This is now happening at an increasing rate. Additionally, it is HM Government policy that well established networks should, where possible, move from radio to cable links.

The 1998 Act allows for charging for radio spectrum, including the use of auctions. BT expects that its operating expenses will increase in consequence if charges are introduced for use of the spectrum. It also expects that the speed and flexibility with which it currently provides new or modified radio links, both within its network and direct to customers, will be reduced, as self managed bands are taken back into Government management.

#### *Overseas regulation*

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

In the United States, the FCC has extensive authority to regulate interstate services and local access facilities and services provided by common carriers, including the right to review the interstate rates charged by common carriers, as well as the authority to implement policies that promote competition for all telecommunication services.

The European Commission has been pursuing a policy of progressive liberalisation and harmonisation in telecommunications. Since 1 January 1998, the provision of infrastructure and all telecommunication services has been liberalised in the EU, apart from some derogations for the less developed member states. Also on 1 January 1998, new rules were put in place in respect of regulatory issues, including interconnections, universal service, transparent accounting and licensing. These are currently being transposed into national regulation and it is too early to assess what their impact on the company will be.

From 1 January 2000, the EU will require the availability of both carrier pre-selection, from operators with significant market power, and number portability at a fixed location between all fixed network operators.

BT has authorisations, either in its own right or through subsidiaries or joint venture companies, to provide services in a number of overseas countries, including the US. BT is also active in pressing for liberalisation of markets around the world to enable it to provide services to customers on a global basis. The agreement on basic telecommunications reached by the WTO in February 1997 and covering most of the world's major national markets is expected to lead to an acceleration of the liberalisation process and to increased opportunities for BT.

#### *General competition law*

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

A bill is currently being considered by the UK Parliament that would amend UK competition law and bring it generally into line with European Union law, and in particular Articles 85 and 86 of the Treaty of Rome (i.e. the EU Treaty, which is the legal basis of the European Union conferring rights which can be upheld by national courts and by the European Court of Justice. Articles 85 and 86 are anti-competitive behaviour measures, prohibiting anti-competitive agreements/concerted practices and abuse of dominant market position). It would introduce general prohibitions in respect of (a) agreements which prevent, restrict or distort competition and (b) abuse of a dominant position by any undertaking. Enforcement will be by the Director General of Fair Trading and, in the case of telecommunications, the Director General of Telecommunications will have concurrent jurisdiction with the Director General of Fair Trading. This legislation would replace the fair trading licence condition currently existing in most public telecommunications operators' licences. Breach of the prohibitions could lead to fines of up to 10% of turnover and/or result in claims for damages in the civil courts. There are powers to order a company to cease an infringing activity. The bill would also introduce an independent appeals mechanism. If passed, the legislation is likely to come into effect during 1998 and 1999.

Under its powers to investigate potential infringements of the EU's competition rules, the European Commission is examining the arrangements of operators within the EU governing prices and accounting rates for international telephone calls. BT has responded to a fact-finding letter from the European Commission on this subject. The Commission's investigations are continuing.

#### **Competition**

The Conservative Party, which formed HM Government from 1979 and continued to be the governing party until 1 May 1997, followed a long-term policy from 1981 of seeking to introduce competition into the building and operation of public telecommunication networks in the United Kingdom, the provision of services over those networks, and the supply of equipment for connection to those networks. Entry to the market for the supply of telecommunications equipment is unrestricted and the supply of equipment to customers is highly competitive.

Direct competition was introduced in 1983 when Mercury, a subsidiary of Cable & Wireless plc, commenced initial services. BT faced competition since 1986 from Mercury in the provision of switched voice telephony and data services, particularly serving business customers. Mercury competed particularly in the provision to call intensive customers of international and long-distance calls, the most profitable parts of the UK telecommunications market.

The duopoly policy allowed only BT and Mercury to provide national fixed-link telecommunication services to the public. After the review of that policy in 1991, HM Government has followed a policy of not restricting entry into the market for UK services and networks. See "Market entry". Mercury merged with three cable operators in April 1997 to form Cable and Wireless Communications ("CWC"). For certain market share information relating to BT and its competitors, see "Item 9 – Management's Discussion and Analysis of Financial Condition and Results of Operations".

#### *Market entry*

Since the BT/Mercury duopoly of national fixed-link public telecommunications services was terminated in 1991, HM Government has issued over 160 new licences to companies providing a range of local, regional and national services. Many operators also provide international telephony by means of international simple resale. In December 1996 the BT/Mercury duopoly of international facilities was also ended, and around 80 international simple voice resale licences have been issued.

The UK market is now fully open to entry and, except in cases where use of a scarce resource such as radio spectrum is required, there is a presumption that licence applications will be granted. There are no restrictions on entry by non-UK firms.

New entrants to the market are not subject to the same degree of regulation as BT and have fewer obligations in their licences.

Many of the entrants to the UK market since 1991 are large companies with substantial financial resources and significant telecommunications experience, much of it gained as the monopoly or dominant operator in an overseas market. Their activities in BT's key markets have led, and will continue to lead, to a loss of market share by BT with consequential effects on revenues. In particular, BT has lost market share in international telephony and expects to experience further loss as the new international facilities operators extend their activities.

#### *Service providers*

Changes proposed in Oftel's February 1997 statement on the regulation of supply of services by BT to independent service providers – those who use BT and other operators to provide services to their customers – have been implemented through amendments to BT's Licence. The measures include an updated classification of BT's Systems Business and Supplemental Services Business (effective from 1 April 1998); increased flexibility for BT to offer lower prices to independent service providers; and increased transparency of the relationship between BT's Systems Business and its Supplemental Services Business. The impact of these changes will not be clear until the market for service providers has developed sufficiently. BT believes that it is unlikely to be material.

#### *Cable operators*

HM Government policy has been to restrict BT from competing in the conveyance and provision of broadcast visual services over its national network, but this policy is currently under review. See "HM Government's review of broadcasting restrictions".

Over 150 cable television franchises have been awarded, which cover about 75% of the UK population. Cable operators are allowed to offer voice telephony and other telecommunication services in addition to "entertainment" services, independently of the company and other public telecommunications operators. Rate of growth has been rapid: in April 1995, 872,000 cable telephony lines had been installed in 45 franchises. By January 1998, there were 3,442,000 lines in 127 franchises. The growth in the number of cable telephony lines is expected to have an increasingly adverse effect on the company's share of the UK residential market as the operators build out their networks.

In recent years the UK cable market has been consolidating and the largest cable operators currently include CWC, Telewest and NTL.

#### *HM Government's review of broadcasting restrictions*

HM Government published a review of broadcasting restrictions on 23 April 1998 which announced proposals to lift the broadcasting restrictions on BT and other national telecommunications operators by 2001. Although BT has no current plans to offer multichannel TV in direct competition with cable, HM Government's policy change will allow BT to develop broadband access using Asymmetric Digital Subscriber Loop ("ADSL") and services to homes that could incorporate broadcast elements.

#### *Mobile services*

HM Government policy places certain restrictions on BT competing in the provision of mobile telecommunication services in the United Kingdom. HM Government has sometimes licensed existing participants in the UK telecommunications market and, in other cases, has expressly excluded existing licensees from participating in new services.

Although BT has a majority share in Cellnet and resells cellular services through its mobile communications unit, the company itself is prohibited from providing mobile services under the Licence and was excluded from participating in the consortia licensed in 1991 by HM Government to operate PCNs. PCNs compete with existing mobile networks (using different radio frequencies), and also with fixed networks (including BT's local network).

HM Government has also licensed mobile telephone operators, Cellnet, Vodafone, Orange and One 2 One to provide fixed-link services in addition to their mobile operations, while continuing to exclude the company and other national fixed-link operators from providing mobile services. BT is allowed to provide radiopaging services, but under a separate licence, vested in the company.

In his statement "Pricing of Telecommunications Services from 1997", the Director General said that he was concerned about the level of payments made by the company to Cellnet and Vodafone for having calls terminated on their networks and, in his opinion, the consequent high prices for calls from the company's fixed network customers to mobile customers of Cellnet and Vodafone. A consultative document "Prices of Calls to Mobile Phones" was published in March 1997 in which the Director General concluded that prices were still too high. In March 1998, the Director General referred BT, Cellnet and Vodafone to the MMC for investigation into BT's retail charges for calls made from BT's fixed network to Cellnet and Vodafone's networks and Cellnet and Vodafone's charges to BT for terminating such calls. 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 and results of operations in view of the continuing reduction in prices.

#### *Number portability*

Number portability enables customers to retain their numbers when changing the operator providing their telephone service. Subject to certain specified criteria being met, the Director General has the power to direct BT to provide portability to other operators, and he has made such a direction.

Following a referral of the issue of charges to the MMC in 1995, and the subsequent publication of the MMC's report, BT's Licence was amended in July 1996 to reflect the MMC's recommendations of allocating various defined categories of costs of providing number portability. In April 1997 the Director General announced that he intended to amend all fixed operators' licences to require them to provide portability on the same basis as BT, and he published proposed licence amendments accordingly.

Portability of geographic numbers was introduced, starting with single numbers, in May 1996, and further development of geographic number portability is under way. A trial of non-geographic number portability (eg 0800 freephone numbers) started in May 1997. The Director General has also announced his intention of extending portability to encompass mobile numbers from July 1998.

The introduction of number portability makes it easier for BT's customers to switch to another operator (although the facility is available in both directions), and may lead to some reduction in the customer base.

#### **Prices**

BT is now subject to price controls in the UK at two levels: retail and network.

#### *Retail price controls*

The company has been subject to controls over certain retail prices since 1984. The controls have allowed some room for flexibility as to the individual price changes and have generally taken the form of requiring it to reduce, or limiting the extent to which it can increase, charges for two groups of services being public switched telephone services and private circuits. The services subject to these controls used to account for the majority of the company's revenues until 31 July 1997 when the controls were relaxed as described below. No competitor is subject to price controls.

The company is not prevented from benefiting from the improvements in efficiency by any limitation to a specific rate of return on capital. While all prices must be consistent with requirements in the company's Licence, such as that they must not be unduly discriminatory, the company is not generally required to obtain the prior approval of any regulatory authority for specific retail price changes.

BT is subject to two basic sets of UK retail price controls, one on certain public switched telephone services, essentially call charges and exchange line rentals, and one on certain private circuits. Each price control is based on a formula calculated by reference to the UK Retail Prices Index ("RPI"). The weighted average increase in prices charged for the services covered by the controls, in each twelve-month period beginning 1 August, cannot exceed a fixed percentage below the change in RPI (referred to as "RPI minus" the fixed percentage) for the twelve months to the preceding 30 June. If the RPI increases by less than the fixed percentage, or falls, the company must lower the weighted average prices for those services accordingly. In calculating the increase or reduction to these prices, each item is weighted in proportion to the contribution it made to the company's turnover from services covered by the respective price controls in the previous financial year. Any permitted increase forgone (or excessive reduction made) in one year can count when establishing the company's prices in future years.

The price control formula for public switched telephone services which applied from August 1993 until July 1997 was RPI minus 7.5.

The retail price control for public switched telephony, applying from August 1997 to July 2001, is RPI minus 4.5. Although it is measured on services used by the lowest 80% of BT's residential customers classified by bill size, controlled prices must be offered to all customers. Price changes required by the control must be made by 1 February each year but any excessive reduction in one year may generally be carried forward to the next control year.

BT has also given an assurance that a normal residential bill will (for the same level of usage) not increase by more than RPI and that a "control" price package will be made available to business customers. The "control" package for business customers provides call charges, which are no higher than the prices used for calculating adherence to the residential price control, and line rental increases will be no more than the increase in RPI. BT is free to offer other packages to business customers with prices which are lower than the "control" package prices. The required reduction in prices for the year commencing 1 August 1997 under the retail price cap is based on the RPI movement for the twelve months to June 1997 which was 2.94%.

The price control formula and the company's performance against the formula since 1 August 1993 have been as follows:

Price control formula	Year commencing August				
	1993	1994	1995	1996	1997
% RPI movement for the relevant period (a)	1.22	2.62	3.52	2.14	<b>2.94</b>
RPI formula in effect (b)	(7.50)	(7.50)	(7.50)	(7.50)	<b>(4.50)</b>
% required reduction in prices (c)	(6.94)	(4.86)	(1.38)	(4.92)	<b>(1.56)</b>
% reduction in prices overall	(6.95)	(7.35)	(1.82)	(4.92)	<b>(1.59)(d)</b>

- (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.

The price control for private circuits, applying from August 1997 to July 2001, applies to analogue and lower speed digital private circuits, the prices of which cannot be increased by more than the change in the RPI in any year. This control also applies to international private circuits.

#### *Network charge control*

The company operates under interconnection agreements with most other licensed operators, including mobile, international simple resale and cable operators, and is in negotiation with other licensed operators.

A network charge control regime running from 1 October 1997 to 30 September 2001 gives BT the freedom to set reasonable charges based on incremental costs for its standard interconnection services. The key feature of the new arrangements is the replacement of the system of annual charge determination by the Director General with one where, depending on the degree of competition for these services, charges are basket controlled (i.e. at RPI minus 8), price cap controlled (i.e. no increases above RPI), or no longer subject to price controls. Those with little or no competition are normally subject to cap or basket controls, whereas fully competitive services are no longer subject to price controls.

The network charge controls are based around RPI minus 'X' rules. The value of 'X' in the 'RPI minus' formula has been set at 8% for the period of control with accompanying timing constraints to ensure that within the charge control year price reductions are not delayed or increases introduced early. Failure to meet the RPI minus 8 constraint must be remedied to the satisfaction of the Director General by making adjustments to the relevant charges either within the control year or in the following year. An obligation has been placed upon BT to publish a notification to the Director General and other licensed operators if it intends to amend existing charges or to offer new services.

BT is not allowed to discriminate unduly among operators or between BT's retail operations and other operators with respect to both price and quality of service. BT is also required to publish and have audited financial statements for the regulatory "businesses" and "activities", in order to support the linkage of costs with interconnect prices and with a view to providing demonstrable evidence that BT is neither behaving in a discriminatory fashion nor unfairly subsidising its activities.

The regulatory “businesses” for which separated accounts are currently produced are: access; apparatus supply; network; retail systems; supplemental services; and residual services. No organisational separation was required by the interconnect and accounting separation (“ICAS”) amendments. Financial statements for the businesses and activities are published both on a historical cost basis and on a current cost basis. BT has also published the accounting documents associated with the ICAS requirements. Historical cost financial statements for the businesses and activities for the 1998 financial year are required to be published by 31 July 1998. BT will also publish current cost financial statements for the businesses and activities for the 1998 financial year including long-run incremental cost information for the network business by 30 November 1998.

## **Relationship with HM Government**

### *HM Government’s interest in BT*

The special rights redeemable preference share of £1 par value in the company (the “Special Share”), formerly held by HM Government, was redeemed at par on 10 September 1997. The Special Share, which could only be held by HM Government, did not carry any rights to vote at general meetings, but entitled the holder to receive notice of, attend and speak at such meetings. Certain matters, in particular the alteration of specified Articles of Association of the company, including the article relating to limitations which prevent a person from owning or having an interest in 15% or more of BT’s voting shares and the article requiring BT’s executive Chairman to be a British citizen, required the written consent of the holder of the Special Share. HM Government, as holder of the Special Share, did not have a right to appoint or nominate directors of the company.

### *Commercial and other relations with HM Government*

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

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

See “Regulation, competition and prices” with respect to the powers of HM Government and the Director General to regulate telecommunications within the United Kingdom.

### *Windfall tax*

In the 1998 financial year HM Government imposed a windfall tax on the “excess profits” of certain privatised companies, including BT. The windfall tax resulted in a charge to BT of £510 million, payable in two equal instalments. The first instalment was paid in December 1997 and the second instalment is payable in December 1998. The tax liability arose in July 1997, and was charged as an exceptional item in BT’s financial statements for the 1998 financial year.



## **ITEM 2 – DESCRIPTION OF PROPERTY**

The group has a property portfolio, comprising approximately 8,100 buildings at 31 March 1998, the majority of which are freehold, located principally throughout the United Kingdom. Specialised buildings account for the majority of properties both in number and book value. They house mainly exchange equipment and are needed as part of the group's continuing operations. They do not readily adapt to other uses. General purpose properties consist chiefly of offices, depots, computer centres and shops.

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

## **ITEM 3 – LEGAL PROCEEDINGS**

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

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 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 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 through 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 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.

#### ITEM 4 – CONTROL OF REGISTRANT

So far as the company is aware, no person is the beneficial owner of more than 10% of the company's Ordinary Shares, nor is the company directly or indirectly owned or controlled by another corporation or by HM Government or any other foreign government.

The following table shows certain information at 15 May 1998 about the ownership of the company's Ordinary Shares by the company's directors and officers as a group at that time.

<b>Title of class</b>	<b>Owner</b>	<b>Number owned</b>	<b>% of class</b>
Ordinary Shares	Directors and officers as a Group ( 9 persons)	310,766 <sup>(a)</sup>	<b>0.005</b>

- (a) Includes 30,935 Ordinary Shares owned by 2 directors under the BT Long Term Remuneration Plan (to be renamed the BT executive Share plan). See "Item 12–Options to purchase securities from registrant or subsidiaries".

There are no arrangements known to the company the operation of which may at a subsequent date result in a change in control of the company.

## ITEM 5 – NATURE OF TRADING MARKET

The principal listing of the Ordinary Shares is on The London Stock Exchange Limited (the “London Stock Exchange”). The Ordinary Shares are also listed on the Tokyo Stock Exchange. ADSs, each representing 10 Ordinary Shares, have been issued by Morgan Guaranty Trust Company of New York, as Depository for the American Depositary Receipts (“ADRs”) evidencing the ADSs, and are listed on the New York Stock Exchange. ADSs also trade, but are not listed, on the London Stock Exchange.

The following table sets forth, for the periods indicated, the highest and lowest closing middle-market quotations for Ordinary Shares, as derived from the Daily Official List of the London Stock Exchange, and the highest and lowest sales prices of ADSs, as reported on the New York Stock Exchange composite tape:

<b>Financial year</b>	<b>£ per Ordinary Share</b>		<b>\$ per ADS</b>	
	<b>High</b>	<b>Low</b>	<b>High</b>	<b>Low</b>
<b>1995</b>				
1 April-30 June 1994	3.96½	3.53½	58¾	53¾
1 July-30 September 1994	3.95½	3.63½	62½	56¾
1 October-31 December 1994	4.00½	3.59½	64¾	56¾
1 January-31 March 1995	4.07½	3.65½	64¼	57¾
<b>1996</b>				
1 April-30 June 1995	4.07½	3.82½	65½	60¾
1 July-30 September 1995	4.13½	3.86½	65½	59¾
1 October-31 December 1995	4.00½	3.40½	63½	52½
1 January-31 March 1996	3.81½	3.33½	58¾	50¾
<b>1997</b>				
1 April-30 June 1996	3.82½	3.26½	58¾	49¼
1 July-30 September 1996	3.97	3.36	60½	53
1 October-31 December 1996	4.10	3.45	68¾	54¾
1 January-31 March 1997	4.61½	3.93	73¾	66¾
<b>1998</b>				
1 April-30 June 1997	4.82½	4.24	78¾	69½
1 July-30 September 1997	5.01½	3.79½	82½	60¾
1 October-31 December 1997	4.83½	4.39½	81¾	71¾
1 January-31 March 1998	6.85	4.80¾	113¾	79¾
<b>1999</b>				
1 April-15 May 1998	6.93½	6.39	112⅝	103⅝

Fluctuations in the exchange rate between the pound sterling and the US dollar will affect the dollar equivalent of the pound sterling price of the company’s Ordinary Shares on the London Stock Exchange and, as a result, are likely to affect the market price of the ADSs on the New York Stock Exchange.

At 15 May 1998 there were 6,412,925,552 Ordinary Shares outstanding. At the same date, approximately 10.4 million ADSs (equivalent to 104 million Ordinary Shares, or approximately 1.6% of the total number of Ordinary Shares outstanding on that date) were outstanding and were held by 2,305 record holders of ADRs.

## ITEM 6 – EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS

There are currently no governmental laws, decrees or regulations in the United Kingdom that restrict the export or import of capital, including, but not limited to, UK foreign exchange control restrictions, or that affect the remittances of dividends or other payments to non-resident holders of the company's Ordinary Shares, except as otherwise set forth in "Item 7 – Taxation" and except in respect of the government of, or any resident of, Iraq or Libya or any person treated as so resident.

There are no limitations under the laws of the United Kingdom restricting the right of non-residents to hold or to vote shares in the company. Except for the general limitations described below, which apply to both residents and non-residents, there are no limitations under the company's Articles of Association (the "Articles") restricting the right of non-residents to hold or to vote shares in the company.

### *Restrictions on voting*

Under Articles 37 and 76 of the Articles no person shall, unless the Board of Directors of the company (the "Board") otherwise determine, be entitled to attend or to vote at any general meeting or to exercise any other right conferred by being a shareholder at or in relation to meetings of the company in respect of any Ordinary Shares held by him or her if:

- (i) he or she or any person appearing to be, directly or indirectly interested in those shares has been duly served with a notice under Section 212 of the UK Companies Act 1985 (which confers upon UK public companies the power to require information with respect to interests in their voting shares), and he or she or any such person is in default in supplying to the company the information requested within the time specified in such notice for compliance, which must be at least 14 days after the service of notice, and the Board resolves that those shares be disqualified. Such disqualification will continue until not more than seven days after the earlier of receipt by the company of notice that those shares have been sold to a bona fide third party who is not a connected person; due compliance, to the satisfaction of the company, with the notice; or the Board resolving to remove the disqualification, or
- (ii) the circumstances described below under "Limitation on shareholdings" apply.

### *Limitation on shareholdings*

The limitation on interests in voting shares of the company imposed by Article 37 of the Articles is described briefly below. For the purpose of these provisions, the expression "interest" is broadly defined; it generally follows, but is more extensive than, the definition used in deciding whether a notification to the company would be required under Part VI of the UK Companies Act 1985. This requires any person who has a material interest in 3% or more, or a non-material interest in 10% or more, in voting shares (all as defined in Part VI of the UK Companies Act 1985), to notify the company of that interest.

If any person has, or appears to the Board to have, or (if the Board is unable to ascertain whether such a person has an interest in those shares and so resolves) is deemed to have, an interest in shares which carry 15% or more of the total votes attaching to relevant share capital (as that expression is defined in the UK Companies Act 1985), the Board shall serve a written notice on all persons (other than certain persons referred to below) who appear to it to have such interests and, if different, on the registered holder(s) of the shares concerned. Such notice will set out the restrictions referred to below and will call for the interest concerned to be reduced to less than 15% by sale or other disposal of shares within 21 days of the giving of the notice to the registered holder(s) (or such longer period as the Board considers reasonable). No transfer of the shares comprised in the interest may be made except for the purpose of reducing such interest to less than 15%.

If such a notice is served and is not complied with in all respects to the satisfaction of the Board and has not been withdrawn, the Board shall itself effect such a disposal on such terms as it may determine, based upon advice obtained by it for the purpose. A registered holder on whom a notice referred to above has been served is not entitled in respect of the share or shares comprised in the interest, until such notice has been withdrawn or complied with to the satisfaction of the Board, to attend or to vote at any general meeting of the company or meeting of the holders of voting shares and such rights will vest in the chairman of any such meeting, who may act entirely at his or her discretion in relation to such rights.

The Board is not required to serve notice on any person if it does not know either the identity or address of such person. The absence of serving such notice in such a case and any accidental error in or failure to give any notice to any person upon whom notice is required to be served will not prevent the implementation of or invalidate any

procedure under the relevant Article. Any resolution or determination of, or decision or exercise of any discretion or power by, the Board shall be conclusive and binding on all persons concerned and shall not be open to challenge.

Any person acting on behalf of HM Government and certain other specified shareholders, including the Depository for the ADRs, are not subject to these restrictions.

## ITEM 7 – TAXATION

The taxation discussion set forth below is intended only as a summary of the principal US Federal income tax and UK tax consequences to beneficial owners of ADSs who are either resident in the United States or who hold Ordinary Shares or ADSs as assets effectively connected with a US trade or business (“US Holders”) and does not purport to be a complete analysis or listing of all potential tax consequences of the purchase, ownership and disposal of Ordinary Shares or ADSs. Investors are advised to consult their tax advisers with respect to the tax consequences of their holdings, including the consequences under applicable state and local law. The statements of UK and US tax laws and practices set out below are based on the laws in force and as interpreted by the relevant taxation authorities as of the date of this Annual Report on Form 20-F. The statements are subject to any changes occurring after that date in UK or US law or practice, in the interpretation thereof by the relevant taxation authorities, or in any double taxation convention between the United States and the United Kingdom.

In particular, this discussion is based on current convention between the United States and the United Kingdom for the avoidance of double taxation with respect to taxes on income and capital gains (the “Treaty”) and the US Internal Revenue Code of 1986, as amended (the “Code”).

### **United States Tax Consequences of the Ownership of Ordinary Shares and ADSs**

In general for US federal income tax purposes, US Holders of ADSs will be treated as the owners of the underlying Ordinary Shares that are represented by such ADSs. Deposits or withdrawals of Ordinary Shares by US Holders in exchange for ADSs will not be subject to US federal income tax.

#### *Taxation of Distributions*

To the extent paid out of current or accumulated earnings and profits of the company, as determined under US federal income tax principles (“EP”), a distribution made with respect to Ordinary Shares or ADSs (including the amount of any Treaty Payment, and any UK Withholding Tax (both as defined below)) will be includable for US federal income tax purposes in the income of a US Holder as ordinary dividend income on the day received by the US Holder, in the case of Ordinary Shares, or on the day received by the Depository, in the case of ADSs. To the extent that such distribution exceeds the EP of the company, it will be treated as a non-taxable return of capital to the extent of the US Holder’s adjusted tax basis in the Ordinary Shares or ADSs and thereafter as taxable capital gain. Dividends paid by the company will not be eligible for the dividends received deduction allowed to corporations under Section 243 of the Code. The amount of any dividend paid in pounds sterling will equal the US dollar value of the pounds sterling received calculated by reference to the exchange rate in effect on the date the dividend is received by the US Holder, in the case of Ordinary Shares, or by the Depository, in the case of ADSs, regardless of whether the pounds sterling are converted into US dollars. If the pounds sterling received as a dividend are not converted into US dollars on the date of receipt, a US Holder will have a basis in the pounds sterling equal to their US dollar value on the date of receipt. Any gain or loss realised on a subsequent conversion or other disposition of the pounds sterling will be treated as ordinary income or loss.

#### *US Credit for UK Taxes Withheld*

Subject to certain conditions and limitations set forth in the Code, US Holders generally may elect to claim a credit, against their US federal income tax liability, for UK Withholding Tax (as defined below) deducted from dividends received in respect of Ordinary Shares or ADSs. For purposes of calculating the foreign tax credit, dividends paid on the Ordinary Shares or ADS, will be treated as income from sources outside the United States and will generally constitute “passive income”. The rules relating to the determination of the foreign tax credit are complex and US Holders should consult their tax advisers to determine whether and to what extent a credit would be available. US Holders that do not elect to claim a foreign tax credit may instead claim a deduction for all foreign taxes paid in the taxable year.

#### *Taxation of Capital Gains*

Upon the sale or other disposition of Ordinary Shares or ADSs, a US Holder will recognise gain or loss for US federal income tax purposes in an amount equal to the difference between the amount realised in consideration for the disposition of the Ordinary Shares or ADSs and the US Holder’s adjusted tax basis in the Ordinary Shares or ADSs. Such gain or loss generally will be subject to US federal income tax and will be treated as long-term capital gain or loss if the Ordinary Shares or ADSs have been held for more than one year. For US federal income tax purposes, capital losses are subject to limitations on deductibility. Gain realised by a US Holder on the sale or other disposition of Ordinary Shares or ADSs generally will be treated as income from sources within the United

States for purposes of the foreign tax credit limitation, unless the gain is attributable to an office or fixed place of business maintained by the US Holder outside the United States and certain other conditions are met. It is currently unclear whether any loss realised by a US Holder will be treated as from sources within the US or without the US for purposes of the foreign tax credit limitation. Under proposed Treasury Regulations not currently in effect, the losses may be treated as from sources without the US.

#### *US Information Reporting and Backup Withholding*

Payments made in respect of Ordinary Shares or ADSs may be subject to information reporting and a 31% US backup withholding tax. Backup withholding will not apply, however, to a holder who furnishes a correct taxpayer identification number or certificate of foreign status and makes any other required certification or who is otherwise exempt from backup withholding. Generally, a US Holder may provide such certification on Form W-9 (Request for Taxpayer Identification Number and Certification). Backup withholding is not an additional tax and may be claimed as a credit against the US federal income tax liability of a US stockholder or refunded, provided that the required information is furnished to the US Internal Revenue Service. Finalised Treasury Regulations have generally expanded the circumstances under which information reporting and backup withholding may apply for payments made after 31 December 1999. Holders of Ordinary Shares or ADSs should consult their tax advisers regarding the application of the information reporting and backup reporting rules, including the finalised Treasury Regulations.

### **United Kingdom Tax Consequences of the Ownership of Ordinary Shares and ADSs**

#### *Taxation of Distributions*

The tax treatment of dividends paid in respect of the Ordinary Shares and ADSs will depend upon the UK law and practice in force at the time dividends are paid. The following summary is based upon current UK law and practice, including the Treaty and the United Kingdom-United States Estate and Gift Tax Convention (the “Estate Tax Treaty”), which may change. The summary of UK tax matters below does not address the tax consequences for US Holders that are resident (or, in the case of individuals ordinarily resident) in the UK for UK tax purposes or for the purposes of the Treaty or that are corporations which, alone or together with one or more associated companies, control directly or indirectly 10% or more of the voting stock or power of the company. For the purposes of the Treaty, US Holders of ADSs will be treated as owners of the Ordinary Shares underlying the ADSs.

The UK Finance Act 1994 contained provisions allowing companies to elect to pay a cash dividend as a foreign income dividend (“FID”) to which special rules apply and, in particular, which does not carry any tax credit. As the company has no present intention of electing to pay any dividends under the FID scheme, this summary does not address dividends paid under that scheme.

Under current laws, an Eligible US Holder (as defined below) who receives as beneficial owner a dividend from the company will generally be entitled under the Treaty to receive from the UK Inland Revenue, in respect of a cash dividend, a payment (a “Treaty Payment”) equal to the amount (currently 25% of the dividend) of the tax credit to which an individual resident in the UK for tax purposes would have been entitled had he received the dividend (the “Tax Credit Amount”), reduced by an amount (referred to herein as a “UK Withholding Tax”) equal to a percentage (currently 15%) of the sum of the dividend payment and the Tax Credit Amount. For example, at current rates, an Eligible US Holder that received a dividend payment of £80 from the company would be entitled to a Treaty Payment of £5 (i.e., the Tax Credit Amount of £20 reduced by 15% of the sum of the dividend and the Tax Credit Amount, i.e. £15) resulting in a total receipt (before applicable US taxes) of £85.

For the purposes of this Form 20-F, the term “Eligible US Holder” means a US person that is a beneficial owner of Ordinary Shares or ADSs and of the cash dividend paid with respect thereto and that (i) is an individual, a corporation, a partnership, a trust or an estate resident in the US for purposes of the Treaty (and, in the case of a corporation, is not also resident in the UK for UK tax purposes), (ii) is not a corporation which, alone or together with one or more associated corporations, controls, directly or indirectly, 10% or more of the voting stock of the company, (iii) holds the Ordinary Shares or ADSs in a manner which is not effectively connected with a permanent establishment in the UK through which such US person carries on business or with a fixed base in the UK from which such person performs independent personal services, and (iv) under certain circumstances is not an investment or holding company, 25% or more of the share capital of which is owned, directly or indirectly, by one or more persons that are not individuals resident in and are not nationals of the United States. Special rules apply if the Eligible US Holder is (i) exempt from tax in the United States on dividends paid by the company or (ii) is the owner of at least 10% of the class of shares of the company in respect of which the dividend is paid. A US person that is a partnership, trust or estate may be entitled under the Treaty to receive a Treaty Payment in

respect of a cash dividend paid by the company, but only to the extent that the dividend income derived by such US person is taxable in the United States as the income of a US resident in the hands of such US person or of its partners or beneficiaries, as the case may be, and, further, if a US trust or estate is also a resident of the UK for the purposes of the Treaty, the Treaty Payment may not be available under the Treaty.

The company has entered into certain arrangements (known as the “H” arrangements) with the UK Inland Revenue under which the Treaty Payment may (subject to certain exceptions) be paid by the company to an Eligible US Holder of ADSs together with and at the same time as the cash dividend in respect of the ADSs. These arrangements generally apply to Eligible US Holders of ADSs other than (i) an individual resident in the United States and also resident in the UK, (ii) estates or trusts any of the beneficiaries of which are not resident in the United States, (iii) persons exempt from US federal income tax with respect to cash dividends paid on the ADSs (other than certain pension funds), (iv) investment or holding companies, 25% or more of the capital of which is owned directly or indirectly by persons who are not individuals resident in, and are not nationals of, the United States and (v) any person beneficially owning 10% or more of the class of shares in respect of which the dividend is paid. The operation of these arrangements will depend upon whether an Eligible US Holder holds ADSs through a broker participating in The Depository Trust Company (“DTC”). Where an Eligible US Holder that is entitled to the benefits of these arrangements does not hold its ADSs through a broker participating in DTC, the registered holder will be required to complete a declaration on the back of the dividend cheque confirming the Eligible US Holder’s entitlement to the Treaty Payment and present the cheque for payment within three months of its date of issue. Where an Eligible US Holder that is entitled to the benefit of these arrangements holds its ADSs through DTC, a declaration as to the conditions entitling the Eligible US Holder to the Treaty Payment must be completed by the broker-dealer or bank-member of DTC which holds the ADSs on behalf of the Eligible US Holder. The “H” arrangements apply at the discretion of the UK Inland Revenue and can be amended or terminated at any time.

The company has also entered into other arrangements (known as “G” arrangements) with the UK Inland Revenue by virtue of which the Treaty Payment may (subject to certain exceptions) be paid by the company together with and at the same time as the associated dividend to an Eligible US Holder of Ordinary Shares provided that he has his Ordinary Shares registered in the name of a nominee approved by the UK Inland Revenue who is prepared to cooperate with the operation of the arrangements and file a general undertaking with the UK Inland Revenue. An Eligible US Holder must provide the name of his or her nominee in order to participate in this arrangement. The Eligible US Holder (if an individual) must: (a) be resident in the United States and not in the UK; (b) not retain the use of any accommodation in the UK; (c) not during the last four years have been in the UK for as much as three months a year on average; (d) not be in the UK for a period or periods amounting in all to six months in the UK income tax year for which the claim on his behalf relates; (e) not have been absent from the United States for a complete US tax year in any of the last four years; (f) not have a permanent establishment in the UK; (g) not perform professional or personal services from a fixed base in the UK; and (h) not own 10% or more of the class of shares in respect of which the dividend was paid. If the Eligible US Holder is a company it must: (a) be managed and controlled in the United States; (b) not have a permanent establishment in the UK; (c) be liable to federal income tax on the dividends; (d) have at least 75% of its capital owned directly or indirectly by persons who are US residents; and (e) not own 10% or more of the class of shares in respect of which the dividend is paid. These arrangements will be extended to trusts, estates in the course of administration, pension funds, foundations, charities, US Mutual Funds/Collective Funds/Pension Trusts and similar bodies only with the prior approval of the UK Inland Revenue and subject to certain additional conditions. These arrangements can be terminated without notice by the UK Inland Revenue.

An Eligible US Holder who does not come within these “H” or “G” arrangements entered into by the company should claim the Treaty Payment to which he is entitled directly from the UK Inland Revenue with respect to any dividends paid to him, in the manner and at the time described in I.R.S. Revenue Procedure 80-18, 1980-1 C.B. 623 and I.R.S. Revenue Procedure 81-58, 1981-2 C.B. 678, summarised below. Claims for payment must be made within six years of the end of the UK year of assessment (generally, the 12-month period ending April 5 in each year) in which the related dividend was paid. The first such claim by an Eligible US Holder for payment under these procedures is made by sending the appropriate UK forms in duplicate to the Director of the US Internal Revenue Service Center with which the Eligible US Holder’s last federal income tax return was filed. If the Eligible US Holder qualifies as a US resident, the Internal Revenue Service will certify the form to that effect and forward it to the UK Inland Revenue. Forms may be obtained by writing to the US Internal Revenue Service, Assistant Commissioner International, 950, L’Enfant Plaza South, S.W., Washington, D.C. 20024, Attention: Taxpayers Service Division. Because a refund claim is not considered made until the UK tax authorities receive the appropriate form from the Internal Revenue Service, forms should be sent to the Internal



Revenue Service well before the end of the applicable limitation period. Any claim under these procedures after the first claim should be filed directly with the UK Financial Intermediaries and Claims Office (International), Fitzroy House, P.O. Box 46, Castle Meadow Road, Nottingham NG2 1BD, England.

Under Section 812 of the Income and Corporation Taxes Act 1988, the HM Treasury has power in certain circumstances to deny a Treaty Payment to a US corporate shareholder of a UK company if it or an associated company has a qualifying presence in a country which operates a unitary system of corporate taxation. These provisions come into force only if the HM Treasury so determines by statutory instrument, and no such instrument has yet been made.

Legislation was introduced in the UK Finance Act 1997 which affects the tax treatment of, amongst other things, share buy-backs made and certain transactions in securities ("Special Dividends") paid after 7 October 1996. The effect of the legislation, broadly, is to deny any refundable tax credit in respect of share buybacks or Special Dividends. There would therefore be no Treaty Payment. The legislation will not apply to normal dividends paid by the company and did not apply to the special dividend paid by the company in September 1997. The UK Finance Act (No. 2) 1997 provides for this legislation to be repealed with respect to distributions made on or after 6 April 1999.

On 2 July 1997, HM Government announced tax changes which affect the tax credit system on UK dividends. The proposed changes described became law on 31 July 1997. Where a dividend is paid on or after 2 July 1997, pension providers and most UK corporate shareholders (including authorised unit trusts) are no longer entitled to repayments of tax credits attaching to the dividends.

From April 1999 changes to the tax credit regime will affect other shareholders and the rate of tax credits will be reduced to 10% (currently 20%) of the net dividend plus the tax credit. Shareholders with no tax liability will no longer be able to claim repayments of tax credits. Individuals who are UK basic or lower rate tax payers will be subject to 10% tax on dividend income from April 1999. The UK higher rate of tax on dividends will be reduced to 32.5% from April 1999. This will compensate higher rate tax payers for the reduction in the rate of tax credits.

The changes to the tax credit regime from April 1999 will also affect US Holders, since the Treaty provides that the Treaty Payment is available to US Eligible Holders only to the extent that a tax credit is available to UK individual shareholders. As a result of the relationship between the UK Withholding Tax and the Treaty Payment computation under the Treaty, it is expected that US Holders will not be entitled to receive any net Treaty Payment in respect of dividends paid after April 1999. On the other hand, the UK Withholding Tax payable is limited to the amount of the Treaty Payment as computed under the Treaty, so that the UK tax burden on an Eligible US Holder will be reduced along with the UK tax credit amount. The net result of these changes is expected to be a decline of approximately 6% in the net amount received by Eligible US Holders after UK taxes but before consideration of any US tax effect. The US tax situation of each US Eligible Holder will depend upon circumstances that are particular to each such shareholder, and persons are advised to consult their individual tax advisers in this regard.

#### *Taxation of Capital Gains*

A US person who is not resident or ordinarily resident for tax purposes in the UK will not normally be liable for UK tax on capital gains realised on the disposal of his Ordinary Shares ADSs unless at the time of the disposal, such US person carries on a trade (which for this purpose includes a profession or vocation) in the UK through a branch or agency and such Ordinary Shares or ADSs are or have been used, held or acquired for the purposes of such trade or branch or agency.

#### *Inheritance and Gift Taxes*

Ordinary Shares and ADSs are assets situated in the UK for the purposes of UK inheritance tax. A gift of such assets by, or the death of, an individual holder of such assets may (subject to certain exemptions and reliefs) give rise to a liability to UK inheritance tax even if the holder is neither domiciled in the UK nor deemed to be domiciled there under special rules relating to long residence or previous domicile. For inheritance tax purposes, a transfer of assets at less than full market value may be treated as a gift and particular rules apply to gifts where the donor reserves or retains some benefit. Special rules also apply to close companies and to trustees of settlements holding Ordinary Shares or ADSs, bringing them within the charge to inheritance tax. An individual who is domiciled in the United States for the purposes of the Estate Tax Treaty and who is not a national of the UK for the purposes of the Estate Tax Treaty will generally not be subject to UK inheritance tax in respect of the Ordinary Shares or ADSs on the individual's death or on a gift of the Ordinary Shares or ADSs during the individual's lifetime, provided that any applicable US federal gift or estate tax liability is paid, unless

the Ordinary Shares or ADSs are part of the business property of a permanent establishment of an enterprise of the individual in the UK or pertain to a fixed base in the UK of the individual used for the performance of independent personal services. Where the Ordinary Shares or ADSs have been placed in trust by a settlor who, at the time of settlement, was a US Holder, the Ordinary Shares or ADSs will generally not be subject to UK inheritance tax if the settlor, at the time of settlement, was domiciled in the United States for the purposes of the Estate Tax Treaty and was not a UK national (provided that the Ordinary Shares or ADSs are not part of the business property of a permanent establishment in the UK and do not pertain to a fixed base in the UK, as more fully summarised above). In the exceptional case where the Ordinary Shares or ADSs are subject both to UK inheritance tax and to US federal gift or estate tax, the Estate Tax Treaty generally provides for the tax paid in the UK to be credited against tax payable in the United States or for tax paid in the United States to be credited against tax payable in the UK based on priority rules set out in the Estate Tax Treaty.

#### *UK Stamp Duty and Stamp Duty Reserve Tax*

A transfer for value of the Ordinary Shares will generally be subject to UK ad valorem stamp duty or to UK stamp duty reserve tax (“SDRT”). Stamp duty and SDRT are normally a liability of the purchaser.

No UK stamp duty will be payable on the acquisition or transfer of ADSs or beneficial ownership of ADSs, provided that any instrument of transfer or written agreement to transfer remains at all times outside the UK, and provided further that any instrument of transfer or written agreement to transfer is not executed in the UK and the transfer does not relate to any matter or thing done or to be done in the UK. An agreement for the transfer of ADSs or beneficial ownership of ADSs will not give rise to a liability to SDRT.

Any transfer for value of the underlying Ordinary Shares represented by ADSs, may give rise to a liability to UK stamp duty or SDRT. The amount of UK stamp duty or SDRT payable is generally calculated at the applicable rate on the consideration for the transfer of the Ordinary Shares at the rate of 50p per £100 (or part thereof) in the case of stamp duty, or in the case of SDRT, at the rate of 0.5%, in either case of the amount or value of the consideration. On a transfer of Ordinary Shares from the Custodian of the Depository to a holder of an ADS upon cancellation of the ADS, only a fixed UK stamp duty of 50p per instrument of transfer will be payable.

## ITEM 8 – SELECTED FINANCIAL DATA

The information set forth under the heading “Five year financial summary” on pages 43 and 44 of the 1998 Report and Accounts contained in the company’s Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

BT’s consolidated financial statements are prepared in accordance with accounting policies generally accepted in the United Kingdom (“UK GAAP”), which differ in certain significant respects from those applicable in the United States (“US GAAP”).

### *Exchange rates*

For information regarding the exchange rates for pounds sterling into US dollars for the five most recent financial years and at a recent date, see “Exchange rates” on page 1.

### *Dividends*

The Board expects to recommend in respect of each financial year an interim and a final dividend, which will normally be payable in February and September, respectively. Additionally, a special dividend was paid to shareholders of BT in September 1997. See “Item 9 – Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

The following table sets forth dividends paid or payable in respect of Ordinary Shares and ADSs for each of the financial years, including the associated UK tax credit available to certain beneficial owners of Ordinary Shares or ADSs who are resident in the United States or Canada for tax purposes, but before deduction of UK withholding taxes. The amounts shown are not those that were actually paid to holders of Ordinary Shares and ADSs. See “Taxation of dividends” below. Dividends have been translated from pounds sterling into US dollars using exchange rates prevailing on the date the dividends were paid to holders of Ordinary Shares. Each ADS represents 10 Ordinary Shares.

Financial year	Pounds sterling per ADS			US Dollars per ADS			Pence per Ordinary Share		
	Interim	Final	Total	Interim	Final	Total	Interim	Final	Total
1994	£0.8312	£1.2563	£2.0875	\$1.217	\$1.964	\$3.181	8.312p	12.563p	20.875p
1995	0.8812	1.3313	2.2125	1.375	2.055	3.430	8.812	13.313	22.125
1996	0.9312	1.4063	2.3375	1.422	2.181	3.603	9.312	14.063	23.375
1997(a)	0.9875	1.4937	2.4812	1.582	2.391	3.973	9.875	14.937	24.812
1998	0.9437	1.4313	2.3750	1.540	(b)	(b)	9.437	14.313	23.750

(a) In addition, a special dividend of £4.375 (\$7.002) per ADS, (43.75 pence per Ordinary Share), including the associated UK tax credit, was paid at the same time as the final dividend for the 1997 financial year, to those qualifying holders of ADSs on record as of 15 August 1997.

(b) Qualifying holders of ADSs on record as of 7 August 1998 are entitled to receive the final dividend which will be paid on 28 September 1998. The US dollar amount of the final dividend to be paid to holders of ADSs will be based on the exchange rate in effect on 21 September 1998, the date of payment to holders of Ordinary Shares.

The Board stated its intention to adjust the level of ongoing annual dividends to take into account the effect of the 1997 special dividend in order broadly to maintain the yield on the company’s Ordinary Shares. This adjustment was first made for the interim dividend for the 1998 financial year.

The level of dividends will continue to be influenced by such factors as the effects of competition and regulation in the United Kingdom, together with investment needs and opportunities in the United Kingdom and overseas. Past relationships between the interim and final dividends are not necessarily indicative of the future.

As dividends paid by the company are in pounds sterling, exchange rate fluctuations will affect the US dollar amounts received by holders of ADSs on conversion by the Depositary of such cash dividends.

### *Taxation of dividends*

Beneficial owners of ADSs or Ordinary Shares who are residents of the United States for tax purposes may be entitled to receive payment of the associated UK tax credit in respect of dividends paid to them. The amount of such dividends and any such credit is subject to UK withholding taxes, currently at the rate of 15% in most cases. Subject to certain limitations, this withholding tax will be treated as a foreign income tax eligible for credit against a holder's US or Canadian federal income taxes.

Certain beneficial owners of ADSs and Ordinary Shares may be entitled to receive payment of the associated UK tax credit at the same time as they receive the dividend payments (subject to UK withholding taxes) if they meet certain requirements including, with respect to beneficial owners of Ordinary Shares, that they hold their shares through a nominee approved by the UK Inland Revenue. Other beneficial owners of ADSs and Ordinary Shares will not be entitled to receive payment of the associated UK tax credit at the same time as they receive their dividend and must make individual claims for refunds of such tax credit.

HM Government announced tax measures on 2 July 1997 that would result in changes to the associated UK tax credit system having a negative impact on the amount of dividends received or receivable by some shareholders, particularly residents in the United States or Canada after April 1999. See "Item 7 – Taxation – United Kingdom Tax Consequences of the Ownership of Ordinary Shares and ADSs – Taxation of Distributions".

## **ITEM 9 – MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The information set forth under the heading "Financial Review" on pages 15 to 25 of the 1998 Report and Accounts contained in the company's Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

### **ITEM 9A – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The information set forth under the headings "Treasury policy" and "Capital resources and foreign currency exposure" on pages 21 and 22 of the 1998 Report and Accounts contained in the company's Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

## **ITEM 10 – DIRECTORS AND OFFICERS OF REGISTRANT**

The information set forth under the headings "Board of Directors" on pages 26 and 27; "Report of the directors" on page 28; and, "Corporate Governance – the Board" and "Corporate Governance – Principal Board committees" on pages 30 and 31 of the 1998 Report and Accounts contained in the company's Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

The business address of each of the directors of the company is BT Centre, 81 Newgate Street, London EC1A 7AJ, England. The executive directors are the executive officers of the company.

The Articles provide that there shall not be less than four directors (no maximum number has been fixed). The Articles also currently require that the Chairman or other chief executive officer be a British citizen within the meaning of the British Nationality Act 1981. A resolution will be put to the Annual General Meeting of the company to be held in July 1998 to remove this provision.

All directors are required to retire by rotation. All directors are also subject to the general corporate law requirements concerning the removal of directors. One-third of the directors (or, if their number is not a multiple of three, the number nearest to but not greater than one-third) – excluding any director appointed by the directors since the last Annual General Meeting – are required to retire from office by rotation at each Annual General Meeting and are eligible to be re-elected by the shareholders. The directors to retire are selected on the basis of time in office since their last election.

Any director appointed by the directors is required to retire at the next following Annual General Meeting and is then eligible for election, but is not taken into account in determining which directors are to retire by rotation at such meeting.

### *Executive directors' service agreements*

All of the executive directors have entered into service agreements with the company. The dates of commencement of their initial service agreements and expiration of their current service agreements are as stated below:

<b>Executive director</b>	<b>Commencement date of initial service agreement</b>	<b>Expiration of current service agreement</b>
Sir Iain Vallance	6 August 1984	(a)
Sir Peter Bonfield	1 January 1996	31 December 1999 (b)
Robert P. Brace	1 October 1993	(c)
William Cockburn	1 April 1998	30 September 1999 (d)

- (a) Terminable on twelve months' notice by the company or Sir Iain. However, Sir Iain takes up a part-time role as Chairman of BT from 31 July 1998 and a revised contract is currently being prepared.
- (b) The initial term of Sir Peter Bonfield's contract has been extended to 31 December 1999. The contract can be terminated by the company or Sir Peter giving twelve months' notice expiring after 31 December 1999.
- (c) Terminable on twelve months' notice by the company or Mr Brace.
- (d) The contract can be terminated by the company or Mr Cockburn giving twelve months' notice expiring after 30 September 1999.

### *Non-executive directors' contracts of appointment*

All the non-executive directors have contracts of appointment and are normally appointed initially for three years. At the end of that period, the Board considers whether to continue the appointments, which then generally become terminable on twelve months' notice from the company or the director.

The dates of commencement and expiration of non-executive directors' contracts are as stated below:

<b>Non-executive director</b>	<b>Commencement date of initial contract</b>	<b>Expiration date of current contract</b>
Sir Colin Marshall	1 April 1995	31 March 2001
Helen Alexander	1 June 1998	31 May 2001
Dr. Iain Anderson	1 November 1995	31 October 1998
Malcolm Argent	1 August 1994	31 December 1998
Sir Ewen Fergusson	24 May 1993	(a)
J. Keith Oates	1 June 1994	(a)

- (a) Terminable on twelve months' notice by the company or the director.

Neville Isdell joins the Board as a non-executive director with effect from 1 July 1998 and has entered into an initial service contract from 1 July 1998 to 30 June 2001. Sir John Weston will join the Board as a non-executive director with effect from 1 October 1998 and will enter into a service contract with the company.

There are no other service agreements, existing or proposed, between any of the directors and the company. There are no arrangements or understandings between any director or executive officer and any other person pursuant to which such director or executive officer was selected to serve. There are no family relationships between any of the directors of the company.

## ITEM 11 – COMPENSATION OF DIRECTORS AND OFFICERS

The information set forth under the heading “Report on directors’ remuneration” on pages 33 to 40 of the 1998 Report and Accounts contained in the company’s Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

Helen Alexander, who was appointed to the Board on 1 June 1998, will receive a fee of £27,000 a year for her services as a non-executive director and as a member of the Audit Committee. Neville Isdell, who will be appointed to the Board on 1 July 1998, will receive a fee of £27,000 a year for his services as a non-executive director and as a member of the Remuneration Committee.

## ITEM 12 – OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT OR SUBSIDIARIES

The information set forth under the heading “Directors’ interests” on pages 38 to 40 of the 1998 Report and Accounts contained in the company’s Report on Form 6-K dated 9 June 1998 is incorporated herein by reference.

At 15 May 1998, the options outstanding under the company’s share option schemes, together with their exercise prices and dates, were as follows:

Scheme	Option price per Ordinary Share	Normal date of exercise	Number of Ordinary Shares	
Savings-related schemes	£2.65	1997	85,687	
	3.20	1998	43,948,910	
	3.00	1999	8,430,856	
	3.41	1999	27,285,160	
	3.06	2000	46,133,961	
	3.19	2000	2,117	
	3.22	2000	4,071	
	3.59	2000	121,792	
	3.65	2000	43,457	
	4.04	2000	5,029,863	
	2.67	2001	67,153,951	
	3.59	2002	53,083,779	
	Other share option schemes	2.81	1992 – 1999	141,660
		2.63	1992 – 1999	136,890
2.89		1993 – 2000	724,349	
3.47		1994 – 2001	820	
3.53		1994 – 2001	30,000	
3.32		1995 – 2002	225,180	
3.33		1995 – 2002	1,281,080	
3.40		1995 – 2002	58,530	
4.30		1996 – 2003	1,461,167	
4.60		1996 – 2003	62,580	
3.70		1997 – 2004	128,983	
3.87		1997 – 2004	116,280	
3.75		1997 – 2004	1,752,070	
3.79		1997 – 2004	114,908	
3.98		1998 – 2005	5,030	
3.46	1998 – 2005	75,160		
3.66	1999 – 2006	122,500		
3.81	2000 – 2007	103,550		
4.01	2000 – 2007	69,830		
4.54	2000 – 2007	193,740		
5.96	2000 – 2008	19,470		
Total options outstanding			258,147,381	

At 15 May 1998, the company’s directors as a group held options to subscribe for 347,218 shares.

### **ITEM 13 – INTEREST OF MANAGEMENT IN CERTAIN TRANSACTIONS**

During and at the end of the 1998 financial year, none of the company's directors was materially interested in any material transaction in relation to the group's business and none is materially interested in any presently proposed material transactions.

### **PART III**

#### **ITEM 15 – DEFAULTS UPON SENIOR SECURITIES**

There has not been any material default in the payment of principal, interest or any sinking fund or purchase fund instalment, or any other material default not cured within 30 days, with respect to any indebtedness of the company or any subsidiary exceeding 5% of the total assets of the group.

#### **ITEM 16 – CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES**

The company's Articles have not been materially modified and the rights evidenced by Ordinary Shares have not been materially limited or qualified by the issuance or modification of any other class of securities.

A resolution will be put to the Annual General Meeting of the company to be held in July 1998 to amend the company's Articles by deleting those provisions which relate to the Special Share, following redemption of that special share on 10 September 1997. See "Item 1 – Description of Business – Relationship with HM Government".



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## PART IV

### ITEM 18 – FINANCIAL STATEMENTS

The information set forth under the following headings on the following pages of the 1998 Report and Accounts contained in the company's Report on Form 6-K dated 9 June 1998 is incorporated herein by reference:

	<b>Pages in BT 1998 Report and Accounts</b>
Report on directors' remuneration	
– Packages – Pensions	35-36
– Directors' remuneration	37
– Directors' interests	38-40
Statement of directors' responsibility	41
Report of the auditors	42
Accounting policies	45-47
Consolidated financial statements	
– Group profit and loss account	48
– Group cash flow statement	49
– Balance sheets	50
– Notes to the financial statements	51-77
– Subsidiary and associated undertakings	78-79

All schedules are omitted because they are not applicable or because the required information is contained in the consolidated financial statements or notes thereto.

### ITEM 19A – FINANCIAL STATEMENTS FILED AS PART OF THIS ANNUAL REPORT

See Item 18 above.

### ITEM 19B – EXHIBITS FILED AS PART OF THIS ANNUAL REPORT

The company's responses to the requirements of Form 20-F have been incorporated by reference to the company's report on Form 6-K dated 9 June 1998 which contains its 1998 Report and Accounts. Pursuant to Rule 12b-23(a) of the Commission, the information incorporated into this report by reference to such Form 6-K is attached as an exhibit hereto.

In addition, the following exhibits are filed as part of this Annual Report:

- 1.1 Modifications made by the Director General dated 30 September 1997, 5 November 1997 and 17 December 1997, and modifications made by the Secretary of State on 9 December 1997, to the Licence granted to the Company on 22 June 1984 under the UK Telecommunications Act 1984.

The company agrees to furnish to the Securities and Exchange Commission, upon request, copies of instruments that define the rights of holders of long-term debt to BT that are not filed as exhibits to this Annual Report.

## SIGNATURE

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all of the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorised.

BRITISH TELECOMMUNICATIONS public limited company

By: /s/R. P. BRACE

Robert Paul Brace  
Group Finance Director

Date: 11 June 1998