Exhibit 1

Notice of Adoption by Vycera Communications, Inc. f/k/a Genesis Communications International, Inc. of the Interconnection Agreement between Pacific Bell Telephone Company and AT&T Communications of California, Inc.

FILE STAMP AND RETURN

CALIFORNIA PUBLIC UTILITIES COMMISSION

TELECOMMUNICATIONS UTILITY
PROPOSAL AND ADVICE LETTER FILING SUMMARY

MUST BE COMPLETED BY UTILITY

Company name: **Vycera Communications, Inc. (f/k/a Genesis Communications International, Inc.)**

Utility type:

☐ LEC ☒ IEC ☐ IER

☒ CLC ☐ CLR ☐ CMRS

CPUC utility #: **U-5477-C**

Contact name: **Rogena Harris**

Phone #: **(202) 295-8303**

● EXPLANATION OF UTILITY TYPE

LEC = Local Exchange Carrier
IEC = Interexchange Carrier
IER = Interexchange Carrier Reseller only
CLC = Competitive Local Carrier
CLR = Competitive Local Carrier Reseller only
CMRS = Commercial Mobile Radio Service

(Date Filed/ Received Stamp by CPUC)

FILED
SEP - 3 2002
PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA

Filing #: **Advice Letter No. 57**

Check one: ☐ proposal ☒ advice letter

Keyword (See list on reverse, or *www.cpuc.ca.gov*): **Interconnection Agreement**

If Proposal was previously submitted, indicate its filing #: **Not Applicable**

Authorization for filing (e.g., decision, resolution, legislation #): **N/A**

Requested effective date: **September 19, 2002** | Number of tariff sheets: **N/A**

Estimate annual revenue effect: $_____ (Applicable only if carrier is a GRC-LEC)

Tariff schedules affected: **N/A**

Subject of filing: **Interconnection Agreement (Opt-In to Existing Agreement)**

FOR CPUC OFFICE USE ONLY

☐ No Resolution Required
(Analysis attached)

☐ Resolution Required
(Draft attached)
____ To Supervisor
____ To Branch Chief
____ To Director

☐ Executive Action Resolution

Assigned Supv/Analyst: _____/_____

AL Due Date:_____

Due to Supv:_____

Analyst Completion Date:_____

Supv. Review Date:_____

AL/Tariff Effective Date:_____

Notes:_____

Resolution #: T-_____ CPUC proposal #:_____

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August 30, 2002

VIA OVERNIGHT DELIVERY

U-5477-C
Advice Letter No. 57

FILED
SEP - 3 2002
PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA

Proposal and Advice Letter (PAL) Coordinator
Telecommunications Division
California Public Utilities Commission
505 Van Ness Avenue, 3rd Floor
San Francisco, California 94102

Re: Notice of Adoption by Vycera Communications, Inc., f/k/a Genesis Communications International, Inc. ("Vycera") of the Interconnection Agreement between Pacific Bell Telephone Company ("PacBell") and AT&T Communications of California, Inc. ("AT&T") (the "AT&T Agreement")

Enclosed for filing with the Commission under section 252(i) of the Telecommunications Act of 1996 (the "Act") are an original and three copies of Advice Letter No. 57, with which is enclosed a copy of a Notice of Adoption advising PacBell that Vycera has elected to adopt in its entirety the AT&T Agreement, which was filed with the Commission on January 24, 2000, and became effective August 14, 2000 ("Notice of Adoption to PacBell"). Vycera, through counsel, respectfully requests that the Commission expedite the processing of this advice letter and notes that Commission approval for an opt-in agreement is not necessary.[1]

The Federal Communications Commission ("FCC") held in 1996 that a carrier electing to adopt an agreement pursuant to section 252(i) "need not make such requests pursuant to the

[1] Resolution ALJ-181 was adopted by the Commission at its regular meeting on October 5, 2000, and became effective on that date. Resolution ALJ-181 clarified Resolution ALJ-178, which adopted "an expedited procedure for carriers to opt-in to preexisting agreements, with little Commission intervention in the process, unless the Incumbent Local Exchange Carrier (ILEC) disputes the adoption on the basis of the requirements of §51.809." (Resolution ALJ-178 at p. 2). Under Revised Rule 7.2 of Resolution ALJ-181, the carrier's Advice Letter filing becomes effective on the 16th day after filing, unless the incumbent requests arbitration "based solely on the requirements in § 51.809." (Resolution ALJ-181 at p. 16).

procedures for initial section 251 requests, but shall be permitted to obtain its statutory rights on an expedited basis."[2] Moreover, the FCC has recognized the need for carriers to be able to opt-in to a previously approved interconnection agreement without the delays associated with the extended processes for negotiation and approval under section 251. The FCC concluded "that the nondiscriminatory, pro-competition purpose of section 252(i) would be defeated were requesting carriers required to undergo a lengthy negotiation and approval process pursuant to section 251 before being able to utilize the terms of a previously approved agreement."[3] The FCC observed that since the underlying agreement has already been subject to state review under section 252(e) of the Act, the expedited process for section 252(i) opt-ins "would be substantially quicker than the time frame for negotiation, and approval, of a new interconnection agreement."[4] Taking heed of these observations, Resolution ALJ-181 rightfully finds now that carriers such as Vycera are entitled to expedited processing of their adoption requests.

Accordingly, Vycera urges that this advice letter be processed under the Commission-approved review procedure that permits the advice letter to become effective as soon as possible.[5] Vycera wishes simply to adopt the AT&T Agreement in its entirety and proposes no alteration to the terms of the underlying agreement.

In compliance with G.O. 96-A and Resolution ALJ-181, copies of this advice letter and the Notice are being mailed to appearances on the service list for the "271/Arbitration," (I.) 93-04-002 (service list attached). A copy of this advice letter and the underlying Notice of Adoption to PacBell have been served on PacBell on this date via overnight delivery.

Anyone may protest this advice letter to the California Public Utilities Commission. The protest must set forth the specific ground on which it is based; any such protest may only address provisions of this Agreement that are alleged to be anticompetitive or unduly discriminatory. A protest must be made in writing and received within twenty (20) days of the date this advice

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[2] Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, *First Report and Order*, 11 FCC Rcd 15499 para. 1321 (1996)*("Local Competition Order")*.

[3] *Id.*

[4] Global NAPs, Inc. Petition for Preemption of Jurisdiction of the New Jersey Board of Public Utilities Regarding Interconnection Disputes with Bell Atlantic-New Jersey, Inc., CC Docket No. 99-154, *Memorandum Opinion And Order,* 14 FCC Rcd 12530 n.14 (1999).

[5] Revised Rule 7 of Resolution ALJ-181 permits carriers intending to opt-in to existing agreements to initiate the advice letter process. Vycera is filing this advice letter to preserve and memorialize the exercise of its statutory rights to opt in to the AT&T Agreement and the commencement of the new Vycera-PacBell Agreement.

letter was filed with the Commission. The address for mailing or delivering a protest to the Commission is:

Director, Telecommunications Division
California Public Utilities Commission
505 Van Ness Avenue, Room 3210
San Francisco, CA 94102

The address for mailing or delivering a protest to Vycera Communications, Inc. is:

Rogena Harris
Katherine A. Rolph
Counsel for Vycera Communications, Inc.
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3000 K Street, NW, Suite 300
Washington, DC 20007-5116

The address for mailing or delivering a protest to PacBell is:

Russ Stanley
Vice President - Industry Market
SBC Telecommunications, Inc.
208 S. Akard Street
One Bell Plaza, Room 1445
Dallas, Texas 75202

Please date stamp the enclosed extra copy of this filing and return it in the self-addressed, postage-paid envelope provided. Should you have any questions on this matter, please do not hesitate to contact Rogena Harris at (202) 295-8303.

Respectfully submitted,

Katherine A. Rolph
Rogena Harris

Counsel for Vycera Communications, Inc.

Enclosures
cc: Derek M. Gietzen

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VIA OVERNIGHT DELIVERY

August 30, 2002

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NOTICE OF ADOPTION
Under Section 252(i) of the Communication Act of 1934,
as amended by the Telecommunications Act of 1996 (the "Act")

Dear Mr. Stanley:

This letter provides notice to Pacific Bell Telephone Company ("PacBell") that Vycera Communications, Inc., f/k/a Genesis Communications International, Inc. ("Vycera") has elected to adopt the interconnection agreement between PacBell and AT&T Communications of California, Inc. ("AT&T"), filed with the California Public Utilities Commission on January 24, 2000, pursuant to Section 252(i) of the Communications Act, 47 U.S.C. §252(i).

Please be advised that notices as well as invoices and other communications to Vycera should be sent to:

Derek M. Gietzen
President
Vycera Communications, Inc.
12750 High Bluff Drive, Suite 200
San Diego, CA 92130

and copies to:

Katherine A. Rolph
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Very truly yours,

Katherine A. Rolph
Rogena Harris

Counsel for Vycera Communications, Inc.

cc: Derek M. Gietzen

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Exhibit 2

Pacific Bell Telephone Company's Application for Arbitration of Advice Letter No. 57 Filed by Vycera Communications, Inc. f/k/a Genesis Communications International, Inc., U-5477-C ("Pacific Bell Application for Arbitration")

Attachment A, AT&T Agreement, included only in relevant part: Attachment 8, Pricing; Attachment 18, Interconnection; and Amendment 3.
Attachment B, "Attachment 19, Negotiated Appendix Reciprocal Compensation (After FCC Order No. 01-131), included.
Attachment C, Testimony of Linda De Bella in Behalf of Pacific Bell Telephone Company's (U 1001 C) Petition in Arbitration not included.

Attachment A

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Pacific Bell Telephone Company's (U 1001 C) Application for Arbitration of Advice Letter No. 57 Filed by Vycera Communications, Inc. f/k/a Genesis Communications International, Inc. ("Vycera") Regarding Vycera's Request to Adopt the Interconnection Agreement between AT&T Communications of California, Inc. and Pacific Bell Telephone Company.	Application No. _____ (filed September 18, 2002)

APPLICATION BY PACIFIC BELL TELEPHONE COMPANY (U 1001 C) FOR ARBITRATION WITH VYCERA COMMUNICATIONS, INC. F/K/A GENESIS COMMUNICATIONS INTERNATIONAL, INC.

Pursuant to Rule 7 of Resolution ALJ-181and 47 C.F.R. §51.809(c), Pacific Bell Telephone Company ("SBC Pacific Bell") files this Application for Arbitration with Vycera Communications, Inc. f/k/a Genesis Communications International, Inc. ("Vycera") because Vycera has not obtained facilities-based certification and, therefore, is not eligible to adopt the August 14, 2000 Interconnection Agreement between SBC Pacific Bell and AT&T Communications of California, Inc. ("AT&T Agreement"). SBC Pacific Bell further files this Application on the basis that the contract provisions that Vycera seeks to adopt, which mandate the payment of inter-carrier compensation for Internet Service Provider ("ISP") bound traffic, have already been made available for a reasonable period of time and are no longer available for adoption. Consequently, Vycera should be prohibited from adopting all such provisions.

I. SBC PACIFIC BELL'S APPLICATION IS TIMELY.

Section 252(i) of the 1996 Telecommunications Act (the "Act") provides:

> A local exchange carrier shall make available any interconnection, service, or network element provided under an agreement approved under this Section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as those provided in the agreement.[1]

In Resolutions ALJ-178 and ALJ-181, the California Public Utilities Commission ("Commission") adopted rules to implement Section 252(i) of the Act. Under those rules, a competitive local exchange carrier ("CLEC") wishing to adopt a previously approved interconnection agreement in order to interconnect with an Incumbent Local Exchange Carrier ("ILEC") must file and serve an Advice Letter identifying the agreement or portions of the agreement it proposes to adopt.[2] If the ILEC believes that the request should be denied on the basis of any ground set forth in 47 C.F.R. §51.809,[3] the ILEC may file a request for arbitration within fifteen days after its *receipt* of the Advice Letter.[4]

Vycera's Advice Letter No. 57 requesting to adopt the AT&T Agreement is dated Friday, August 30, 2002. SBC Pacific Bell received Vycera's notice of adoption request via overnight delivery. Because of the holiday on Monday, September 2, 2002, SBC Pacific Bell received Vycera's notice of adoption request on Tuesday, September 3, 2002. As such, the deadline for SBC Pacific Bell to protest Vycera's Advice Letter No. 57 is September 18, 2002 -- fifteen days after SBC Pacific Bell's receipt of Vycera's Advice Letter No. 57. Consequently, this Application is timely.

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[1] 47 U.S.C. §252(i).
[2] CPUC Res. ALJ-181, Rule 7.1.
[3] 47 C.F.R. §51.809 (hereinafter sometimes referred to as "Rule 51.809").
[4] CPUC Res. ALJ-181, Rule 7.2.

II. STATEMENT OF WHY VYCERA'S ADOPTION REQUEST SHOULD BE DENIED

A. Vycera Has Not Obtained the Required Facilities-Based Certification and Is Therefore Not Eligible to Adopt the AT&T Agreement Because It Would Be Technically Infeasible to Implement Certain Provisions of the Agreement, as Vycera is not a Facilities-Based Carrier.

Pursuant to 47 C.F.R. §51.809(b)(2), the obligations of ALJ-181, Rule 7.2 do not apply if the provision of a particular interconnection, service, or element to the requesting carrier is not technically feasible. Certain parts of the AT&T Agreement entitle the CLEC to interconnect and purchase services from SBC Pacific Bell that necessitate that the CLEC be a facilities–based carrier and not just a reseller of SBC Pacific Bell services. Vycera has a certificate of public convenience and necessity as only a reseller.[5] Vycera is not certified to be a facilities-based local service provider. Vycera is, therefore, not eligible to opt in to the AT&T Agreement, as it is technically infeasible to provide interconnection, unbundled elements, access to our rights-of-way, and collocation (among other things) to a carrier that has not obtained facilities-based certification. SBC Pacific Bell proposed that Vycera file a supplemental advice letter stating that the request for adoption shall become effective upon Vycera obtaining its facilities-based certification, but Vycera did not agree with this approach. SBC Pacific Bell therefore must object to Vycera's request to opt in to the entire AT&T Agreement on the basis that Vycera has failed to obtain the appropriate facilities-based certification.

B. The Terms in the AT&T Agreement Mandating the Payment of Inter-Carrier Compensation for ISP-Bound Traffic are Stale Within the Meaning of 47 C.F.R. §51.809(c) and May Not Be Adopted.

Pursuant to 47 C.F.R. §51.809(c), the terms of an interconnection agreement shall be available for adoption under Section 252(i) of the 1996 Telecommunications Act for only *"a reasonable period of time"* after the agreement

[5] See D.96-02-072 (Feb. 23, 1996).

to be adopted has been approved by the state commission.[6] On April 18, 2001, the FCC adopted its Order on Remand and Report and Order in connection with its proceeding on Inter-Carrier Compensation for ISP-Bound Traffic.[7] There, the FCC exercised its authority under section 201 of the Act to adopt new rules to clarify the proper inter-carrier compensation for telecommunications traffic delivered to Internet Service Providers ("ISPs"). In its Order, the FCC concluded that telecommunications traffic delivered to an ISP is interstate access traffic and, thus, not subject to reciprocal compensation. The FCC also ordered that, "as of the date this Order is published in the Federal Register, carriers may no longer invoke section 252(i) to opt in to an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic."[8] The Order was published in the Federal Register on May 15, 2001.

Even prior to publication in the Federal Register, the FCC Order specifically gave ILECs the right to object to a CLEC's adoption request on the ground that, under 47 C.F.R. §51.809(c), the "reasonable period of time" for CLECs to adopt rates for the exchange of ISP-bound traffic had expired as of April 18, 2001. Specifically, the FCC stated:

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[6] 47 C.F.R. §51.809(c) (emphasis added).

[7] In the Matters of Implementation of Local Competition Provisions of Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic, CC Dkt. Nos. 96-98 and 99-68, Order on Remand and Report and Order, FCC 01-131 (rel. April 27, 2001).

[8] Id. at para. 82. Although FCC orders generally do not become effective until thirty days after publication in the Federal Register, the FCC found there was good cause to make its decision to prohibit 252(i) adoptions of inter-carrier compensation provisions effective immediately upon publication. The FCC stated, "We find there is good cause under 5 U.S.C. §553(d)(3), however, to prohibit carriers from invoking section 252(i) with respect to rates paid for the exchange of ISP-bound traffic upon publication of this Order in the Federal Register, in order to prevent carriers from exercising opt in rights during the thirty days after Federal Register publication." Id. at fn. 154. Consequently, as of May 15, 2001, by operation of law, CLECs are prohibited from adopting the compensation terms contained in existing interconnection agreements relating to inter-carrier compensation for ISP-bound traffic.

> [O]ur rule implementing section 252(i) requires incumbent LECs to make available "[i]ndividual interconnection, service, or network element arrangements" to requesting telecommunications carriers only "for a reasonable period of time." 47 C.F.R. §51.809(c). *We conclude that any "reasonable period of time" for making available rates applicable to the exchange of ISP-bound traffic expires upon the [Federal Communication] Commission's adoption in this Order* of an intercarrier compensation mechanism for ISP-bound traffic.[9]

The FCC's Order was adopted on April 18 and released on April 27, 2001. The AT&T agreement Vycera attempts to adopt is dated August 14, 2002. Consequently, Vycera's attempt to adopt provisions in the AT&T Agreement, which mandate payment of inter-carrier compensation for ISP-bound traffic, is prohibited on two grounds. First, because the FCC has declared that the "reasonable period of time" for CLECs to adopt an interconnection agreement's rates applicable to the exchange of ISP-bound traffic is deemed to have expired upon adoption of FCC's Order, i.e., April 18, 2001, Vycera's request to adopt said terms is untimely under 47 C.F.R. §51.809(c). Second, pursuant to the FCC's Order, as of May 15, 2001 (the date in which the FCC Order was published in the Federal Register), CLECs are prohibited by operation of law from invoking Section 252(i) of the Act to opt in to an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic.[10]

C. The Rates Paid for the Exchange of ISP-bound traffic are Legitimately Related to the Terms and Conditions that Address the Payment of ISP-bound traffic and Therefore Vycera Is Precluded from Adopting Such Legitimately Related Terms.

Pursuant to 47 C.F.R. §51.809(a), the individual interconnection,

[9] Id. at fn. 155 (emphasis added).

[10] The D. C. Circuit's Orders in WorldCom, Inc. v. FCC, No. 01-1218 (D. C. Circ. 2002) does not have any effect on the FCC's ISP Remand Order and its interim rule regarding ISP-bound calls. The D.C. Circuit held that Section 251(g) was an insufficient basis for the FCC's interim rule and ordered a remand, but declined to vacate the FCC Order. The interim rule regarding ISP-bound calls is therefore still in effect.

service, or network element arrangements of an agreement that a CLEC seeks to adopt shall be made available to that CLEC "upon the same rates, terms, and conditions as those provided in the agreement."[11] Stated otherwise, a CLEC must accept all terms and conditions of the donor agreement that are legitimately related to the interconnection, service or network element desired by the CLEC. Both the FCC and the United States Supreme Court have confirmed this principle.[12] Conversely, any terms and conditions that are legitimately related to the rates for ISP-bound traffic must be exempted by the CLEC from the request for adoption. The terms and conditions that are legitimately related to the rates for ISP-bound traffic are contained in Sections 2, 3 and 5 of Attachment 18 of the AT&T Agreement and involve compensation for call termination. In order to replace the exempted provisions and to assist Vycera in obtaining a full interconnection agreement, SBC Pacific Bell proposed that Vycera file a supplemental advice letter exempting the reciprocal compensation provisions from the request for adoption and amending the agreement with negotiated reciprocal compensation provisions. Vycera did not agree. SBC Pacific Bell therefore must object to Vycera's request to opt in to the entire AT&T on the basis that the reciprocal compensation rates, terms and conditions are no longer MFN-able.

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[11] 47 C.F.R. §51.809(a).

[12] See In the Matter of Implementation of Local Competition Provisions of Telecommunications Act of 1996, CC Dkt. Nos. 95-185 and 96-98, First Report and Order, 11 FCC Rcd. 15499 (Aug. 8, 1996), modified on recon., 11 FCC Rcd. 13042 (1996), vacated in part, Iowa Utils. Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997), aff'd. in part, rev'd. in part, AT&T v. Iowa Utils. Bd., 525 U.S. 366, 119 S.Ct. 721 (1999), ¶¶1314–1315; see also AT&T Corp. v. Iowa Utils. Bd., 119 S.Ct. 721, 738 (1999).

III. AN INTERCONNECTION AGREEMENT WITHOUT RATES, TERMS AND CONDITIONS FOR PAYMENT OF ISP-BOUND TRAFFIC AND LEGITIMATELY RELATED PROVISIONS IS NOT A COMPREHENSIVE AGREEMENT CANNOT BE IMPLEMENTED.

Pursuant to Rule 7.3.2 of ALJ-181, the ILEC shall, if it files for arbitration, immediately honor the adoption of those terms not subject to objection pursuant to Rule 7.2 effective as of the date of the filing of the arbitration request. SBC Pacific Bell objects to Vycera's request in its entirety because Vycera has not obtained the appropriate certification from the Commission. Accordingly, SBC Pacific Bell is unable to honor the adoption of any part of the AT&T Agreement. Assuming arguendo that the Commission finds that SBC Pacific Bell must implement the interconnection agreement despite the fact that Vycera has not obtained facilities-based certification or if Vycera obtains facilities-based certification while this petition is pending, SBC Pacific Bell should not be asked to implement the entire agreement. An interconnection agreement that does not contain critical reciprocal compensation provisions is not a comprehensive agreement that can be implemented because it lacks the mechanism for payment of traffic exchanged between the parties. ILECs cannot be required to implement partial interconnection agreements.[13] Until the parties have an approved negotiated reciprocal compensation amendment that replaces the rates, terms, and conditions excluded from the request for adoption, SBC Pacific Bell should not be required to implement such a partial interconnection agreement. Included with this Application, as Attachment B, is SBC Pacific Bell's proposed amendment for reciprocal compensation that would result in a

[13] See, e.g., AT&T Communications of Southwest, Inc. v. Southwestern Bell Telephone Co., 38 F.Supp.2d 902, 904 (D. Kan. 1999).

complete agreement. Also included with this Application, as Attachment A, is the entire AT&T Agreement with the objectionable reciprocal compensation portions in the contract identified.

IV. STATEMENT OF COMPLIANCE WITH RULE 7.3.3(b) OF RES. ALJ-181

Pursuant to Rule 7.3.3(b) of Resolution ALJ-181, the complete AT&T Agreement has been included as Attachment A to this Application. Supporting testimony is included as Attachment C.

IV. CONCLUSION

Vycera's request to adopt the AT&T Agreement should be denied because it gives Vycera certain rights that it cannot lawfully exercise without being authorized to be a facilities-based carrier. Additionally, the request to adopt the provisions regarding reciprocal compensation from the AT&T Agreement should be denied. The FCC has stated that such provisions are "stale" within the meaning of 47 C.F.R. §51.809(c) and may not be adopted under Section 252(i) of the Act.

Additionally, apart from the staleness issue, the FCC has ordered that, effective May 15, 2001, such adoptions are not permitted by operation of law. Because the terms and conditions mandating the payment of ISP-bound traffic are legitimately related to those rates, they are also precluded from being adopted.

Dated at San Francisco, California, this 18th day of September 2002.

Respectfully submitted,

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VERIFICATION

CYNTHIA G. MARSHALL, under penalty of perjury, certifies as follows:

I am an officer, to wit, Sr. Vice President-Regulatory for Pacific Bell Telephone Company, a corporation, and make this verification for and on behalf of said corporation. I have read the foregoing **APPLICATION OF PACIFIC BELL TELEPHONE COMPANY (U 1001 C) FOR ARBITRATION WITH VYCERA COMMUNICATIONS, INC. F/K/A GENESIS COMMUNICATIONS INTERNATIONAL, INC. ("VYCERA")**. I declare under penalty of perjury that the contents thereof, and the facts therein stated, are true to the best of my knowledge, information and belief.

Dated at San Francisco, California this 18th day of September 2002.

Cynthia G. Marshall

CYNTHIA G. MARSHALL
Sr. Vice President-Regulatory
Pacific Bell Telephone Co.

ATTACHMENT 8

PRICING

ATTACHMENT 8
PRICING

1. GENERAL PRINCIPLES

1.1 All services and capabilities currently provided by PACIFIC under this Agreement (including Resale Services, Network Elements, Combinations and Ancillary Functions) and all new and additional services, Network Elements, Combinations or Ancillary Functions to be provided hereunder, shall be priced in accordance with all applicable provisions of the Act and the rules and orders of the FCC and the Commission.

1.2 PACIFIC shall not assess any charges against AT&T for services, facilities, Network Elements, Ancillary Functions and other related work or services covered by this Agreement, unless a charge is expressly provided for in this Agreement. If PACIFIC offers, or is required to offer, additional services, facilities, Network Elements, Ancillary Functions or other related work or services that are not currently covered by this Agreement, the rates shall be determined pursuant to Section 14 (To Be Determined), unless and until the Commission adopts rates, at which point the Commission-adopted rates shall apply. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect.

2. RESALE SERVICES

2.1. The prices charged to AT&T for Resale Service shall be calculated using the avoided cost discount set forth herein. The interim wholesale discount shall be 17% off the applicable retail rate for all PACIFIC services subject to resale. The interim discount shall remain in effect until the Commission determines a different wholesale discount, in any proceeding subsequent to the Effective Date of this Agreement. Once so determined by the Commission, said different wholesale discount shall apply instead of the interim discount for the remaining Term of this Agreement. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's

consent to application of those rates under this Agreement for so long as the rates are in effect.

2.2. The prices shall be based on PACIFIC's retail rates applicable on the Effective Date, less the applicable discount. If PACIFIC changes its retail rates after AT&T executes this Agreement, the applicable discount shall be applied to the changed retail rates from the time such changes become effective. PACIFIC shall send AT&T notice of price changes at the same time it notifies the Commission of these changes by Advice Letter.

2.3. Non-recurring Charges for Resale Services

2.3.1 Non-recurring charge(s) shall be based on PACIFIC's retail rates less the applicable discount.

2.3.2 When an End User converts existing service to AT&T resold service of the same type without any additions or changes, charges for such conversion will apply as set forth in Appendix C.

2.3.3 When AT&T converts an End User(s) existing service and additions or changes are made to the service at the time of the conversion, the normal service order charges and/or non-recurring charges associated with said additions and/or changes will be applied in addition to the conversion charge. Non-recurring charge(s) shall be based on PACIFIC's retail rates less the applicable discount.

2.4 Charges for Traffic Alert Referral Service (TARS) and Repair Transfer Service (RTS) are set forth in Appendix C.

3. UNBUNDLED NETWORK ELEMENTS

3.1. The prices to be charged to AT&T for Network Elements and Combinations are as specified in Appendix A-1 to this Attachment 8. The prices listed in Appendix A-1 are subject to change to conform with rates and non-recurring charges for unbundled Network Elements that may be adopted by the Commission, subsequent to the Effective Date of this Agreement. Once such Commission-determined prices are adopted, said prices will be substituted for the corresponding prices in Appendix A-1 as of the effective date set by the Commission's order and shall apply for the

remainder of the Term of this Agreement, or until the Commission further revises the prices. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect.

3.2. There shall be no charges for combining network elements, except the sum of the service order charges or sum of stand-alone nonrecurring charges, as applicable, for the network elements included in the Combination. Appendix A-2 furnishes illustrative calculations taken from Commission Decision 99-11-050 showing the compensation that PACIFIC shall receive in certain UNE Combination situations. Appendix A-2 is not intended to be exhaustive. For other UNE Combination situations, the compensation principles set forth in D. 99-11-050 shall apply.

3.3. The interim charge for xDSL loop qualification shall be set at zero. Once the Commission subsequently adopts a final xDSL loop qualification charge in a generic proceeding, the rate set in this Agreement shall be subject to true up to the rate adopted by the Commission.

3.4. In lieu of a separate charge for xDSL loop conditioning, on an interim basis the nonrecurring charge for xDSL capable loops that require conditioning shall be the nonrecurring connect charge shown in Appendix A-1 for the channel connection for an ISDN Loop. Once the Commission adopts a final xDSL loop conditioning charge in a generic proceeding, the rate set in this Agreement shall be subject to true up to the rate adopted by the Commission. The applicable nonrecurring loop charge found in Appendix A-1 shall apply for loops that do not require conditioning.

3.5. For UNEs and Combinations for which flow-through is required by Appendix B of the California Public Utilities Commission's Decision 98-12-069, the fully mechanized non-recurring charges shall apply for all orders placed through LEX and EDI. For UNEs and Combinations ordered via LEX or EDI that are not included within Appendix B of D. 98-12-069, the semi-mechanized nonrecurring charges shall apply until the Commission determines that the fully mechanized charge should apply. Except as the Commission may direct otherwise, when AT&T orders UNEs or combinations through manual processes, PACIFIC may charge the manual non-recurring charge; provided, however, if the manual process was used because PACIFIC's semi-mechanized or fully mechanized process

was unavailable, the price for the semi-mechanized or fully mechanized process that otherwise would have been used shall apply.

4. COLLOCATION

4.1. The interim prices to be charged to AT&T for collocation are as specified in Appendix B to this Attachment. The prices listed in Appendix B are interim prices only and are subject to true up to final prices for collocation adopted by the Commission subsequent to the Effective Date of this Agreement. Once the Commission-determined prices are adopted, said prices will be substituted for the interim prices and shall apply for the remainder of the Term of this Agreement. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect.

4.2. Notwithstanding the foregoing, the physical collocation rates and discounts payable to PACIFIC by TCG-Los Angeles, TCG-San Diego and TCG-San Francisco shall be subject to true-up for the one hundred forty-one (141) calendar day period preceding the Effective Date of this Agreement, based upon the collocation rates and discounts payable under this Agreement as of its Effective Date. Pacific and AT&T shall mutually calculate the amount of this true-up, which shall be due and payable within 30 days after the Parties have agreed upon the amount. If the Parties cannot agree upon the amount, the issue shall be submitted to Alternative Dispute Resolution under Attachment 3 of this Agreement.

5. LOCAL INTERCONNECTION SERVICES

5.1. Rates for Network Elements provided by PACIFIC that will be used for local interconnection, among other things, appear in Appendix A-1.

5.2. Rates for local interconnection services to be provided by AT&T are as follows:

5.2.1. Rates for the Space License described in Attachment 18 shall be equivalent to the rates charged by PACIFIC for collocation, unless AT&T justifies and demonstrates to PACIFIC that higher rates are justified by higher costs that

AT&T incurs in providing the Space License arrangement. In order for an amount charged by AT&T to be equivalent to the amount charged by PACIFIC, it shall not be necessary that the pricing structures be identical.

5.2.2. Rates for all other local interconnection services provided by AT&T to PACIFIC are those in AT&T Schedule Cal. P.U.C. No. E-T, as it may be modified from time to time. Those rates shall also apply for comparable services provided by AT&T Affiliates on whose behalf AT&T has entered into this Agreement, unless different rates appear in tariffs filed by those Affiliates, in which case the Affiliates' tariffed rates shall apply.

5.3. Rates for reciprocal compensation for termination of Local Traffic are specified in Appendix D to this Attachment 8. Terms and conditions regarding application of the rate elements to different types of calls are set forth in Attachment 18.

5.4. The transit switching rate applies when either Party uses the other Party's tandem switch to originate a Local Call to a third party such as another LEC, CLC, or CMTS Provider. On an interim basis, the transit switching rate shall be equal to the tandem switching rate specified in Appendix A-1. When a permanent transit switching rate is adopted consistent with the cost and pricing methodologies used in the Commission's OANAD proceeding, that rate shall be substituted for interim rate.

6. RIGHTS OF WAY, CONDUITS AND POLE ATTACHMENTS

The annual fee for placement of AT&T's facilities in or on PACIFIC's poles, ducts, conduits and other support structures shall be negotiated annually, on a calendar year basis. If the Parties are unable to reach agreement, the Parties shall seek to have the annual fee established by the Commission as described in the Commission's Decision 98-10-058. PACIFIC's charges for make ready work and rearrangements shall be no higher than PACIFIC's actual costs incurred. PACIFIC may charge fees equal to PACIFIC's actual costs for copies or preparation of maps, drawings and plans for attachment to or use of support structures. The rates described in this Section 6 are subject to change, pursuant to Section 8.3 (Changes in Law) of the Preface (General Terms and Conditions) of this Agreement, in the event the Commission adopts rules setting forth a new methodology for determination of such rates.

7. 911 ARRANGEMENTS

Charges for 911 arrangements, when applicable, are set forth in Appendix E to this Attachment 8.

8. OPERATIONS SUPPORT SYSTEMS

Charges for OSS training classes are set forth in Appendix G to this Attachment 8. There are no other charges for access to Pacific's Operation Support Systems except as determined pursuant to any Commission action, as described in Section 10 of Attachment 9.

9. LABOR CHARGES

If AT&T requests or approves that a PACIFIC technician perform special installation, maintenance, conversion, testing, or similar services, AT&T will pay the labor rates set forth in PACIFIC's Tariff Schedule Cal. P.U.C. No. 175T. Pacific shall not assess any additional labor charges for work routinely required for the installation, maintenance, testing or conversion of UNEs. The labor rates for escort services and supervision of installation associated with collocation arrangements are set forth in Appendix B. PACIFIC will manage and apply all labor charges in a non-discriminatory manner that is equivalent to PACIFIC's internal management and assignment of these costs. All charges shall be at the "basic time" rate unless AT&T requests that work be performed outside the "basic time" period and approves the charges in advance.

10. LOCAL NUMBER PORTABILITY – COST RECOVERY

PACIFIC shall bill the amount set forth in PACIFIC Access Services Tariff No. 1 for LRN-PNP queries made by PACIFIC in accordance with applicable FCC rulings. AT&T shall pay the amounts billed, subject to AT&T's right to challenge tariff filings made by PACIFIC and to obtain true-ups authorized by the FCC. AT&T shall not be responsible for any charges billed for queries made prior to the first port in an NXX.

11. DIRECTORY LISTINGS, ACCESS TO DIRECTORY ASSISTANCE DATABASE LISTINGS, AND SUBSCRIBER LIST INFORMATION

11.1. Directory Listings.

There shall be no charge for inclusion of AT&T's End User's listings (primary and additional) in PACIFIC's directory assistance database and white pages directories, except for enhanced listings in the white pages directories, for which the rates set forth in Appendix C shall apply.

11.2. Access to Directory Assistance Database Listings.

On an interim basis, AT&T shall pay $0.02 (two cents) per directory listing provided by PACIFIC pursuant to Attachment 4, Section 2 of this Agreement. Once the Commission adopts prices for access to PACIFIC's directory assistance database listings, those prices will be substituted for the interim pricing arrangement and shall apply for the remainder of the Term of this Agreement or until the Commission modifies the prices by subsequent order. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect.

11.3. Subscriber List Information.

The rates for Subscriber List Information shall be the rates in PACIFIC's Schedule Cal. P.U.C. No. A5.7.4. AT&T reserves any right it may have to challenge such tariff in accordance with Applicable Law.

12. OTHER

12.1 The following prices also shall apply:

- Rates set forth in Appendix C (Miscellaneous Rates).
- Rates set forth in Appendix H for Operator Services and Directory Assistance Services, when those services are not provided as Network Elements at TELRIC rates.

12.2 All such rates shall remain in effect until the Commission determines different rates in any proceeding subsequent to the Effective Date of this Agreement. Once so determined by the Commission, said different rates, shall apply instead of the rates set forth herein for the remaining Term of this Agreement. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect.

12.3 References to PACIFIC's Switched and Special Access tariffs or service shall mean the rates in PACIFIC's intrastate (Cal. Schedule P.U.C. 175T) or interstate (FCC No. 1) access tariffs, as applicable, shall apply.

13. IMPLEMENTATION COST RECOVERY

The Parties disagree whether or in what amount PACIFIC should charge AT&T for implementation costs incurred as a result of requests to establish and provide interconnection services, Local Services, Network Elements or Combinations. PACIFIC shall track all such costs and propose recovery of same to the Commission. To the extent granted by the Commission, AT&T shall pay such costs as ordered by the Commission. AT&T is free to contest PACIFIC's right to recover any such costs and/or what its share of such costs should be.

14. TO BE DETERMINED

In this Agreement, rates for certain services, Network Elements, Combinations or Ancillary Functions may be specified as "To Be Determined" (TBD). In addition, numerous provisions of this Agreement refer to specific prices set forth in Attachment 8. In the event of such a reference in this Agreement where there is no corresponding price in this Attachment 8, it shall be deemed to be TBD. With respect to all TBD prices, prior to a Party ordering any such TBD items, the Parties shall meet and confer to establish a price, in accordance with the Act and other pricing methodologies adopted by the FCC or the Commission for similar services, Network Elements, Combinations or Ancillary Functions, if applicable. If no agreement is reached, the Parties shall refer any disputes to the Alternative Dispute Resolution process set forth in Attachment 3. Any rates set in the Alternative Dispute Resolution process shall be set using the pricing methodologies described above, if applicable, and shall be subject to modification by any subsequent decision of the Commission. Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect. AT&T or PACIFIC, as applicable, shall be responsible for payments of any such rates so established through Alternative Dispute Resolution or by the Commission.

15. RECURRING CHARGES

15.1 Unless otherwise identified in the Pricing Tables, where rates are shown as monthly, a month will be defined as a calendar month. The minimum term for each monthly rated Unbundled Network Element (UNE), Resale, Other (Resale), and Reciprocal Compensation elements will be one month. After the initial month, billing will be on the basis of whole or fractional months used. The minimum service period for Network Elements provided under the Bona Fide Request (BFR) process set forth in Section 22 of the Preface (General Terms and Conditions) may be longer.

15.2 For usage-based Network Elements and Combinations and for reciprocal compensation, measurement of Connectivity Charges shall be in actual conversation seconds based upon a tenth of a second increment, and the total conversation seconds per chargeable traffic types will be totaled for the entire monthly bill cycle and then rounded to the next whole minute.

15.3 Where rates are distance sensitive, the mileage will be calculated on the airline distance involved between the locations. To determine the rate to be billed, PACIFIC will first compute the mileage using the V&H coordinates method, as set forth in the National Exchange Carrier Association, Inc. Tariff FCC No 4. When the calculation results in a fraction of a mile, PACIFIC will round up to the next whole mile before determining the mileage and applying rates.

16. COMMISSION-ADOPTED RATES

Each Party reserves its right to oppose, appeal or otherwise seek modification of rates adopted by the Commission, notwithstanding the Party's consent to application of those rates under this Agreement for so long as the rates are in effect. Where the Parties have agreed that rates adopted by the Commission after the Effective Date of this Agreement are to be substituted for corresponding rates in this Agreement, the Commission-adopted rates shall take effect on the effective date set by the Commission, or, if the Commission does not set an effective date, the rates shall take effect as of the date of the Commission's order adopting the rates.

APPENDICES TO ATTACHMENT 8

Appendix A-1	Recurring and Non-Recurring UNE Rates
Appendix A-2	UNE Combinations - Scenarios
Appendix B	Collocation Rates
Appendix C	Miscellaneous Rates
Appendix D	Reciprocal Compensation Rates
Appendix E	Rates for 911-Related Services
Appendix F	Intentionally Omitted
Appendix G	OSS Training Rates
Appendix H	Operator Services and Directory Assistance Rates (Non-UNE)

UNE Recurring Rates

Loop / Link

2 Wire Basic, ADSL, Assured Link

Zone 1	$	10.03
Zone 2	$	13.51
Zone 3	$	23.53

4 Wire Basic Link and HDSL Link

Zone 1	$	33.02
Zone 2	$	41.90
Zone 3	$	67.49

ISDN Option (In addition to 2-wire loop charges)

All Zones	$	4.44

Digital Link - 1.544 Mbps

Zone 1	$	89.24
Zone 2	$	100.05
Zone 3	$	131.19

PBX Trunk Option (Ground Start Only)

All Zones	$	2.18

Subloop Unbundling TBD
(all subloops to be deaveraged into three zones)

Switching

Port

2-Wire Port	$2.88
Centrex Port	$4.37
DID Port	$4.18
DID Num. Block	$1.00
ISDN BRI Port	$14.10
ISDN PRI Trunk Port	$167.18
DS1 Trunk Port	$20.99

Switch Usage

Interoffice Originating	
Set-Up per Attempt	$ 0.005940
Holding time per MOU	$ 0.001840
Interoffice Terminating	
Setup per Call	$ 0.007000
Holding time per MOU	$ 0.001870
Intraoffice	
Setup per Call	$ 0.013990
Holding time per MOU	$ 0.003620
Tandem Switching	
Set-Up per Attempt	$ 0.000750
Set-Up per Completed Msg.	$ 0.001130
Holding time per MOU	$ 0.000670

Trunk Port Termination

End Office Termination	$	20.99
Tandem Termination	$	142.82

Entrance Facilities

Voice Grade (2W)	$	23.45
Voice Grade (4W)	$	46.90
DS1	$	153.46
DS3 w/equipment	$	1,837.18
DS3 w/o Equipment	$	724.04
OC3		$1,494.39
OC12		$4,323.29
OC48		TBD
OC192 "When Available"		TBD

Cross Connect (EISCC)

Voice Grade/ISDN	EISCC	$	0.44
	Jack Panel	$	1.79
DS0	EISCC	$	26.07
	Jack Panel	$	5.60
DS1	EISCC	$	16.52
	Jack Panel	$	2.49
	Repeater	$	24.15
DS3	EISCC	$	45.80
	Jack Panel	$	25.88
	Repeater	$	101.36

Optical Carrier Cross Connect

OC 3		TBD
OC 12		TBD
OC 48		TBD
OC 192	*When Available*	TBD

Interoffice Transmission Facilities

Shared Transport	Fixed	$ 0.001259
	Variable Mileage	$ 0.000021
	With Option C LSNE	ICB
Shared Transport - Overflow		
	Fixed	$ 0.011360
	Variable Mileage	$ 0.000021
Common Transport	Fixed	$ 0.001330
	Variable Mileage	$ 0.000021

Optical Carrier (IOD)

OC 3 Fixed		$925.74
Variable Mileage		$95.03
OC 12 Fixed		$2,673.92
Variable Mileage		$366.41
OC 48 Fixed		TBD
Variable Mileage		TBD
OC 192 Fixed	*When Availabl*	TBD
Variable Mileage	*When Availabl*	TBD

Dedicated Transport

Voice Grade Fixed		$	3.22
Variable Mileage		$	0.19
DS1	Fixed	$	32.32
	Variable Mileage Per Mile	$	1.84
DS3	Fixed	$	372.70
	Variable Mileage Per Mile	$	35.72

SS7 Signaling

SS7 Links		
Voice Grade Fixed	$	3.22
Variable Mileage	$	0.19
DS-1 Fixed	$	32.32
Variable Mileage	$	1.84
STP Port	$	263.76

Multiplexing

DS0/DS1 per multiplexer	$	255.58
DS1/DS3 per multiplexer	$	287.88

Optical Carrier Multiplexing

OC 3 to 84 DS1's	$839.94
(Grp of 28)	
OC3 to 1-3 DS3	$658.70
OC3 to 1-3 EC-1	$735.65
OC 12 to 1-12 DS3	$1,177.79
OC 12 / EC1 /STS1	$1,284.61
OC 48 to DS3	TBD
OC 48 to OC3	TBD
OC 192 to	
1-12 ECA/STS-1 *When Available*	TBD

Database Query

800 Database - per Query	$	0.00231
Multiple Destination		
& Routing		$0.00040
6 Digit Master		
# List Turnaround		$0.0044

LIDB

LIDB - per Query	
OLNS Query	$0.002633
Validation Query	$0.002633
CNAM Query	$0.002666
Query Transport	
(Validation & OLNS)	$0.000033

Transit Signaling TBD

Dark Fiber

Per fiber per foot per month TBD

UNE Recurring Rates

Operator Services [when provided as UNE]	
DA per Call	$ 0.394940
Opr. Svcs per Work Second	$ 0.029520
DSL CAPABLE LOOPS (to be deaveraged into three zones)	
PSD Class #1 Capable Loop	
2-Wire Digital "ISDN Digital Subscriber Line" ("IDSL") technology	TBD
2-Wire (copper only facilities)	TBD
PSD Class #2 2-Wire Capable Loop	TBD
PSD Class #3 Capable Loop	TBD
2-Wire Mid-band Symmetric Technology	TBD
4-Wire Mid-band Symmetric Technology	TBD
PSD Class #4 2-Wire Capable Loop	TBD
PSD Class #5 2-Wire Capable Loop	TBD
PSD Class #7 2-Wire Capable Loop	TBD
2-Wire DSL Non-Shielded Cross Connect to Collocation	TBD
4-Wire DSL Non-Shielded Cross Connect to Collocation	TBD
Jack Panel	$1.79

Switch Features	
Busy Call Forwarding	$ 0.56
Call Forward Variable	$ 0.57
Call Forwarding Busy/Delay	$ 0.56
Call Restriction	$ 0.88
Call Return	$ 0.65
Call Screen	$ 0.63
Call Trace	$ 0.57
Call Waiting	$ 0.56
Caller Hold	$ 0.56
Caller ID	$ 0.73
Caller ID Blocking	$ 0.58
Delayed Call Forwarding	$ 0.56
Direct -Shared	$ 0.56
Direct -Unshared	$ 0.56
Directed Call Pickup	$ 0.57
Distinctive Ringing	$ 0.56
DNCF	$ 0.96
Hunting	$0.29
Intercom	$ 0.62
Intercom Plus	$ 0.62
Message Waiting Indicator	$ 0.56
Remote Access to Call Fwding	$ 0.60
Remote Call Forwarding	$ 0.93
Repeat Dialing	$ 0.65
Select Call Forward	$ 0.60
Speed Call 6	$ 0.56
Speed Calling 30	$ 0.56
Speed Calling 8	$ 0.56
Three Way Calling	$ 0.57
WATS Access per Group	$ 1.73
WATS Access per Port	$ 0.56

Centrex-Like Features	
Automatic Callback	$ 0.42
Call Forwarding BusyLine	$ 0.28
Call Forwarding Don't Answer	$ 0.28
Call Forwarding Variable	$ 0.29
Call Hold	$ 0.28
Call Pick-up (Group and Station)	$ 0.30
Call Transfer - DID to DOD	$ 0.29
Call Waiting - Incoming	$ 0.28
Call Waiting - Intragroup	$ 0.28
Call Waiting - Originating	$ 0.28
Caller ID	$ 0.52
Caller ID Blocking	$ 0.28
Conferencing - Station Controlled - Large	$ 133.95
Conferencing - Station Controlled - Small	$ 0.33
Directed Call Pick-up - Group - Barge-In	$ 0.29
Directed Call Pick-up - Group - Non-Barge-In	$ 0.28
Distinctive Ringing and Call Waiting Tone	$ 0.29
Message Waiting Indicator - Stutter DT	$ 0.29
Remote Access to Call Forwarding	$ 0.33
Speed Calling - Group (30)	$ 0.28
Speed Calling - Individual (30)	$ 0.28
Speed Calling - Individual (6 or 8)	$ 0.28

UNE Non-Recurring Rates
Manual

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Loop/Link									
2-wire/*Basic*	Initial	$57.53	$48.94	$52.25	$47.42	$18.56	$8.57	$15.50	$0.00
	Additional	$3.24	$1.85	$2.02	$0.00	$12.67	$5.77	$0.00	$0.00
4-wire	Initial	$63.06	$49.90	$53.09	$47.50	$28.84	$10.41	$11.40	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$18.95	$7.43	$0.00	$0.00
Assured	Initial	$57.53	$48.94	$52.25	$47.42	$18.66	$8.54	$15.43	$0.00
	Additional	$3.24	$1.85	$2.02	$0.00	$12.53	$5.75	$0.00	$0.00
DS1 Copper	Initial	$63.06	$49.90	$53.09	$47.50	$104.59	$13.44	$0.00	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$58.25	$10.73	$0.00	$0.00
DS1 Fiber	Initial	$63.06	$49.90	$53.09	$47.50	$108.56	$17.38	$0.00	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$61.00	$14.67	$0.00	$0.00
ISDN Link	Initial	$63.06	$49.90	$53.09	$47.50	$18.55	$8.57	$15.50	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$12.67	$5.68	$0.00	$0.00
Port - Switching									
2-wire	Initial	$51.55	$47.74	$47.74	$41.67	$7.82	$4.09	$0.04	$0.00
	Additional	$2.02	$1.62	$2.02	$0.00	$5.80	$1.99	$0.04	$0.00
Centrex	Initial	$69.67	$47.74	$47.74	$41.67	$7.82	$4.09	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$5.80	$1.99	$0.04	$0.00
DID	Initial	$69.67	$47.74	$47.74	$41.67	$20.03	$11.73	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$9.51	$3.99	$0.04	$0.00
DID NBR Block		$69.67	$47.74	$47.74	$41.67	$27.71	$18.22	$0.00	$0.00
ISDN BRI	Initial	$69.67	$47.74	$47.74	$41.67	$19.50	$11.69	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$9.51	$3.99	$0.04	$0.00
ISDN PRI	Initial	$76.49	$51.43	$0.00	$42.94	$228.28	$28.20	$0.00	$0.00
	Additional	$3.09	$0.77	$0.00	$0.00	$228.28	$28.20	$0.00	$0.00
Basic Switching Functions									
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cross Connect (EISCC)									
VG/ISDN	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DS0	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DS1	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DS3	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Optical Carrier Cross Connect									
OC 3	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 12	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 48	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 192 When available	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
When available	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Unbundled Service (DS0)									
	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Trunk Port Termination									
End Office Dedicated DS1	Initial	$80.03	$53.81	$0.00	$44.91	$103.90	$31.26	$0.00	$0.00
	Additional	$3.24	$0.81	$0.00	$0.00	$80.16	$23.14	$0.00	$0.00
Tandem Termination DS1	Initial	$80.03	$53.81	$0.00	$44.91	$103.69	$30.23	$0.00	$0.00
	Additional	$3.24	$0.81	$0.00	$0.00	$78.84	$23.14	$0.00	$0.00
Signaling and Database									
SS7 Link		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
STP Port		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Network Interface Device									
NID to NID X- Con	Simple	$46.53	$0.00	$0.00	$0.00	$38.54	$0.00	$0.00	$0.00
NID to NID X- Con	ComInitial	$46.53	$0.00	$0.00	$0.00	$60.32	$0.00	$0.00	$0.00
NID to NID X- Con	ComAdditional	$0.00	$0.00	$0.00	$0.00	$15.01	$0.00	$0.00	$0.00
DNCF (Direct Number Call Forwarding)									
Centrex	Initial	$71.39	$54.01	$56.59	$52.07	$0.00	$0.00	$0.00	$0.00
	Additional	$4.05	$2.63	$2.29	$0.00	$0.00	$0.00	$0.00	$0.00
DID	Initial	$71.39	$54.01	$56.59	$52.07	$0.00	$0.00	$0.00	$0.00
	Additional	$4.05	$2.63	$2.29	$0.00	$0.00	$0.00	$0.00	$0.00
POTS	Initial	$56.52	$51.55	$52.11	$49.54	$0.00	$0.00	$0.00	$0.00
	Additional	$3.24	$2.66	$2.97	$0.00	$0.00	$0.00	$0.00	$0.00
Dedicated Transport									
DS1	Initial	$72.75	$44.91	$0.00	$42.48	$67.62	$35.81	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
DS3	Initial	$72.75	$44.91	$0.00	$42.48	$67.25	$35.81	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
VG	Initial	$72.75	$44.91	$0.00	$42.48	$62.05	$20.05	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$40.05	$13.65	$0.00	$0.00
Optical Carrier Dedicated Transport									
OC3	Initial	$84.22	$51.99	$0.00	$49.18	$69.83	$34.85	$0.00	$0.00
	Additional	$84.22	$51.99	$0.00	$49.18	$69.83	$34.85	$0.00	$0.00
OC 12	Initial	$84.22	$51.99	$0.00	$49.18	$69.83	$34.85	$0.00	$0.00
	Additional	$84.22	$51.99	$0.00	$49.18	$69.83	$34.85	$0.00	$0.00

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Optical Carrier Dedicated Transport									
OC 48	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 192 When Available	Initial	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	Additional	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Entrance Facility									
VG	Initial	$72.75	$48.15	$0.00	$42.48	$21.85	$7.56	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$9.36	$5.03	$0.00	$0.00
DS1	Initial	$72.75	$48.15	$0.00	$42.48	$68.87	$43.77	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$58.41	$39.48	$0.00	$0.00
DS3 (w/equip)	Initial	$72.75	$48.15	$0.00	$42.48	$114.90	$43.48	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$74.60	$38.19	$0.00	$0.00
DS3 (w/o equip)	Initial	$72.75	$48.15	$0.00	$42.48	$69.10	$44.79	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$58.41	$38.39	$0.00	$0.00
Optical Carrier Entrance Facility									
OC 3	Initial	$84.22	$51.99	$0.00	$49.18	$129.26	$46.56	$0.00	$0.00
	Additional	$84.22	$51.99	$0.00	$49.18	$129.26	$46.56	$0.00	$0.00
OC 12	Initial	$84.22	$51.99	$0.00	$49.18	$129.26	$46.56	$0.00	$0.00
	Additional	$84.22	$51.99	$0.00	$49.18	$129.26	$46.56	$0.00	$0.00
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Multiplexing									
DS1/DS0		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DS3/DS1		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Optical Carrier Multiplexing									
OC3 / DS1 Initial & Additional		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC3 / DS3 Initial & Additional		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC3 / EC1 Initial & Additional		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC12/EC1 Initial & Additional		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 12/DS3 Initial & Additional		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 48 to DS3		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC48 to OC3		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
OC 192 to 1-12 EC1/STS-1 When Available		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Switch Features									
Centrex Station	Initial	$3.24	$0.00	$46.53	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Centrex System		$3.24	$0.00	$46.53	$0.00	$21.27	$15.61	$21.27	$0.00
Custom Calling	Initial	$3.24	$0.00	$46.53	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Hunting	Initial	$3.24	$0.00	$46.53	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Remote Call Forwarding	Initial	$3.24	$0.00	$46.53	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00

	Service Order				Channel Connection			
DSL CAPABLE LOOPS (to be deaveraged into three zones)	**Connect**	**Disc.**	**Change**	**Record**	**Connect**	**Disc.**	**Change**	**Record**
PSD Class #1 Capable Loop								
2-Wire Digital "ISDN Digital Subscriber Line" ("IDSL") technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
2-Wire (copper only facilities) "Symmetric Digital Subscriber Line" ("SDSL")								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #2 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #3 Capable Loop								
2-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
4-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #4 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #5 2-Wire Capable Loop - Asymmetrical Digital Subscriber Line								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #7 2-Wire Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD

UNE Non-Recurring Rates
Semi-Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Loop/Link									
2-wire/Basic	Initial	$29.93	$21.03	$24.33	$19.58	$18.56	$8.57	$15.50	$0.00
	Additional	$3.24	$1.85	$2.02	$0.00	$12.67	$5.77	$0.00	$0.00
4-wire	Initial	$35.09	$21.57	$24.00	$19.61	$28.84	$10.41	$11.40	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$18.95	$7.43	$0.00	$0.00
Assured	Initial	$29.93	$21.03	$24.33	$19.58	$18.66	$8.54	$15.43	$0.00
	Additional	$3.24	$1.85	$2.02	$0.00	$12.53	$5.75	$0.00	$0.00
DS1 Copper	Initial	$35.09	$21.57	$24.00	$19.61	$104.59	$13.44	$0.00	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$58.25	$10.73	$0.00	$0.00
DS1 Fiber	Initial	$35.09	$21.57	$24.00	$19.61	$108.56	$17.38	$0.00	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$61.00	$14.67	$0.00	$0.00
ISDN Link	Initial	$35.09	$21.57	$24.00	$19.61	$18.55	$8.57	$15.50	$0.00
	Additional	$3.69	$3.64	$1.94	$0.00	$12.67	$5.68	$0.00	$0.00
Port - Switching									
2-wire	Initial	$23.84	$20.03	$20.43	$13.96	$7.82	$4.09	$0.04	$0.00
	Additional	$2.02	$1.62	$2.02	$0.00	$5.80	$1.99	$0.04	$0.00
Centrex	Initial	$41.96	$20.03	$20.03	$11.33	$7.82	$4.09	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$5.80	$1.99	$0.04	$0.00
DID	Initial	$41.96	$20.03	$20.03	$11.33	$20.03	$11.73	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$9.51	$3.99	$0.04	$0.00
DID Nbr Block		$41.96	$20.03	$20.03	$11.33	$27.71	$18.22	$0.00	$0.00
ISDN BRI	Initial	$41.96	$20.03	$20.03	$11.33	$19.50	$11.69	$0.04	$0.00
	Additional	$2.02	$2.02	$2.02	$0.00	$9.51	$3.99	$0.04	$0.00
ISDN PRI	Initial	$52.32	$27.26	$0.00	$18.75	$228.28	$28.20	$0.00	$0.00
	Additional	$3.09	$0.77	$0.00	$0.00	$228.28	$28.20	$0.00	$0.00
Basic Switching Functions									
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA & DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	$277.98	$133.76	$187.54	$0.00	$0.00	$0.00	$0.00	$0.00
Cross Connect (EISCC)									
VG/ISDN	Initial	$2.08	$3.29	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
DS0	Initial	$2.08	$3.29	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
DS1	Initial	$2.08	$3.29	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
DS3	Initial	$2.08	$3.29	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00

UNE Non-Recurring Rates
Semi-Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Optical Carrier Cross Connect									
OC 3	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 12	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Unbundled Service (DS0)									
	Initial	$2.08	$3.29	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.81	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Trunk Port Termination									
End Office Dedicated DS1									
	Initial	$54.74	$28.52	$0.00	$19.62	$103.90	$31.26	$0.00	$0.00
	Additional	$3.24	$0.81	$0.00	$0.00	$80.16	$23.14	$0.00	$0.00
Tandem Termination DS1									
	Initial	$54.74	$28.52	$0.00	$19.62	$103.69	$30.23	$0.00	$0.00
	Additional	$3.24	$0.81	$0.00	$0.00	$78.84	$23.14	$0.00	$0.00
Signaling and Database									
SS7 Link	CESAR/LEX	$35.09	$21.57	$24.00	$19.61	$164.68	$54.21	$0.00	$0.00
STP Port	CESAR/LEX	$41.96	$20.03	$20.03	$11.33	$123.34	$43.73	$0.00	$0.00
Network Interface Device									
NID to NID X- Con Simple		$17.73	$0.00	$0.00	$0.00	$38.54	$0.00	$0.00	$0.00
NID to NID X- Con Complex	Initial	$17.73	$0.00	$0.00	$0.00	$60.32	$0.00	$0.00	$0.00
NID to NID X- Con Complex	Additional	$0.00	$0.00	$0.00	$0.00	$15.01	$0.00	$0.00	$0.00
DNCF (Direct Number Call Forwarding)									
Centrex	Initial	$44.91	$26.06	$28.32	$23.90	$0.00	$0.00	$0.00	$0.00
	Additional	$4.05	$2.63	$2.29	$0.00	$0.00	$0.00	$0.00	$0.00
DID	Initial	$44.91	$26.06	$28.32	$23.90	$0.00	$0.00	$0.00	$0.00
	Additional	$4.05	$2.63	$2.29	$0.00	$0.00	$0.00	$0.00	$0.00
POTS	Initial	$29.74	$23.94	$24.51	$22.04	$0.00	$0.00	$0.00	$0.00
	Additional	$2.89	$2.66	$2.97	$0.00	$0.00	$0.00	$0.00	$0.00
Dedicated Transport									
DS1	Initial	$46.65	$18.81	$0.00	$14.77	$67.62	$35.81	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
DS3	Initial	$46.65	$18.81	$0.00	$14.77	$67.25	$35.81	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
VG	Initial	$46.65	$18.81	$0.00	$14.77	$62.05	$20.05	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$40.05	$13.65	$0.00	$0.00
Optical Carrier Dedicated Transport									
OC3	Initial	$54.01	$21.78	$0.00	$17.10	$69.83	$34.85	$0.00	$0.00
	Additional	$54.01	$21.78	$0.00	$17.10	$69.83	$34.85	$0.00	$0.00
OC 12	Initial	$54.01	$21.78	$0.00	$17.10	$69.83	$34.85	$0.00	$0.00
	Additional	$54.01	$21.78	$0.00	$17.10	$69.83	$34.85	$0.00	$0.00

UNE Non-Recurring Rates
Semi-Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Optical Carrier Dedicated Transport									
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When Available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Entrance Facility									
VG	Initial	$46.65	$22.25	$0.00	$14.77	$21.85	$7.56	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$9.36	$5.03	$0.00	$0.00
DS1	Initial	$46.65	$22.25	$0.00	$14.77	$68.87	$43.77	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$58.41	$39.48	$0.00	$0.00
DS3 (w/equip)	Initial	$46.65	$22.25	$0.00	$14.77	$114.90	$43.48	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$74.60	$38.19	$0.00	$0.00
DS3 (w/o equip)	Initial	$46.65	$22.25	$0.00	$14.77	$69.10	$44.79	$0.00	$0.00
	Additional	$5.66	$2.43	$0.00	$0.00	$58.41	$38.39	$0.00	$0.00
Optical Carrier Entrance Facility									
OC 3	Initial	$54.01	$21.28	$0.00	$17.10	$129.26	$46.56	$0.00	$0.00
	Additional	$54.01	$21.28	$0.00	$17.10	$129.26	$46.56	$0.00	$0.00
OC 12	Initial	$54.01	$21.28	$0.00	$17.10	$129.26	$46.56	$0.00	$0.00
	Additional	$54.01	$21.28	$0.00	$17.10	$129.26	$46.56	$0.00	$0.00
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When Available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Multiplexing									
DS1/DS0		$4.05	$4.05	$0.00	$0.00	$80.12	$36.13	$0.00	$0.00
DS3/DS1		$4.05	$4.05	$0.00	$0.00	$84.17	$36.32	$0.00	$0.00
Optical Carrier Multiplexing									
OC3 / DS1 Initial & Additional		$4.68	$4.68	$0.00	$0.00	$611.76	$260.44	$0.00	$0.00
OC3 / DS3 Initial & Additional		$4.68	$4.68	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC3 / EC1 Initial & Additional		$4.68	$4.68	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC12/EC1 Initial & Additional		$4.68	$4.68	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC 12/DS3 Initial & Additional		$4.68	$4.68	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC 48 to DS3		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC48 to OC3		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 to 1-12 EC1/STS-1 When available		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Switch Features									
Centrex Station	Initial	$3.24	$0.00	$18.81	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Centrex System		$3.24	$0.00	$18.81	$0.00	$21.27	$15.61	$21.27	$0.00
Custom Calling	Initial	$3.24	$0.00	$18.81	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Hunting	Initial	$3.24	$0.00	$18.81	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00
Remote Call Forwarding									
	Initial	$3.24	$0.00	$18.81	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.81	$0.00	$2.02	$0.00	$0.00	$0.00	$0.00	$0.00

UNE Non-Recurring Rates
Semi-Mechanized

	Service Order				Channel Connection			
DSL CAPABLE LOOPS (to be deaveraged into three zones)	Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
PSD Class #1 Capable Loop								
2-Wire Digital "ISDN Digital Subscriber Line" ("IDSL") technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
2-Wire (copper only facilities) "Symmetric Digital Subscriber Line" ("SDSL")								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #2 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #3 Capable Loop								
2-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
4-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #4 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #5 2-Wire Capable Loop - Asymmetrical Digital Subscriber Line								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #7 2-Wire Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD

UNE Non-Recurring Rates
Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Loop/Link									
2-wire/Basic	Initial	$0.16	$0.16	$0.16	$0.00	$18.56	$8.57	$15.50	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$12.67	$5.77	$0.00	$0.00
4-wire	Initial	$0.16	$0.16	$0.16	$0.00	$28.84	$10.41	$11.40	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$18.95	$7.43	$0.00	$0.00
Assured	Initial	$0.16	$0.16	$0.16	$0.00	$18.66	$8.54	$15.43	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$12.53	$5.75	$0.00	$0.00
DS1 Copper	Initial	$0.16	$0.16	$0.16	$0.00	$104.59	$13.44	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$58.25	$10.73	$0.00	$0.00
DS1 Fiber	Initial	$0.16	$0.16	$0.16	$0.00	$108.56	$17.38	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$61.00	$14.67	$0.00	$0.00
ISDN Link	Initial	$0.16	$0.16	$0.16	$0.00	$18.55	$8.57	$15.50	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$12.67	$5.68	$0.00	$0.00
Port - Switching									
2-wire	Initial	$0.16	$0.16	$0.16	$0.16	$7.82	$4.09	$0.04	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$5.80	$1.99	$0.04	$0.00
Centrex	Initial	$0.49	$0.49	$0.49	$0.49	$7.82	$4.09	$0.04	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$5.80	$1.99	$0.04	$0.00
DID	Initial	$0.49	$0.49	$0.49	$0.49	$20.03	$11.73	$0.04	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$9.51	$3.99	$0.04	$0.00
DID Nbr Block		$0.49	$0.49	$0.49	$0.49	$27.71	$18.22	$0.00	$0.00
ISDN BRI	Initial	$0.49	$0.49	$0.49	$0.49	$19.50	$11.69	$0.04	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$9.51	$3.99	$0.04	$0.00
ISDN PRI	Initial	$0.46	$0.46	$0.00	$0.46	$228.28	$28.20	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$228.28	$28.20	$0.00	$0.00
Basic Switching Functions									
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
1AESS CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
5ESS CLC Switch Services Establishement (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA & DA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
DMS100 CLC Switch Service Establishment (Per CLC, per Switch)	OA TG	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A

UNE Non-Recurring Rates
Mechanized

			Service Order				Channel Connection			
			Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Cross Connect (EISCC)										
	VG/ISDN	Initial	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	DS0	Initial	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	DS1	Initial	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
	DS3	Initial	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Optical Carrier Cross Connect										
	OC 3	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
		Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	OC 12	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
		Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
		Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	OC 192 When available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
		Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Unbundled Service (DS0)										
		Initial	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Trunk Port Termination										
End Office Dedicated DS1										
		Initial	$0.49	$0.49	$0.00	$0.49	$103.90	$31.26	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$80.16	$23.14	$0.00	$0.00
Tandem Termination DS1										
		Initial	$0.49	$0.49	$0.00	$0.49	$103.69	$30.23	$0.00	$0.00
		Additional	$0.00	$0.00	$0.00	$0.00	$78.84	$23.14	$0.00	$0.00
Signaling and Database										
	SS7 Link		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
	STP Port		N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Network Interface Device										
NID to NID X- Con	Simple		$0.16	$0.00	$0.00	$0.00	$38.54	$0.00	$0.00	$0.00
NID to NID X- Con	Comple	Initial	$0.16	$0.00	$0.00	$0.00	$60.32	$0.00	$0.00	$0.00
NID to NID X- Con	Comple	Additional	$0.00	$0.00	$0.00	$0.00	$15.01	$0.00	$0.00	$0.00

UNE Non-Recurring Rates
Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
DNCF (Direct Number Call Forwarding)									
Centrex	Initial	$0.16	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
DID	Initial	$0.16	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
POTS	Initial	$0.16	$0.16	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Dedicated Transport									
DS1	Initial	$0.73	$0.73	$0.00	$0.00	$67.62	$35.81	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
DS3	Initial	$0.73	$0.73	$0.00	$0.00	$67.25	$35.81	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$57.35	$29.97	$0.00	$0.00
VG	Initial	$0.73	$0.73	$0.00	$0.00	$62.05	$20.05	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$40.05	$13.65	$0.00	$0.00
Optical Carrier Dedicated Transport									
OC3	Initial	$0.84	$0.84	$0.00	$0.00	$69.83	$34.85	$0.00	$0.00
	Additional	$0.84	$0.84	$0.00	$0.00	$69.83	$34.85	$0.00	$0.00
OC 12	Initial	$0.84	$0.84	$0.00	$0.00	$69.83	$34.85	$0.00	$0.00
	Additional	$0.84	$0.84	$0.00	$0.00	$69.83	$34.85	$0.00	$0.00
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When Available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Entrance Facility									
VG	Initial	$0.32	$0.32	$0.00	$0.00	$21.85	$7.56	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$9.36	$5.03	$0.00	$0.00
DS1	Initial	$0.32	$0.32	$0.00	$0.00	$68.87	$43.77	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$58.41	$39.48	$0.00	$0.00
DS3 (w/equip)	Initial	$0.32	$0.32	$0.00	$0.00	$114.90	$43.48	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$74.60	$38.19	$0.00	$0.00
DS3 (w/o equip)	Initial	$0.32	$0.32	$0.00	$0.00	$69.10	$44.79	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$58.41	$38.39	$0.00	$0.00

UNE Non-Recurring Rates
Mechanized

		Service Order				Channel Connection			
		Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
Optical Carrier Entrance Facility									
OC 3	Initial	$0.84	$0.84	$0.00	$0.00	$129.26	$46.56	$0.00	$0.00
	Additional	$0.84	$0.84	$0.00	$0.00	$129.26	$46.56	$0.00	$0.00
OC 12	Initial	$0.84	$0.84	$0.00	$0.00	$129.26	$46.56	$0.00	$0.00
	Additional	$0.84	$0.84	$0.00	$0.00	$129.26	$46.56	$0.00	$0.00
OC 48	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 When available	Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
	Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Multiplexing									
DS1/DS0		$0.16	$0.16	$0.00	$0.00	$80.12	$36.13	$0.00	$0.00
DS3/DS1		$0.16	$0.16	$0.00	$0.00	$84.17	$36.32	$0.00	$0.00
Optical Carrier Multiplexing									
OC3 / DS1		$0.19	$0.19	$0.00	$0.00	$611.76	$260.44	$0.00	$0.00
OC3 / DS3		$0.19	$0.19	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC3 / EC1		$0.19	$0.19	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC12/EC1		$0.19	$0.19	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC 12 / DS3		$0.19	$0.19	$0.00	$0.00	$98.75	$40.88	$0.00	$0.00
OC 48 to DS3		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC48 to OC3		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
OC 192 to 1-12 EC1/STS-1 When Available		TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Switch Features									
Centrex Station	Initial	$0.16	$0.00	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Centrex System		$0.16	$0.00	$0.16	$0.00	$21.27	$15.61	$21.27	$0.00
Custom Calling	Initial	$0.16	$0.00	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Hunting	Initial	$0.16	$0.00	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00
Remote Call Forwarding									
	Initial	$0.16	$0.00	$0.16	$0.00	$0.00	$0.00	$0.00	$0.00
	Additional	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00	$0.00

UNE Non-Recurring Rates
Mechanized

	Service Order				Channel Connection			
	Connect	Disc.	Change	Record	Connect	Disc.	Change	Record
DSL CAPABLE LOOPS (to be deaveraged into three zones)								
PSD Class #1 Capable Loop								
2-Wire Digital "ISDN Digital Subscriber Line" ("IDSL") technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
2-Wire (copper only facilities) "Symmetric Digital Subscriber Line" ("SDSL")								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #2 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #3 Capable Loop								
2-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
4-Wire Mid-band Symmetric Technology								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #4 Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #5 2-Wire Capable Loop - Asymmetrical Digital Subscriber Line								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
PSD Class #7 2-Wire Capable Loop								
Initial	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD
Additional	TBD	TBD	TBD	TBD	TBD	TBD	TBD	TBD

UNE Non-Recurring Rates

Other Non-Recurring Rates

Loop Conditioning	See Att 8, Sec 3.4
Loop Qualification	$0.00
2-Wire DSL Non-Shielded Cross Connect to Collocation	TBD
4-Wire DSL Non-Shielded Cross Connect to Collocation	TBD
Sub-loop unbundling (all subloops to be deaveraged into three zones)	TBD
Dark Fiber	TBD
Dark Fiber Inquiry	TBD
Customized Routing Option C	ICB

Scenario 1

CLEC leases an EISCC, a Loop and a Network Interface Device (NID) on and individual basis. The EISCC is passed on to the CLEC at the CLEC's collocation cage. Under this approach the CLEC requests that each of the elements ordered should be unbundled. In the TELRIC costs adopted in D.98-02-106, the NID was not separated from the loop. Therefore the service order price for the NID is already captured in the nonrecurring charge for the loop.

CONNECT	EISCC	LOOP	NID	TOTAL
Nonrecurring Charge	NRC	NRC	NRC	
Manual-FAX	$2.08	$76.09	$0.00	$78.17
Semi-Mechanized	$2.08	$48.48	$0.00	$50.56
Mechanized	$0.17	$18.72	$0.00	$18.89

DISCONNECT	EISCC	LOOP	NID	TOTAL
Nonrecurring Charge	NRC	NRC	NRC	
Manual-FAX	$3.30	$57.51	$0.00	$60.81
Semi-Mechanized	$3.30	$29.60	$0.00	$32.90
Mechanized	$0.16	$8.73	$0.00	$8.89

Scenario 2

CLEC leases an EISCC, a Loop and Dedicated Transport. The EISCC is passed on to the CLEC at the CLEC's collocation cage. An additional DS-1 EISCC is passed from the collocation cage to the Dedicated Trunk (Transport). As in Scenario 1, the NID is not unbundled from the Loop and the DS-1 EISCC and Trunk serve 24 voice grade channels.

CONNECT	NID	LOOP	EISCC	DS-1 EISCC	TRUNK	TOTAL
Nonrecurring Charge	SO	NRC	NRC	NRC	NRC	
Manual-FAX	$0.00	$76.09	$2.08	$2.08	$140.37	$220.62
Semi-Mechanized	$0.00	$48.48	$2.08	$2.08	$114.28	$166.92
Fully Mechanized	$0.00	$18.72	$0.17	$0.17	$68.35	$87.41

DISCONNECT	NID	LOOP	EISCC	DS-1 EISCC	TRUNK	TOTAL
Nonrecurring Charge	SO	NRC	NRC	NRC	NRC	
Manual-FAX	$0.00	$57.51	$3.30	$3.30	$80.72	$144.83
Semi-Mechanized	$0.00	$29.60	$3.30	$3.30	$54.62	$90.82
Fully Mechanized	$0.00	$8.73	$0.16	$0.16	$36.53	$45.58

Scenario 3

A CLEC leases an EISCC, Switching and SS7 Signaling. The EISCC is passed onto the CLEC at the CLEC's collocation cage. The nonrecurring charges for SS7 ports and links are determined on a one-time basis per connection per central office. Pacific only identified semi-mechanized costs for the SS7 port and link.

CONNECT	EISCC	SWITCHING PORT	SS7 PORT	SS7 LINK	TOTAL
Nonrecurring Charge	NRC	NRC	SO	SO	
Manual-FAX	$2.08	$59.37	$41.96	$35.09	$138.50
Semi-Mechanized	$2.08	$31.65	$41.96	$35.09	$110.78
Fully Mechanized	$0.17	$7.98	$41.96	$35.09	$85.20

DISCONNECT	EISCC	SWITCHING PORT	SS7 PORT	SS7 LINK	TOTAL
Nonrecurring Charge	NRC	NRC	SO	SO	
Manual-FAX	$3.30	$51.84	$20.03	$21.57	$96.74
Semi-Mechanized	$3.30	$24.12	$20.03	$21.57	$69.02
Fully Mechanized	$0.16	$4.26	$20.03	$21.57	$46.02

Scenario 4

CLEC leases an *as is* migration for Loop, NID, Switch Port and Existing Features. Because this is an as is migration, there is not an existing collocation cage or EISCC.
Therefore the elements are leased as an existing platform of network elements

CONNECT	LOOP	NID	SWITCH PORT	EXISTING FEATURES	TOTAL
Nonrecurring Charge	SO	SO	SO	SO	
Manual-FAX	$57.52	$0.00	$51.55	$3.24	$112.31
Semi-Mechanized	$29.93	$0.00	$23.84	$3.24	$57.01
Mechanized	$0.17	$0.00	$0.17	$0.17	$0.51

DISCONNECT	LOOP	NID	SWITCH PORT	EXISTING FEATURES	TOTAL
Nonrecurring Charge	SO	SO	SO	SO	
Manual-FAX	$48.94	$0.00	$47.74	$0.00	$96.68
Semi-Mechanized	$21.03	$0.00	$20.03	$0.00	$41.06
Mechanized	$0.17	$0.00	$0.17	$0.00	$0.34

Scenario 5

CLEC leases an *as is* migration for Plain Old Telephone Service (POTS) which includes the Loop, NID and, Switch Port. Thereafter the customer changes service from POTS to ISDN service.

CONNECT	LOOP	SWITCH	ISDN	ISDN	TOTAL
LINK		PORT	PORT	LINK	
Nonrecurring Charge	SO	SO	NRC	NRC	
Manual-FAX	$57.52	$51.55			$109.07
Semi-Mechanized	$29.93	$23.84			$53.77
Mechanized	$0.17	$0.17			$0.34

DISCONNECT	LOOP	SWITCH	ISDN	ISDN	TOTAL
LINK		PORT	PORT	LINK	
Nonrecurring Charge	SO	SO	NRC	NRC	
Manual-FAX	$48.94	$47.74			$96.68
Semi-Mechanized	$21.03	$20.03			$41.06
Mechanized	$0.17	$0.17			$0.34

CONNECT		ISDN	ISDN	ISDN	TOTAL
ISDN		PORT	LINK	Features	
Nonrecurring Charge		NRC	NRC	SO	
Manual-FAX		$89.17	$81.61	$3.24	$170.78
Semi-Mechanized		$61.45	$53.65	$3.24	$115.10
Mechanized		$19.98	$18.72	$0.17	$38.70

DISCONNECT		ISDN	ISDN	ISDN	TOTAL
ISDN		PORT	LINK	Features	
Nonrecurring Charge		NRC	NRC	SO	
Manual-FAX		$59.43	$58.48	$0.00	$117.91
Semi-Mechanized		$31.71	$30.14	$0.00	$61.85
Mechanized		$12.17	$8.73	$0.00	$20.90

Scenario 6

CLEC leases an extended link which is comprised of a Loop, Digital Cross Connect System (DCS), and Dedicated DS-1 Transport. This is a custom combination, thus the sum of the stand-alone NRC approach is used to calculate final nonrecurring charges.

CONNECT		DIGITAL CROSS	DEDICATED	TOTAL
	LOOP	CONNECT	TRANSPORT	
Nonrecurring Charge	NRC	NRC	NRC	
Manual-FAX	$76.09	$81.15	$140.37	$297.61
Semi-Mechanized	$48.48	$81.15	$114.28	$243.91
Mechanized	$18.72	$80.28	$68.35	$167.35

DISCONNECT		DIGITAL CROSS	DEDICATED	TOTAL
	LOOP	CONNECT	TRANSPORT	
Nonrecurring Charge	NRC	NRC	NRC	
Manual-FAX	$57.51	$40.19	$80.72	$178.42
Semi-Mechanized	$29.30	$40.19	$54.62	$124.11
Mechanized	$8.73	$36.30	$36.53	$81.56

Scenario 6A

CLEC leases an extended link which is comprised of a Loop, Digital Cross Connect System (DCS), and Dedicated DS-1 Transport. In this case, the extended link is an "as is" migration, thus the sum of the service order approach is used to calculate final nonrecurring charges.

CONNECT		DIGITAL CROSS	DEDICATED	TOTAL
	LOOP	CONNECT	TRANSPORT	
Nonrecurring Charge	SO	SO	SO	
Manual-FAX	$57.52	$4.05	$72.74	$134.31
Semi-Mechanized	$29.93	$4.05	$46.65	$80.63
Mechanized	$0.17	$0.17	$0.73	$1.07

DISCONNECT		DIGITAL CROSS	DEDICATED	TOTAL
	LOOPS	CONNECTS	TRANSPORT	
Nonrecurring Charge	SO	SO	SO	
Manual-FAX	$48.94	$4.05	$44.91	$97.90
Semi-Mechanized	$21.03	$4.05	$18.81	$43.89
Mechanized	$0.17	$0.17	$0.73	$1.07

Scenario 7

CLEC leases an extended link which is comprised of a DS-1 Loop and Dedicated DS-1 Transport. This is also a custom combination, thus the sum of the stand-alone NRC approach is used to calculate final nonrecurring charges.

CONNECT	DS-1	DEDICATED	TOTAL
	LOOP	TRANSPORT	
Nonrecurring Charge	NRC	NRC	
Manual-FAX	$167.65	$140.37	$308.02
Semi-Mechanized	$139.68	$114.28	$253.96
Mechanized	$104.74	$68.35	$173.09

DISCONNECT	DS-1	DEDICATED	TOTAL
	LOOP	TRANSPORT	
Nonrecurring Charge	NRC	NRC	
Manual-FAX	$63.34	$80.72	$144.06
Semi-Mechanized	$35.02	$54.62	$89.64
Mechanized	$13.60	$36.53	$50.13

Scenario 7A

CLEC leases an extended link which is comprised of a DS-1 Loop and Dedicated DS-1 Transport. In this case the Extended Link is an "as is" migration, thus the sum of the stand-alone service order approach is used to calculate final nonrecurring charges.

CONNECT	DS-1	DEDICATED	TOTAL
	LOOP	TRANSPORT	
Nonrecurring Charge	SO	SO	
Manual-FAX	$63.06	$72.74	$135.80
Semi-Mechanized	$35.09	$46.65	$81.74
Mechanized	$0.17	$0.73	$0.90

DISCONNECT	DS-1	DEDICATED	TOTAL
	LOOP	TRANSPORT	
Nonrecurring Charge	SO	SO	
Manual-FAX	$49.91	$44.91	$94.82
Semi-Mechanized	$21.03	$18.81	$39.84
Mechanized	$0.17	$0.73	$0.90

Key

NRC = Full Stand Alone Nonrecurring Charge Which Includes Service Order and Channel Connect (i.e. Provisioning and Maintenance) Charges

SO = Service Order Charges Only And Is Used To Estimate Nonrecurring Charges Under The Sum Of The Service Order Approach.

RATES FOR PHYSICAL COLLOCATION

ATTACHMENT 8
Appendix B
08/14/2000

Cage construction	NON-Recurring	Unit (If Not Total)	RECURRING	Unit (If Not Total)
Planning	$ 3,584.48	Per Request	$ 17.30	Per 100 Sq.Ft. Cage
Planning	$ 1,240.78	Per Subsequent Request (Cabling Only)		
Grounding	$ -		$ 5.01	Per 100 Sq.Ft. Cage
Cage Prep.	$ -		$ 62.72	Per 100 Sq.Ft. Cage
HVAC	$ -		$ 5.55	Per 10 AMPS
Land & Building	$ -		$ 1,211.67	Per 100 Sq.Ft. Cage
Cable Racking	$ -		$ 25.59	Per 100 Sq.Ft. Cage
Entrance Fiber	$ 1,107.76	Per Cable	$ 2.57	Per Cable
Power Delivery	$ 172.86	Per 40 AMP		
	$ 225.47	Per 100 AMP		
	$ 293.87	Per 200 AMP		
Power Consumption				
DC Plant			$ 5.70	Per AMP
AC Usage			$ 4.70	Per AMP
Optical Circuits				
Connection to FDF	$ 2,656.01	Per Cable	$ 7.78	Per Cable
Physical to Physical Connection				
Cable Racking & Hole for Optical			$ 0.79	Per Cable
Cable Racking & Hole for DS1 or DS3			$ 0.71	Per Cable
Connection for DS1	$ 1,439.70	Per 28 Ckt.		
Connection for DS3	$ 367.90	Per 1 Ckt.		
Connection for Optical	$ 2,306.54	Per Cable		
Security Access				
Security Access Cards	$ 93.95	Per Request (5 Cards)		
Entrance Fiber Structure Tariff				
Structure Charge			$ 0.0186	Per Ft. Innerduct

Element	NON-Recurring	Unit (If Not Total)	RECURRING	Unit (If Not Total)
Planning	$ 6,203.91	Per Request		
Planning	$ 1,240.78	Per Subsequent Request (Cabling Only)		
Land & Building	$ -		$ 0.46	Per Square Foot
Entrance Fiber	$ 1,204.09	Per Cable	$ 2.55	Per Cable
Racking			$ 1.79	Per Rack
Racking	$ 299.71	Per Rack	$ 22.44	Per Rack
Cable Entrance	$ 858.22	Per Wall Opening		
Power Delivery				
200 AMP Power Cables	$ 6,135.03	Per 200 AMP Service	$ 14.98	Per 200 AMP Service
400 AMP Power Cables	$ 11,913.08	Per 400 AMP Service	$ 29.98	Per 400 AMP Service
600 AMP Power Cables	$ 15,740.21	Per 600 AMP Service	$ 31.63	Per 600 AMP Service
800 AMP Power Cables	$ 23,431.83	Per 800 AMP Service	$ 47.45	Per 800 AMP Service
Racking	$ 301.51	Per Service Establishment	$ 32.28	Per DC Power Service Feed
Cable Entrance	$ 723.87	Per Service Establishment		
Power Consumption				
DC Plant			$ 4.89	Per AMP
AC Usage			$ 4.70	Per AMP
Optical Circuits				
Connection to FDF	$ 2,949.57	Per Cable	$ 7.81	Per Cable
Racking			$ 0.71	Per Cable
Voice Grade Circuits				
Connection to MDF	$ 1,078.75	Per 100 Circuits	$ 5.90	Per 100 Circuits
Racking			$ 0.50	Per 100 Circuits
Racking	$ 304.52	Per Rack	$ 32.58	Per Rack
DS-1 Circuits				
Connection to DCS	$ 1,841.07	Per 28 Circuits	$ 278.73	Per 28 Circuits
Connection to DSX	$ 1,841.07	Per 28 Circuits	$ 13.73	Per 28 Circuits
Racking			$ 0.58	Per 28 Circuits
DS-3 Circuits				
Connection to DCS	$ 470.47	Per 1 Circuit	$ 69.88	Per 1 Circuit
Connection to DSX	$ 470.47	Per 1 Circuit	$ 12.04	Per 1 Circuit
Racking			$ 0.58	Per 1 Circuit
Entrance Fiber Structure Tariff				
Structure Charge			$ 0.0186	Per Ft. Innerduct

I ES FOR ADJACENT OFF SITE COLLO TION

Element	NON-Recurring	Unit (If Not Total)	RECURRING	Unit (If Not Total)
Planning	$ 1,295.58	Per Request		
Optical Circuits				
Connection to FDF	$ 2,740.01	Per Cable	$ 8.56	Per Cable
Voice Grade Circuits				
Connection to MDF	$ 481.64	Per 900 Circuits	$ 324.89	Per 900 Circuits
DS-1 Circuits				
Connection to MDF	$ 481.64	Per 450 Circuits	$ 324.89	Per 450 Circuits
Connection to DCS	$ 1,439.70	Per 28 Circuits	$ 278.72	Per 28 Circuits
Connection to DSX	$ 1,439.70	Per 28 Circuits	$ 13.71	Per 28 Circuits
Structure Tariff				
Structure Charge			$ 0.0186	Per Ft. Innerduct

MISCELLANEOUS RATES

1. Miscellaneous Charges Related to Resale Service

1.1 Traffic Alert Referral Service (TARS) -TBD

1.2 Repair Transfer Service (RTS) -

Change Request	Rate
Recorded Name Announcement	$2,300.00
800/888 Telephone Number	$ 750.00
Name Announcement & Tele Number	$2,400.00

1.3 Warm line (Operator) transfer - The rates specified in PACIFIC Cal. P.U.C. Tariff 175-T, Section 6.8.2 (G) shall apply.

1.4 Resale Conversion Charge - The rates specified PACIFIC's Cal. PUC 175-T, Section 18.13.4 shall apply on a per billable telephone number basis.

2. Miscellaneous Charges Related to Directories and Directory Listings

2.1 Access to Directory Assistance Database Listings - See Section 11.2 of Attachment 8.

2.2 The following rates apply for enhanced listings in PACIFIC's white pages directories.

	Monthly Rate	One-Time Service Charge
Lines of Information in Addition to Basic Listings		
Business	$1.75	$7.00
Residence	$0.85	$5.00
Caption Listing		
Business	$0.00	$7.00
Residence	$0.00	$5.00
Alternate User Listing (each listing)	$1.50	$7.00

2.3 Bulk delivery of directories – TBD.

3. Miscellaneous Charges Related to Local Interconnection Services

   3.1 Transit Rate – See Section 5.4 of Attachment 8.

   3.2 Space License Fees payable by PACIFIC – See Section 5.2.1 of Attachment 8.

4. Intentionally omitted.

5. Other Miscellaneous Rates.

   5.1 Interim NXX Migration Charge to be paid by the Party to whom an entire NXX is migrated – $7,500.00. (See Attachment 15, Section 14.7.1)

   5.2 Local Disconnect Report (LDR) per Working Telephone Number (WTN) – TBD. (See Attachment 9, Section 6.3.)

   5.3 Customer Billing Charge – See Attachment 14, Exhibit A of Appendix II.

   5.4 Pacific Billing Charge - See Attachment 14, Exhibit A of Appendix II.

   5.5 Pacific Settlement Charge - See Attachment 14, Exhibit A of Appendix II.

Reciprocal Compensation Rate Elements

1. Tandem Switching – For Local Calls terminated by either Party, this element is applicable when the terminating Party provides the tandem switching function.

    (i) Setup per attempt or completed message at the rates specified in Appendix A-1, and
    (ii) Holding time per MOU at the rates specified in Appendix A-1.

2. Common Transport - For Local Calls terminated by either Party, this element is applicable when the terminating Party provides the tandem switching function and transmission facilities between a local tandem and an end office subtending that tandem.

    (i) Fixed Mileage at the rates specified in Appendix A-1, and
    (ii) Variable Mileage at the rates specified in Appendix A-1.

3. Local Switching - Interoffice Terminating – This element applies to all Local Calls terminated by a Party.

    (i) Setup per call at the rates specified in Appendix A-1; and
    (ii) Holding time per MOU at the rates specified in Appendix A-1.

Rates for 911 Arrangements

When AT&T orders 911 arrangements as a facilities based carrier, Pacific's tariff rates shall apply as set forth in Pacific's Schedule CAL PUC A9, Section 9.2, except for E911 trunks which are addressed below. These rates will be used on an interim basis. These rates shall remain in effect until the Commission adopts different rates in any proceeding subsequent to the Effective Date of this Agreement. Once such Commission-determined rates are adopted, said rates will be substituted for the interim rates and shall apply for the remainder of the Term of this Agreement, subject to Section 19 of Attachment 8.

AT&T may, at its option, obtain E911 trunks for connectivity to PACIFIC's E911 selective routers by ordering E911 trunks from Pacific's CAL PUC Schedule A9, Section 9.2, or by ordering Unbundled Dedicated Transport under this Agreement at the rates set forth in Appendix A-1 on an interim basis until the Commission adopts a final rate.

The interim rate for DBMS corrections made by PACIFIC's Data Integrity Unit (DIU) is set forth in Pacific's Schedule CAL PUC A9, Section 9.2.5.

OSS Training Rates

Training Rates	5 day class	4.5 day class	4 day class	3.5 day class	3 day class	2.5 day class	2 day class	1.5 day class	1 day class	1/2 day class
1 to 5 students	$4,050	$3,650	$3,240	$2,835	$2,430	$2,025	$1,620	$1,215	$810	$405
6 students	$4,860	$4,380	$3,890	$3,402	$2,915	$2,430	$1,945	$1,455	$970	$490
7 students	$5,670	$5,100	$4,535	$3,969	$3,400	$2,835	$2,270	$1,705	$1,135	$570
8 students	$6,480	$5,830	$5,185	$4,536	$3,890	$3,240	$2,590	$1,950	$1,300	$650
9 students	$7,290	$6,570	$5,830	$5,103	$4,375	$3,645	$2,915	$2,190	$1,460	$730
10 students	$8,100	$7,300	$6,480	$5,670	$4,860	$4,050	$3,240	$2,430	$1,620	$810
11 students	$8,910	$8,030	$7,130	$6,237	$5,345	$4,455	$3,565	$2,670	$1,780	$890
12 students	$9,720	$8,760	$7,780	$6,804	$5,830	$4,860	$3,890	$2,920	$1,945	$970

Operator Services (when not provided as a UNE):

Fully Automated Call Processing	
Call Completion LATA Wide - Per MOU	$0.00436
Rate per completed automated call	$0.09381
Operator - Assisted Call Processing	
Call Completion LATA Wide - Per MOU	$0.00436
Operator Assisted Call Processing (Per work second)	$0.02967
Call Branding	
Establish/Change Branding Announcement (Per TOPS - Switch)	$447.96 NRC
Operator Services rate/reference information	
Rate per initial load	TBD
Rate per subsequent rate change	TBD
Rate per subsequent reference change	TBD
OA/DA Trunks	
Trunk installation per trunk - initial	$500.00 NRC
Trunk installation per trunk - additional	184.00 NRC
BLV/I Trunks	
Trunk installation per trunk - initial	$500.00 NRC
Trunk installation per trunk - additional	184.00 NRC

Directory Assistance (when not provided as a UNE):

Directory Assistance	
Rate per call	IEC DA Rate in Pacific Bell Schedule Cal.P.U.C D-5, Section 5
Express Call Completion	
Rate per call	$0.14516
Call Completion LATA Wide - Per MOU	$0.00436
Directory Assistance (nationwide listing service)	
Rate per call	$0.82

Call Branding

Establish/Change Branding Announcement (Per TOPS - Switch)	$447.96 NRC

DA rate/reference information

Rate per initial load	TBD
Rate per subsequent rate change	TBD
Rate per subsequent reference change	TBD

ATTACHMENT 18

INTERCONNECTION

ATTACHMENT 18

1. LOCAL INTERCONNECTION TRUNK ARRANGEMENTS

1.1. The Parties will establish Local Interconnection Trunks to exchange Local Traffic, IntraLATA Toll Traffic, and Transit Traffic; provided, however, that either Party may also deliver Local and IntraLATA Toll Traffic to the other Party over Switched Access trunks. Local Interconnection Trunks will be provisioned as one-way trunks unless both Parties agree to implement two-way trunks on a case-by-case basis. Neither Party shall terminate interLATA traffic over Local Interconnection Trunks.

1.2. When the Parties jointly provide Switched Access services to third party carriers, two-way Meet Point Trunks separate from Local Interconnection Trunks will be established for that purpose.

1.3. Interconnection Points

1.3.1 For the purpose of interconnecting AT&T's network with Pacific's network or Unbundled Network Elements provided by PACIFIC, PACIFIC shall permit AT&T to interconnect with PACIFIC at any technically feasible point, including, without limitation, Tandems, End Offices, designated points of interface (facility or switch) or customer premises.

1.3.2 Intentionally omitted.

1.3.3 For the purpose of receiving Local Calls, IntraLATA Toll Calls, Transit Calls and Meet Point Calls (collectively "Interconnection Traffic") from the other Party, the Parties shall mutually agree to the quantity and location of Points of Interconnection ("POIs") that each Party will establish within each respective LATA. The POI locations of one Party may be exactly the same, partially the same or completely different than the POI locations of the other Party.

1.3.3.1 In the event that the Parties cannot reach mutual agreement as to the quantity or location of POIs, the default shall be a PACIFIC POI at the location of each of PACIFIC's Tandem Switches and an AT&T POI at the location of each AT&T switch. A PACIFIC POI is a point on PACIFIC's network where AT&T interconnects and delivers Interconnection Traffic from AT&T's network to PACIFIC. An AT&T POI is a point on AT&T's network where PACIFIC interconnects and delivers Interconnection Traffic from its network to AT&T.

1.3.3.2 For traffic that originates from AT&T and is delivered to a POI at the location of a PACIFIC Tandem Switch, AT&T shall either:

1.3.3.2.1 establish tandem trunks between the AT&T switch and the location of the PACIFIC POI and compensate PACIFIC on

a usage basis for tandem switching and transport to the appropriate PACIFIC end office; or

1.3.3.2.2 establish direct end office trunks between the AT&T switch and the appropriate PACIFIC end office, by AT&T providing facilities between the AT&T switch and the PACIFIC POI, and PACIFIC providing facilities between the PACIFIC POI and the PACIFIC end office. Upon request PACIFIC shall provide such facilities, and direct end office trunks shall be established over these interconnected facilities.

1.3.3.2.3 Notwithstanding PACIFIC's obligations under Section 1.3.3.2.2, as an alternative to the arrangements described in that section, AT&T may, at its option and in its sole discretion, provide or cause to be provided, facilities to any PACIFIC end office and deliver traffic destined for that end office over such facilities.

1.3.3.3 Once POIs are established either by mutual agreement or default, each Party shall specify to the other Party the POI associated with each switch it operates. The sending Party agrees to terminate its Interconnection Traffic to the POI specified by the receiving Party or, when mutually agreed to, a secondary POI identified as part of any jointly-developed trunk service plans.

1.3.3.4 The Parties will work cooperatively to establish the most efficient trunking network in accordance with the provisions set forth in this Agreement and accepted industry practices.

1.3.3.5 On its side of the POIs, each party will be responsible for engineering, provisioning and maintaining facilities on which Local Interconnection Trunks are provisioned.

1.3.3.6 Nothing in this section limits AT&T's right to interconnect with PACIFIC at any technically feasible point for access to Unbundled Network Elements.

1.4 Interconnection Within Each LATA

1.4.1 Each Party will establish Local Interconnection Trunk Groups in the LATA(s) in which it originates or terminates Local and/or IntraLATA Toll Traffic with the other Party.

1.4.2 The Parties may not route traffic sent on Local Interconnection Trunks or Meet Point Trunks to an Access Tandem destined for an NXX that subtends another Tandem. The Parties agree that direct trunking to an end office from either Party's End Office or Access Tandem is permitted under the terms of this section.

1.4.3 Each Party will provide (or cause to be provided) facilities to each POI of the other Party within the LATA. The Parties will utilize such interconnected facilities to establish End Office-to-End Office or End Office-to-Tandem or Tandem-to-Tandem trunk groups.

1.4.4 Each Party shall provide sufficient facilities to deliver its originating Interconnection Traffic to the other Party's applicable POI for termination.

1.5 Methods of Interconnection

1.5.1 The Parties shall interconnect their networks utilizing one of the following methods in accordance with the provisions set forth in this section.

1.5.2 When one Party interconnects with the other Party at the other Party's premises, it will be according to the provisions set forth in the following subsections.

1.5.2.1 AT&T may terminate its interconnection facilities from collocation space in PACIFIC's Eligible Structures. PACIFIC shall provide collocation to AT&T pursuant to the terms set forth in Attachment 10 (Ancillary Functions).

1.5.2.2 AT&T, at its sole discretion, may permit PACIFIC to utilize space and power in AT&T facilities specified by AT&T solely for the purpose of terminating Interconnection Traffic. The pricing, terms and conditions of such arrangement shall be pursuant to Section 12 (Space License).

1.5.2.3 The Parties may mutually agree to establish Mid-Span Fiber Meet arrangements in accordance with the following.

1.5.2.3.1 Each Party shall bear its own costs to install and operate the facilities on its side of the POI.

1.5.2.3.2 The Parties will work cooperatively in the selection of compatible transmission equipment and the location of the Mid-Span Fiber Meet.

1.5.2.3.3 The Parties will work cooperatively to establish joint access to transmission overhead signals and commands for such facilities. The Parties agree that the data communications channel should be disabled on Mid-Span Fiber Meets.

1.5.2.3.4 Trunks provisioned over the Mid-Span Fiber Meet arrangement may be one-way or two-way trunks.

1.5.3. The Parties may chose from the following options as methods for providing interconnection facilities for which the Party is responsible.

1.5.3.1 When available, a Party requesting interconnection may lease facilities offered by the other Party under tariff. Such leased facilities shall be provided at the rates, terms, and conditions set forth in the providing Party's applicable tariff, except that in the event of any conflict between this Agreement and the tariff, the terms of this Agreement shall prevail.

1.5.3.2 The Party requesting interconnection may utilize facilities provided by a third party. The Party utilizing this option shall comply with industry standards to maintain network integrity and shall be solely responsible for any charges or fees assessed by the third party for use of its facilities.

1.5.3.3 AT&T may utilize the Network Elements provided by PACIFIC pursuant to Attachment 6, at the rates set forth in Attachment 8, for interconnection facilities.

1.5.3.4 The Parties may agree to establish a POI and use intra-building cable within a commercial building (other than a telephone central office) where both have constructed broadband facilities into the building.

1.5.3.5 The Parties may mutually agree to and may utilize any other technically feasible method of interconnection.

1.6 Sizing and Structure of Interconnection Facilities.

1.6.1 The Parties agree to jointly manage the capacity of Local Interconnection Trunk Groups by developing and implementing engineering guidelines which will encourage the economic deployment of increasingly robust and diverse interconnection between their networks. The Parties agree that these guidelines, when developed, will form the basis for creation of additional trunking. The respective engineering groups will work cooperatively to assure that reasonable diversity is achieved among the trunk groups between each Party's switches within each LATA.

1.6.2 The capacity of interconnection facilities provided by each Party will be based on mutual forecasts and sound engineering practice, as mutually agreed to by the Parties during planning and forecasting meetings.

1.6.3 The interconnection facilities provided by each Party shall be formatted using either Alternate Mark Inversion Line Code or Superframe Format Framing. DS3 facilities will be optioned for C-bit Parity where technically feasible.

1.6.4 The Parties agree to utilize Bipolar 8 Zero Substitution Extended Super Frame ("B8ZS ESF") facilities where available to establish 64KB CCC trunks. Where additional equipment is required, such equipment shall be obtained, engineered, and installed on the same basis and with the

same intervals as any similar growth job for IXC, CLC, or PACIFIC internal customer demand for 64K CCC trunks.

1.6.5 When interconnecting at PACIFIC 4ESS access tandems but not any other type of tandem switches, sixty four kilobit clear channel capability (64 K CCC) ISDN calls cannot be combined with voice calls on the same B8ZF ESF facilities and trunk group. Trunk groups that carry voice only traffic will be provisioned with AMI line code and SF framing facilities.

1.6.6 When interconnecting at PACIFIC's digital end offices, the Parties have a preference for use of B8ZS ESF facilities and 64CCC trunks for all traffic between their networks. Where available, such trunk equipment will be used for Local Interconnection Trunk Groups. Where AMI facilities with non-64KB CCC trunks are used, either Party may request upgrade to B8ZS ESF facilities and 64KB CCC trunks when such equipment is available.

1.6.7 Interconnection will be established utilizing either a DS-1 or DS-3 interface, or with the mutual agreement of the Parties, another technically feasible interface (*e.g.,* STS-1).

1.7 Intentionally omitted.

1.8 Signaling Protocol. The Parties will interconnect their networks using SS7 signaling as defined in GR-317 and GR-394, including ISDN User Part ("ISUP") for trunk signaling and Transaction Capabilities Application Part ("TCAP") for CCS-based features in the interconnection of their networks. Either Party may establish CCS interconnections either directly and/or through a third party. CCS interconnection, whether direct or by third party shall be pursuant to PUB L-780023-PB/NB and in accordance with the rates, terms and conditions of the Parties' respective tariffs. The Parties will cooperate in the exchange of TCAP messages to facilitate full interoperability of CCS-based features between their respective networks, including all CLASS features and functions, to the extent each carrier offers such features and functions to its own end users. The Parties will provide all CCS signaling parameters, including CPN, and will honor all privacy indicators.

1.9 Transit Signaling: AT&T may choose to route SS7 signaling information (e.g., ISUP, TCAP) from AT&T's signaling network to another carrier's signaling network via PACIFIC's signaling network for the purpose of signaling call processing and network information between AT&T and the other carrier's network, whether or not PACIFIC has a direct-traffic trunk to the terminating address, provided that AT&T furnishes PACIFIC with:

1.9.1 the destination point codes of all the switches to which it wishes to send transit signaling;

1.9.2 the identity of the STPs in PACIFIC's network in which each DPC will be translated;

1.9.3 the identity of the STPs in the other signaling network to which such transit signaling will be sent; and

1.9.4. a letter from the other party authorizing PACIFIC to send such signaling messages

AT&T agrees to pay the rates for Transit Signaling as specified in Attachment 8.

1.10 Each Party shall deliver to the other Party over the Local Interconnection Trunk Group(s) only such traffic which is destined for those publicly dialable NPA NXX codes served by end offices that directly subtend the Access Tandem or to those LECs, CLCs and CMRS providers that directly subtend the Access Tandem.

1.11 Intentionally omitted.

1.12 Unless otherwise agreed to, each Party shall deliver all traffic destined to terminate at either Party's end office or tandem in accordance with the serving arrangements defined in the Local Exchange Routing Guide ("LERG").

1.13 Where the Parties deliver over the Local Interconnection Trunk group miscellaneous calls (e.g., time, weather, NPA-555, California 900, Mass Calling Codes) destined for each other, they shall deliver such traffic in accordance with the serving arrangements defined in the LERG.

1.14 N11 codes (e.g.,411, 611 and 911) shall not be sent between AT&T's and PACIFIC's network over the Local Interconnection Trunk groups. Where necessary (e.g., 911), the Parties will establish separate trunk groups to carry traffic associated with such codes.

1.15 The Parties will convert all existing interconnection arrangements and trunks to the interconnection arrangements described in this Attachment 18 in accordance with the following:

1.15.1 Within 45 days after the Effective Date of this Agreement, the Parties will mutually develop an operations plan based on sound engineering and operations principles, which will specify the guidelines to convert from the existing interconnection arrangements to the interconnection arrangements described in this Attachment 18. Such guidelines will conform to standard industry practices, such as OBF procedures.

1.15.2 Each Party shall bear its own costs to convert from the existing interconnection arrangements to the interconnection arrangements described in this Attachment 18.

1.15.3 The Parties will complete the conversion within one year of the Effective Date of this Agreement, unless otherwise mutually agreed.

1.15.4 If, following one year after the Effective Date of the Agreement, there exist any interconnection arrangements that have not been converted

to the interconnection arrangements described in this Attachment 18, then either Party may elect to initiate an Alternative Dispute Resolution proceeding, pursuant to Attachment 3 of this Agreement, to require the other party to complete such conversion, and to obtain per-diem liquidated damages in the amount of $20 per trunk per day from the other Party for each interconnection trunk that remains under the former interconnection arrangement due to the fault of that Party.

2. ~~THIRD-PARTY (TRANSIT) TRAFFIC~~

~~2.1 Transit Traffic Service provides the first Party with the ability to use its connection to the second Party's tandem and/or transport facilities for the delivery of calls which originate or terminate with the first Party and terminate to or originate from a carrier other than the second Party, such as another LEC or a wireless carrier.~~

~~2.2 PACIFIC shall terminate traffic from third-party LECs, CLCs, or CMRS providers delivered to PACIFIC's network through an AT&T tandem. Transit traffic shall be considered within the scope of forecasting obligations set forth in Section7 below.~~

~~2.3 Intentionally omitted.~~

~~2.4 PACIFIC shall complete traffic delivered from AT&T destined to third-party LECs, CLCs or CMRS providers in the LATA. PACIFIC shall have no responsibility to ensure that any third-party LEC, CLC or CMRS provider will accept such traffic.~~

~~2.5 PACIFIC shall accept, from any third-party LEC, CLC, or CMRS provider in the LATA, traffic destined to AT&T and shall terminate such traffic to AT&T's network.~~

3. ~~COMPENSATION FOR CALL TERMINATION~~

~~3.1 In all cases, Resale Services (whether purchased by AT&T or a third party) provided by PACIFIC will be treated in the same manner as PACIFIC's End User customers for the purposes of call termination charges.~~

~~3.2 For purposes of compensation under this Agreement, the telecommunications traffic traded between AT&T and PACIFIC will be classified as either Local, Transit, IntraLATA Toll, or InterLATA toll. The Parties agree that, not withstanding the classification of traffic in this Agreement, either Party is free to define their own "local" calling areas for purposes or its provision of telecommunications services to its end users. The provisions of this Attachment apply to calls originated over the originating carrier's facilities or, unless otherwise provided in the Agreement, over unbundled network elements. AT&T shall not provision Feature Group A services over Pacific's network until compensation arrangements are established.~~

~~3.3. Intentionally omitted.~~

~~3.4 The compensation arrangements set forth in this Attachment are not applicable to (i) Exchange Access traffic, (ii) traffic originated by one Party on a number ported to its network that terminates to another number ported on that same Party's network or (iii) any other type of traffic found to be exempt from reciprocal compensation by the FCC or the Commission.~~

~~3.5 Reciprocal Compensation applies to traffic terminated at either parties' end office switch. Traffic that is delivered from a DSLAM directly to an ISP and that bypasses the terminating switch is not subject to intercarrier compensation.~~

~~3.6 The Parties shall bill each other reciprocal compensation in accordance with the standards set forth in this Agreement for Local Calls. Such traffic shall be recorded and transmitted to AT&T in accordance with Attachment 13 (Billing and Recording) of this Agreement. Reciprocal compensation for the transport and termination of Local Traffic shall be charged at rates specified in Attachment 8 (Pricing) of this Agreement. Pacific Bell and AT&T shall receive the end-office terminating switching rate for termination of all Local Calls, and the tandem switching and common transport rates when those functions are provided.~~

~~3.7 Where AT&T provides service to an AT&T Customer using any combination of Network Elements that includes the unbundled local switching Network Element, AT&T will deal directly with a third party carrier for purposes of reciprocal compensation. The following reciprocal compensation terms shall apply in all cases where AT&T purchases PACIFIC's LSNE. These terms and conditions are in addition to the terms and conditions outlined in Attachment 6. Pacific is required to provide AT&T with timely, complete and correct information to enable AT&T to meet the requirements of this section.~~

~~3.7.1 For Local intra-switch calls where AT&T has purchased PACIFIC's LSNE, the Parties agree to impose no call termination charges pertaining to reciprocal compensation on each other.~~

~~3.7.2 For local inter-switch calls where AT&T has purchased PACIFIC's LSNE, and AT&T's end user originates a call that is terminated to a PACIFIC end user, AT&T will pay PACIFIC local switching-interoffice terminating reciprocal compensation.~~

~~3.7.3 For local inter-switch calls where AT&T has purchased PACIFIC's LSNE, and PACIFIC's end user originates a call that is terminated to an AT&T end user, PACIFIC will not pay AT&T local switching-interoffice terminating reciprocal compensation, nor will PACIFIC bill AT&T local switching-interoffice terminating for the use of the local switching UNE.~~

~~3.8. Nothing in this Agreement shall be construed in any way to constrain either Party's choices regarding the size of the local calling areas that it may establish for its customers.~~

~~3.9 For purposes of the reciprocal compensation provisions of this Agreement, except for traffic that is delivered from a DSLAM directly to an ISP and that bypasses the terminating switch, all traffic that is exchanged between the Parties and that is originated by or terminated to an enhanced service provider shall be~~

~~settled on the same basis as if such traffic were a voice telephone call. Accordingly, Local Traffic originated by or terminated to any enhanced service provider, including internet service providers, is subject to payment of reciprocal compensation under this Agreement.~~

~~3.10 Intentionally omitted.~~

~~3.11 Intentionally omitted.~~

~~3.12 Neither party shall be prohibited from designating different rating and routing points for the delivery of telephone calls for purposes of providing customers a local presence within a foreign exchange. Calls shall be rated in reference to the rate center of the assigned NXX prefix of the calling and called parties' numbers. PACIFIC is entitled to receive tandem switching and transport compensation for its facilities used in the carriage of traffic from the rate center where the calling party physically resides to the point of interconnection closest to the switch used for terminating calls to the NXX rate center where the call terminates. This section is applicable only to traffic with disparate rating and routing points. The outcome of the Commission's rulemaking in R.00-02-005 on this issue will be incorporated into this Agreement on a prospective basis.~~

~~3.13 Compensation for terminating IntraLATA Toll Calls is governed by each Party's applicable tariff.~~

~~3.14 Intentionally omitted.~~

~~3.15 AT&T and PACIFIC may establish meet-point billing ("MPB") arrangements to provide a common transport option to Switched Access customers via an access tandem switch maintained by either Party, in accordance with the MPB guidelines adopted by and contained in the Ordering and Billing Forum's MECAB and MECOD documents, except as may be otherwise agreed in this Agreement. The arrangements described in this Section 3.15 are intended to be used to provide Switched Access service that originates and/or terminates on a telephone exchange service that is provided by either Party, where the transport component of the switched Exchange Access service is routed through a tandem switch that is provided by either Party.~~

~~3.16 In each LATA, the Parties shall establish MPB arrangements between the applicable rating point/PACIFIC local serving wire center combinations.~~

~~3.17 Interconnection for the MPB arrangement shall occur as outlined in Section 4 (Meet-Point Trunking Arrangements) of this Attachment.~~

~~3.18 The rate elements to be billed by each Party are as set forth in Attachment 13 (Billing and Recording) of this Agreement.~~

~~3.19. Transit Traffic Compensation:~~

~~3.19.1 The Transit Rate element applies when one Party sends Local or IntraLATA Toll traffic to a third party network through the other Party's tandem. The originating Party is responsible for payment of the Transit Rate. The Transit Rate element is only applicable when calls~~

~~do not terminate to the other Party's End User. The Transit Rate is specified in Attachment 8.~~

~~3.19.2 In the event one Party originates traffic that transits the other Party's network to reach a third party telecommunications carrier with whom the originating Party does not have a traffic interexchange agreement, then the originating Party will pay the transiting Party any lawful charges that any terminating third-party carrier imposes or levies on the transiting Party for the delivery or termination of such traffic, provided that (i) such charges are no greater than those that would be imposed or levied on, or incurred by, the transiting Party if such traffic were originated by the transiting Party rather than the other Party, (ii), the transiting Party provides to the originating Party data supporting the transiting Party's belief that the originating Party is responsible for the third party charges and (iii) the transiting Party provides the originating Party with notice of such proposed charges and the opportunity to contest such charges with the third party carrier prior to making payment. Neither the terminating party nor the tandem provider will be required to function as a billing intermediary, e.g. clearinghouse.~~

~~3.19.3 Subject to section 3.19.6 below, AT&T shall not bill PACIFIC for terminating any Transit traffic, whether identified or unidentified, i.e. whether PACIFIC is sent CPN or is not sent CPN by the originating company. However, in the event AT&T indicates to Pacific that unidentified transit traffic volume has become significant, Pacific agrees to work with AT&T to explore alternatives and to devise a jointly agreed approach to minimizing the amount of unidentified transit traffic.~~

~~3.19.3.1 The transiting Party will pass the original and true CPN if it is received from the originating third party.~~

~~3.19.4 Consistent with the requirements of Attachment 13 (Billing and Recording) of this Agreement, each Party will calculate terminating interconnection minutes of use based on standard Automatic Message Accounting ("AMA") recordings made within each Party's network. Except as may otherwise be provided in this Agreement, these recordings will be the basis for each Party to generate bills to the other Party. Where available, each Party agrees to forward to the other with each call information that may be used to identify the originating and terminating telephone numbers for each call and each carrier involved in transmission of the call.~~

~~3.19.5 Intentionally omitted.~~

~~3.19.6 Where the Parties are performing a transiting function as defined in Section 2.1 above and AT&T is a PACIFIC LSNE user, the transiting Party will pass the original and true CPN if it is received from the originating carrier. The transiting Party will also provide records in~~

~~accordance with Attachment 14, including providing the OCN of the originating third party carrier to the terminating Party. In the event that the originating OCN is not included in the records provided to AT&T from PACIFIC, PACIFIC will be billed for termination of calls on a default basis.~~

~~3.19.7 Meet-Point Billing compensation arrangements are described in Attachment 13 (Billing and Recording), Section 8.~~

~~3.19.8 The Parties expect that most networks involved in Transit Traffic wil deliver each call to each involved network with CCS and the appropriate TCAP message to facilitate full interoperability of those services supported by ILEC and billing functions. PACIFIC agrees to ensure that AT&T receives, in accordance with the record transfer provisions of Attachment 14 (Provision of Customer Usage Data) of this Agreement, equivalent information on all calls that are originated by any other LEC, CLC or CMRS provider with which PACIFIC interconnects and which are subsequently terminated to AT&T.~~

~~3.19.9 AT&T may, in its sole discretion, offer Transit Traffic services to PACIFIC or other third parties that originate or terminate Transit Traffic. Compensation arrangements for such services shall be comparable to those applicable to Transit Traffic services provided by PACIFIC.~~

~~3.20 For intraLATA Toll Free Service (8YY) calls where such service is provided by one of the Parties, the compensation set forth in this Section 3, shall be charged to the 800 service provider terminating the call~~

~~3.20.1 Only queried intraLATA 800 traffic shall be delivered to PACIFIC over the Local intraLATA Trunks. If the queried 800 traffic is determined to be InterLATA than the traffic must be delivered over the Meet Point Trunks/800 Trunks. If PACIFIC performs the 800 query function, the Traffic shall be delivered to PACIFIC over the Meet Point Trunks/800 Trunks. If the Local/intraLATA Trunks are used and Requesting Carrier performs the 800 query function, the intraLATA 800 Traffic will be recorded as interconnection.~~

~~3.20.2 The Parties shall provide to each other intraLATA 800 Access Detail Usage Data for Customer billing and intraLATA 800 Copy Detail Usage Data for access billing in Exchange Message Interface (EMI) format. The Parties agree to provide this data to each other at no charge. In the event of errors, omissions, or inaccuracies in data received from either Party, the liability of the Party providing such data shall be limited to the provision of corrected data only. If the originating Party does not send an End User billable record to the terminating Party, the originating Party will not bill the terminating Party any interconnection charges for this traffic.~~

~~3.20.3 IntraLATA 800 Traffic calls are billed to and paid for by the called or terminating 800 service provider, regardless of which Party performs the 800 query.~~

~~3.21 Each Party will calculate terminating interconnection minutes of use based on standard Automatic Message Accounting ("AMA") recordings made within each Party's network. These recordings are the basis for each Party to generate bills to the other Party. Either Party may request the exchange of originating EMI records in order to bill the other Party terminating minutes of use. The Parties agree to cooperate in the exchange of the records if so requested.~~

~~3.22 Measurement of minutes of use over Interconnection Trunk groups shall be in actual conversation seconds based upon a tenth of a second increment. The total conversation seconds over each individual trunk group will be totaled for the entire monthly bill and then rounded to the next whole minute.~~

~~3.23For those usage based charges where actual charge information is not determinable by PACIFIC because the jurisdiction (i.e., intrastate vs. local) or origin of the traffic is unidentifiable, the Parties will jointly develop a Percent Local Usage (PLU) factor in order to determine the appropriate charges. PLU is calculated by dividing the Local MOU delivered to a Party for termination by the total MOU delivered to a Party for termination.~~

~~3.24 AT&T will pay the rates for SS7 CCS interconnection as specified in Attachment 8. The Parties will exchange TCAP messages to facilitate full interoperability of CCS-based features and functions, to the extent each carrier offers such features and functions to its own end users. All CCS signaling parameters will be provided, including CPN. All privacy indicators will be honored. The Parties will provide all line information signaling parameters including, but not limited to, Calling Party Number, Charge Number (if it is different from calling party number), and originating line information ("OLI"). For terminating FGD, either Party will pass any CPN it receives from other carriers. Where available, network signaling information such as Transit Network Selection ("TNS") parameter (SS7 environment) will be provided by the end office Party wherever such information is needed for call routing or billing. Where TNS information has not been provided by the end office Party, the tandem Party will route originatng Switched Access traffic to the IXC using available translations. The Parties will follow all industry Ordering and Billing Forum (OBF) adopted guidelines pertaining to TNS codes.~~

~~3.25 For 976 or California 900 calls (those 900 NXXs shown in the LERG as PACIFIC's 900 NXXs), AT&T shall deliver calls originated over AT&T-provided exchange services to the Local Interconnection Trunk groups. The Parties have separately reached agreement on the rating and billing of such calls.~~

4. MEET-POINT TRUNKING ARRANGEMENTS

4.1 With respect to Meet Point traffic, the Parties shall establish Meet Point Trunk groups separate from Local Interconnection Trunks.

4.2 Either Party may provide the tandem transport and switching functions and either Party may use Meet Point Trunks to send and receive Feature Group B and D ("FGB and FGD") Switched Access traffic to customers who are connected to the other Party's access tandem. If it so elects, the Switched Access customer may direct which Party will provide each function based on Access Service Requests ("ASRs") placed with both Parties

4.3 The Parties will use facilities and two-way Meet Point Trunk groups in GR-394-CORE format to jointly provide Switched Access services under this Section 4. Neither Party will charge the other any amount for any meet-point facilities, including multiplexing and cross connects. The Parties will agree to the allocation of revenues from such Switched Access services based on MECOD/MECAB guidelines.

4.4 Notwithstanding the interim arrangements described Section 4.5, in the case of Switched Access services provided through either Party's Access Tandem, the Party providing the access tandem transit will have no responsibility for ensuring that the Switched Access service customer will accept or pay for the traffic. Nor will either party offer blocking capability for Switched Access traffic delivered to either Party's tandem for completion on either Party's network. Each Party agrees to furnish the other with a list of those IXCs that interconnect with the Party's tandems.

4.5 For so long as AT&T does not seek to provide Access Tandem service to Switched Access customers, the Parties agree that Meet-Point Trunk arrangements are available and functional only to or from Switched Access customers who directly connect with PACIFIC's tandems that AT&T subtends in each LATA. During that interim period PACIFIC will not be required to route such traffic through more than one tandem for connection to or from Switched Access customers.

4.6 Notwithstanding the interim arrangements described in Section 4.5, the Parties agree to cooperate in determining the future technical feasibility of routing originating Meet Point Billing traffic via a tandem of one Party and a tandem of the other Party for the purpose of delivering such traffic to the Switched Access customer. If such an arrangement is found to be technically feasible, the Parties will cooperate in implementing the arrangement, including the adoption of appropriate compensation terms.

4.7 The Parties will exchange SS7 signaling messages with one another, where and as available, in conjunction with Meet Point Trunk groups. The Parties will provide all line information signaling parameters including, but not limited to, Calling Party Number, Charge Number (if it is different from calling party number), and originating line information ("OLI"). For terminating FGD, either Party will pass any CPN it receives from other carriers. AT&T may establish SS7 interconnections (either directly or through a third party), provided such third party is interconnected with PACIFIC pursuant to inter- and intra-state access

tariffs. The Parties will exchange TCAP messages to facilitate full interoperability of SS7-based features between their respective networks, including all CLASS features and functions, to the extent each carrier offers such features and functions to its own end users. All privacy indicators will be honored. Where available, network signaling information such as Transit Network Selection ("TNS") parameter (SS7 environment) will be provided by the end office Party wherever such information is needed for call routing or billing. Where TNS information has not been provided by the end office Party, the tandem Party will route originating Switched Access traffic to the IXC using available translations The Parties will follow all Ordering and Billing Forum (OBF) adopted standards and guidelines pertaining to TNS codes.

4.8 At AT&T's request, one-way Meet Point Trunks will be established by the Parties to enable AT&T to deliver undipped 8YY traffic from AT&T Customers served by AT&T 4ESS switches to the LEC SSP for dipping in the Industry Toll Free Data Base. The facilities for this trunk group will be provided by AT&T, unless otherwise agreed to by Pacific. AT&T shall deliver all other originating Toll Free Service calls for switches that are not 4ESS for which it requests that PACIFIC perform the Service Switching Point ("SSP") function (e.g., performs the database query) over the two-way Meet-Point Trunk group. These trunk groups shall use GR-394-CORE format signaling. AT&T shall use Carrier Code "0110" and Circuit Code of "08" for all such calls. Charges for dipping and transport to the IXC will be billed in accordance with meet point guidelines.

4.9 When AT&T performs the SSP function for Toll Free Service calls, and if such calls are destined for an IXC, if AT&T delivers such calls to PACIFIC it shall do so over Meet Point Trunk groups using GR-394 format. When AT&T performs the SSP function for Toll Free service calls, and if such calls are destined for NXXs within the LATA, if AT&T delivers such calls to PACIFIC, it shall do so over the Local Interconnection Trunk Group using GR-317 format.

4.10 Originating Feature Group B calls delivered to PACIFIC's tandem shall use GR-317 signaling format unless the associated FGB carrier employs GR-394 signaling for its FGB traffic at the serving Access Tandem.

5. ADDITIONAL RESPONSIBILITIES OF THE PARTIES

~~5.1 AT&T and PACIFIC agree to exchange such reports and/or data as provided in this Attachment to facilitate the proper billing of traffic. Either Party may request an audit of such usage reports on no fewer than thirty (30) business days written notice and any audit shall be accomplished during normal business hours at the office of the Party being audited (which shall be Atlanta, Georgia for AT&T and San Francisco for PACIFIC). Such audit must be performed by a mutually agreed-to auditor paid for by the Party requesting the audit. Such audits shall be requested within six months of having received the usage reports from the other Party and may not be requested more than twice per year, once per calendar year for each call detail type unless the audit finds there has been a 20% or higher net error or variance in calculations, in which case a subsequent audit is required. Based upon the audit, previous compensation, billing and/or settlements will be adjusted for the past six (6) months. Also, if the PLU is adjusted based upon the audit results, the adjusted PLU will apply for the six (6)~~

~~month period following the completion of the audit. If, as a result of the audit, either Party has overstated the PLU or underreported the call detail usage by twenty percent (20%) or more, that Party shall reimburse the auditing Party for the cost of the audit and will pay for the cost of a subsequent audit which is to happen within nine (9) months of the initial audit.~~

~~5.2 Where SS7 connections exist, each Party will include in the information transmitted to the other for each call being terminated on the other's network, where available, the original and true Calling Party Number (CPN).~~

~~5.3 If one Party is passing CPN but the other Party is not properly receiving information, the Parties will work cooperatively to correct the problem.~~

~~5.4 Where SS7 connections exist, if the percentage of calls passed with CPN is greater than ninety percent (90%), all calls exchanged without CPN information will be billed as either Local Traffic or intraLATA Toll Trafficin direct proportion to the minutes of use (MOU) of calls exchanged with CPN information. If the percentage of calls passed with CPN is less than ninety percent (90%), all calls passed without CPN will be billed as intraLATA switched access.~~

5.5 Intentionally omitted.

5.6 For one-way Local Interconnection Trunks and trunk groups, the originating carrier shall be responsible for all Control Office functions and for the overall coordination, installation, and maintenance of those trunks and trunk groups. The terminating carrier shall cooperate with the originating carrier as necessary for installation, augmentation and maintenance of one-way interconnection trunks and trunk groups. During the transition from two-way to one-way interconnection trunks, the Parties shall share responsibility for Control Office functions for the two-way trunks and trunk groups, and both parties shall share the overall coordination, installation, and maintenance responsibilities for the two-way trunks and trunk groups. For Meet Point Billing Trunks and trunk groups, the end office Party shall be responsible for all Control Office functions, and shall be responsible for the overall coordination, installation, and maintenance responsibilities for those trunks and trunk groups.

5.7 The Parties shall deliver over any Local Interconnection Trunk group groomed for a specific access tandem only traffic destined for those publicly-dialable NPA NXX codes served by: (1) end offices that directly subtend the access tandem; (2) other PACIFIC end offices that do not normally subtend such tandem, for which calls are routed to that end office on an alternate routing basis; and (3) those providers (including, but not limited to CMRS providers, other independent LECs, and CLCs) that directly connect to the access tandem.

5.8. The Parties shall deliver over any Local Interconnection Trunk group groomed for a specific end office only traffic destined for those publicly-dialable NPA NXX codes served by that end office, unless otherwise agreed to by the Parties.

5.9 Each Party shall establish procedures whereby its operator bureau will coordinate with the operator bureau of the other Party in order to provide BLV/BLVI services on calls between their respective line side end users. BLV

and BLVI inquiries between operator bureaus shall be routed over the Local Interconnection Trunk Group(s) using network-routable access codes published in the LERG.

5.10 AT&T and PACIFIC shall:

5.10.1 Provide trained personnel with adequate and compatible test equipment to work with each other's technicians. The Parties will implement trouble and testing procedures.

5.10.2 Notify each other when there is any change affecting the service requested, including the due date.

5.10.3 Coordinate and schedule testing activities of their own personnel, and others as applicable, to ensure its interconnection trunks/trunk groups are installed per the interconnection order, meet agreed upon acceptance test requirements, and are placed in service by the due date.

5.10.4 Perform sectionalization to determine if a trouble is located in its facility or its portion of the interconnection trunks prior to referring the trouble to each other.

5.10.5 Advise each other's Control Office if there is an equipment failure that may affect the interconnection trunks.

5.10.6 Provide each other with a trouble reporting number that is readily accessible and available 24 hours/7 days a week.

5.10.7 Provide to each other test-line numbers and access to test lines, including a test-line number that returns answer supervision in each NPA-NXX opened by a Party.

5.10.8 To ensure that blocking standards are being met, PACIFIC agrees to provide upon request of AT&T, the following information on all trunks, regardless of the type of traffic being transported:

5.10.8.1 percentage of Pacific's common transport trunk groups that exceed blocking thresholds,

5.10.8.2 for two-way trunk groups, usage data (including, but not limited to, usage, peg and overflow counts) for each AT&T trunk group subtending PACIFIC's tandem will be used to determine which AT&T traffic by trunk group is being blocked, and for one-way trunk groups, information on any AT&T trunk groups that are blocked will be provided pursuant to Section 14 of the Preface (General Terms and Conditions) of this Agreement, and

5.10.8.3 the Pacific common transport trunk groups (with A and Z location) that exceed blocking thresholds.

5.10.8.4 At AT&T's option, PACIFIC will provide blockage data by NXX trunk group. AT&T and PACIFIC shall negotiate the terms for this special systems development work.

5.10.9 AT&T and PACIFIC will provide their respective billing contact numbers to one another on a reciprocal basis.

5.10.10 The Parties will conduct cooperative testing for the proper recording of AMA records in each carrier switch(es) before establishing service.

6. INSTALLATION OF TRUNKS

6.1 Installation of Local Interconnection Trunk groups and Meet Point Trunks covered by this Agreement are subject to the performance measures and remedies described in Section 14 of the Preface (General Terms and Conditions) of this Agreement.

7. TRUNK FORECASTING

7.1 The Parties shall work towards the development of joint forecasting responsibilities for traffic utilization over trunk groups. Orders for trunks that exceed forecasted quantities for forecasted locations will be accommodated as facilities and/or equipment becomes available. The Parties must provide forecast information to each other twice a year. The semi-annual forecasts shall include:

7.1.1 Yearly forecasted trunk quantities (which include measurements that reflect actual Local Interconnection and Meet Point Trunk groups and end office equivalent trunking requirements, whether or not tandem subtending) for a minimum of three (current and plus-1 and plus-2) years;

7.1.2 The use of Common Language Location Identifier, described in Bellcore documents BR 795-100-100 and BR 795-400-100 and;

7.1.3 A description of major network projects anticipated for the following six months. Major network projects include trunking or network rearrangements, shifts in anticipated traffic patterns, or other activities that are reflected by a significant increase or decrease in trunking demand for the following forecasting period.

7.2 If differences in semi-annual forecasts of the Parties vary by more than 48 additional DS0 trunks for each Local Interconnection Trunk group, the Parties shall meet to reconcile the forecast to within 48 DS0 trunks.

7.3 Each Party shall provide a specified point of contact for planning, forecasting and trunk servicing purposes.

8. GRADE OF SERVICE

8.1 A blocking standard of one half of one percent (.005) during the average busy hour for final trunk groups between the Parties' networks carrying Meet-Point traffic shall be maintained. All other final trunk groups shall be engineered with a blocking standard of one percent (.01).

9. LOCAL INTERCONNECTION TRUNK SERVICING

9.1 Orders between the Parties to establish, add, change or disconnect trunks shall be processed by use of an Interconnection Service Request ("ISR") for AT&T orders to PACIFIC or an Access Service Request "ASR" for PACIFIC orders to AT&T, or other methods as may be mutually agreed to by the Parties.

9.2 PACIFIC's Circuit Provisioning Assignment Center ("CPAC") or successor center and AT&T's equivalent center will send a Trunk Group Service Request ("TGSR") to the other Party to trigger changes to the Local Interconnection Trunk Groups based on capacity assessment. Either Party upon receipt of the TGSR will issue an ISR/ASR to the other Party:

9.2.1 Within 10 business days after receipt of the TGSR; or

9.2.2 At any time as a result of either Party's own capacity management assessment, in order to begin the provisioning process.

9.3 Orders that comprise a major project shall be submitted at the same time, and their implementation shall be jointly planned and coordinated. Major projects are those that require the coordination and execution of multiple orders or related activities between and among PACIFIC and AT&T work groups including, but not limited to, the initial establishment of Local Interconnection or Meet Point Trunk groups and service in an area, NXX code moves, re-homes, facility grooming, or network rearrangements.

9.4 The Parties will cooperate to establish separate high-volume trunk groups for the completion of calls to high volume customers, such as radio contest lines.

9.5 AT&T will be responsible for engineering its network on its side of the POI. PACIFIC will be responsible for engineering its network on its side of the POI.

10. TROUBLE REPORTS

10.1 AT&T and PACIFIC will cooperatively plan and implement coordinated repair procedures for the Meet Point and Local Interconnection Trunks and facilities to ensure that trouble reports are resolved in a timely and appropriate manner consistent with procedures referenced in Section 5 of this Attachment.

11. NETWORK MANAGEMENT

11.1 Protective Controls. Either Party may use protective network traffic management controls, such as 7-digit and 10-digit code gaps, on traffic toward each other's network, when required to protect the public switched network from congestion due to facility failures, switch congestion or failure, or focused overload. AT&T

and PACIFIC will immediately notify each other of any protective control action planned or executed.

11.2 Expansive Controls. Where the capability exists, either Party may implement originating or terminating traffic reroutes to relieve network congestion temporarily due to failures or abnormal calling patterns. Reroutes will not be used to circumvent normal trunk servicing. Expansive controls will only be used when the Parties mutually agree.

11.3 Mass Calling. AT&T and PACIFIC shall cooperate and share pre-planning information regarding cross-network call-ins expected to generate large or focused temporary increases in call volumes.

12. SPACE LICENSE

12.1 AT&T, at its sole discretion, may license PACIFIC to situate PACIFIC equipment in an AT&T central office and to utilize AT&T site support services in the AT&T central office such as power, heating, ventilation, air conditioning and security for such equipment, for the sole purpose of delivering Interconnection Traffic to AT&T for completion. Such licenses and site support services are referred to herein collectively as a "Space License."

12.2 The only allowable network interfaces under a Space License are DS1 and DS3.

12.3 Space Licenses are available at AT&T's sole discretion and are further subject to the availability of space and site support services in each AT&T central office. To establish a Space License, PACIFIC must complete and submit a questionnaire providing requested information to support new space and site support services or to provide additional capacity for existing arrangements.

12.3.1 In completing the questionnaire, PACIFIC shall identify the quantity, manufacturer, type and model of any equipment to be installed; the quantity, type and specifications of any transmission cable to be installed (collectively "Licensed Facilities"). The space in the AT&T central office in which PACIFIC's equipment is or is to be located is referred toherein as the "Equipment Space."

12.3.2 PACIFIC is responsible for the installation of Licensed Facilities in accordance with AT&T's installation processes and procedures.

12.3.3 If PACIFIC desires to modify its request, prior to notification from AT&T regarding availability, PACIFIC may do so by requesting that AT&T cancel the original request providing a new questionnaire to AT&T to process.

12.4 Following receipt of the questionnaire, AT&T will determine whether there is sufficient AT&T central office space and site support services to meet the request contained in PACIFIC's questionnaire. AT&T will notify PACIFIC in writing whether there is sufficient AT&T central office space available for each such request.

12.5 Upon receiving written notification of the availability of AT&T central office space from AT&T, PACIFIC will provide written verification that it still requires such AT&T central office space. This written notification is PACIFIC's firm order for each AT&T central office space requested, and will constitute an executed Space License under the terms of this Agreement.

12.6 AT&T agrees to provide site support services as follows:

12.6.1 AT&T will design, engineer, furnish, install, and maintain cable racks for PACIFIC's use.

12.6.2 AT&T will design, engineer, furnish, install, and maintain a battery distribution fuse board (BDFB) from which AT&T will supply DC power to PACIFIC.

12.6.3 AT&T will provide common use convenience outlets (120V) as required for test equipment, etc. within Equipment Space.

12.6.4 AT&T will maintain temperature and humidity conditions for the Equipment Space within substantially the same ranges that AT&T maintains for its own similar equipment.

12.7 AT&T will specify the location and dimensions of the Equipment Space and at its sole discretion will specify any physical or space separation requirements.

12.8 PACIFIC will use the Space Licenses for the sole purpose of delivering its Interconnection Traffic to AT&T, so that AT&T may complete such calls. PACIFIC agrees not to make any other use of the Space Licenses without the advance written consent of AT&T.

12.9 Upon reasonable advance notice and for the limited purpose of performing work for which PACIFIC is responsible under this Agreement, AT&T licenses PACIFIC to enter and exit the Equipment Space through portions of the AT&T central office as designated by AT&T. Unless a service outage is occurring or appears to be imminent, PACIFIC shall perform its work in the AT&T central office during regular business hours as designated from time to time by AT&T. AT&T will honor other Pacific reasonable requests for "out of normal hours" access to its Equipment Space. PACIFIC shall compensate AT&T for all additional expenses AT&T incurs in granting such "out of normal hours" access.

12.10 PACIFIC shall either furnish to AT&T, and keep current, a written list of all PACIFIC's employees and AT&T approved contractors authorized to enter the Equipment Space, or provide a 24 hour local or toll-free telephone number which AT&T can use to verify the authority of such persons. PACIFIC shall also furnish to AT&T, and keep current, samples of the identifying credentials to be carried by such persons. AT&T will permit entry to the Equipment Space by persons named on such then-current lists or verified by means of the local or toll-free telephone number, and bearing such identifying credentials.

12.11 The same insurance and indemnification requirements, if any, that apply to AT&T and its contractors when collocating in PACIFIC's Eligible Structures pursuant to

Attachment 10 (Ancillary Functions) shall apply to PACIFIC and its contractors in connection with this Space License.

12.12 While in the AT&T central office, employees of PACIFIC and its contractors must comply at all times with AT&T's security and safety procedures and requirements. AT&T may refuse entry to, or require the departure of, any person who is disorderly or who has failed to comply with AT&T's procedures and requirements after being notified of them.

12.13 PACIFIC will be responsible for selecting its contractors and causing their compliance with this Agreement.

12.14 Each party shall cause its employees and contractors to act in a careful and workmanlike manner to avoid damage to the other party's property and the property of others in and around AT&T's central office.

12.15 PACIFIC's employees and contractors shall refrain from using any Licensed Facilities, equipment, tools, materials, or methods that, in AT&T's sole judgment, might cause damage to or otherwise interfere with AT&T's operations. AT&T reserves the right to take any reasonable action to prevent potential harm to the services, personnel, or property of AT&T (and its affiliates, vendors, and customers).

12.16 In addition to the Licensed Facilities, PACIFIC may bring into the Equipment Space the small tools and portable test equipment needed for the work for which PACIFIC is responsible. PACIFIC will be responsible for the care and safeguarding of all such items. PACIFIC may not bring any other items into the AT&T central office without AT&T's prior written consent. In particular, and without limiting the foregoing, PACIFIC may not bring into the AT&T central office any of the following: wet cell batteries, explosives, flammable liquids or gases, alcohol, controlled substances, weapons, cameras, tape recorders, and similar items.

12.17 AT&T and its designees may inspect or observe the Equipment Space, the space designated by AT&T for PACIFIC transmission cable, the Licensed Facilities, and any work performed by or behalf of PACIFIC in the AT&T central office, at any time. If the Equipment Space is surrounded by a security enclosure, PACIFIC shall furnish AT&T with all mechanisms and information needed for entry to the Equipment Space.

12.18 AT&T and PACIFIC intend that the Licensed Facilities, whether or not physically affixed to the AT&T central office, shall not be construed to be fixtures. PACIFIC (or the lessor of PACIFIC equipment, if applicable) will report the Licensed Facilities as its personal property wherever required by applicable laws, and will pay all taxes levied upon the Licensed Facilities.

12.19 PACIFIC agrees not to sell, convey, or lease PACIFIC transmission cable under any circumstances, except for a conveyance of PACIFIC transmission cable to AT&T upon termination of the applicable Space License. PACIFIC further agrees not to cause, suffer, or permit PACIFIC transmission cable to become encumbered by a lien, trust, pledge, or security interest as a result of rights

granted by PACIFIC or any act or omission of PACIFIC. If PACIFIC transmission cable becomes so encumbered, PACIFIC agrees to discharge the obligation within thirty (30) days after receiving notice of the encumbrance.

12.20 The licenses granted by this Agreement are non-exclusive personal privileges allowing PACIFIC to situate the Licensed Facilities in the locations indicated by AT&T. These licenses and the payments by PACIFIC under this Agreement do not create or vest in PACIFIC (or in any other person) any property right or interest of any nature in any part of the AT&T central office.

12.21 The licenses granted to PACIFIC under this Agreement shall be subordinate to any mortgages or deeds of trust that may now exist or may in the future be placed upon any AT&T central office; to any and all advances to be made under such mortgages or deeds of trust; and to the interest thereon and all renewals, replacements, or extensions thereof.

12.22 AT&T may relocate the Equipment Space, or the AT&T central office, or both upon thirty (30) days prior written notice to PACIFIC. If relocation of Licensed Facilities is required, the party that originally installed such Licensed Facilities will be responsible for relocating them. Any such relocation work that is AT&T's responsibility and is performed by AT&T will be without charge to PACIFIC. AT&T will reimburse PACIFIC for the reasonable cost of such relocation work performed by PACIFIC, and AT&T will provide at its own expense any additional or replacement cable racks and PACIFIC transmission cable needed to accommodate the relocation of the installation. AT&T and PACIFIC will work together in good faith to minimize any disruption of service in connection with such relocation.

12.23 Licensed Facilities will be furnished, installed and maintained in accordance with the following:

12.23.1 PACIFIC agrees to furnish all Licensed Facilities.

12.23.2 PACIFIC agrees to install the Licensed Facilities. PACIFIC agrees to comply with specifications and processes furnished by AT&T for installation performed by PACIFIC.

12.23.3 PACIFIC agrees to install the DC power supply and single circuit (battery and ground) from its fuse panel located in PACIFIC's frame to the designated AT&T power source. PACIFIC will distribute the power among its equipment within the Equipment Space.

12.23.4 PACIFIC agrees to maintain in good working order all PACIFIC equipment in Equipment Space. AT&T agrees to repair PACIFIC transmission cable. PACIFIC is not permitted to repair installed PACIFIC transmission cable in order to avoid possible harm to other transmission cables.

12.23.5 PACIFIC may use contractors to perform installation and maintenance for which PACIFIC is responsible. AT&T consents to use of those contractors listed on a then current AT&T approved list

of PACIFIC submitted contractors. Use of any other contractors shall require AT&T's prior written consent, which shall not be unreasonably withheld.

12.23.6 PACIFIC may, at its own discretion and expense, choose to install its equipment in locked cabinets, provided that space and configuration will permit such. If PACIFIC chooses to install its equipment in locked cabinets, PACIFIC shall leave the appropriate keys with AT&T and agrees to allow AT&T the right of entry to such cabinets.

12.23.7 PACIFIC shall pay the charges set forth or described in Attachment 8 for Space Licenses.

12.24 Under the Space Licenses, AT&T performs no communications services, provides no goods except for short lengths of wire or cable and small parts incidental to the services furnished by AT&T, and provides no maintenance for any PACIFIC equipment in Equipment Space. AT&T warrants that the services provided under this Agreement will be performed in a workmanlike manner and in accordance with AT&T technical specifications and that the incidental material provided by AT&T shall be free from defects. AT&T MAKES NO OTHER WARRANTIES, EXPRESS OR IMPLIED, AND SPECIFICALLY DISCLAIMS ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE.

12.25 In addition to any other rights or remedies that AT&T may have under this Agreement or at law, AT&T may terminate the applicable Space License if any of the following events occurs and is not corrected within thirty (30) days after written notice to cure:

12.25.1 PACIFIC fails to utilize the Licensed Facilities for the authorized purpose described herein.

12.25.2 PACIFIC fails to comply with Applicable Laws or is in any way prevented by the order or action of any court, or other governmental entity from performing any of its obligations under this Section.

12.26 In the event that a Space License is terminated for any reason, the Parties will act in accordance with the following:

12.26.1 Within thirty (30) days after termination of a Space License, PACIFIC will, at its sole expense, remove all PACIFIC equipment in Equipment Space and restore the Equipment Space to its previous condition, normal wear and tear excepted. If PACIFIC fails to complete such removal and restoration within thirty (30) days after termination of the applicable Space License, AT&T may, at its option, upon ten (10) days written notice to PACIFIC, perform the removal and restoration at PACIFIC's sole risk and expense.

12.26.2 Because removal of installed PACIFIC transmission cable may cause damage to other cables or fiber, PACIFIC agrees to relinquish its

transmission cable to AT&T in lieu of removal. Upon termination of the applicable Space License, all PACIFIC transmission cable will be automatically conveyed to AT&T, thereby becoming the property of AT&T, free of any interest or lien of any kind by PACIFIC (or by any person claiming through PACIFIC). At AT&T's request, PACIFIC will promptly execute and deliver to AT&T a bill of conveyance or such other assurances as may be requisite to confirm or perfect the transfer of PACIFIC transmission cable to AT&T.

12.26.3 If no monies are owed by PACIFIC to AT&T under this Agreement, AT&T agrees to deliver such removed equipment to PACIFIC's last known business address or to a domestic location designated by PACIFIC, at PACIFIC's sole risk and expense. If monies are so owed, PACIFIC agrees that AT&T may either take ownership free of any interest or lien by PACIFIC (or those claiming through PACIFIC) or treat such equipment as abandoned by PACIFIC.

AMENDMENT NO. 3

TO THE INTERCONNECTION AGREEMENT

BETWEEN

SBC PACIFIC BELL TELEPHONE COMPANY

AND

AT&T COMMUNICATIONS OF CALIFORNIA, INC., TCG-LOS ANGELES, TCG-SAN DIEGO, TCG-SAN FRANCISCO, AND AT&T BROADBAND PHONE OF CALIFORNIA, LLC

WHEREAS, SBC Pacific Bell Telephone Company ("Pacific"), formerly Pacific Bell, and AT&T Communications of California, Inc., TCG-Los Angeles, TCG-San Diego, TCG-San Francisco, AT&T Broadband Phone of California, LLC ("AT&T") (collectively, the "Parties") entered into an Agreement relating to local interconnection which became effective on August 14, 2000, ("Agreement") and which permits the Parties to mutually amend the Agreement in writing; and

WHEREAS, pursuant to Resolution ALJ 181, this filing will become effective, absent rejection of the advice letter by the California Public Utilities Commission ("Commission"), thirty days after the filing date of the Advice Letter to which this Amendment is appended ("Effective Date"); and

NOW THEREFORE the Parties agree as follows:

I. The underlying Agreement is amended by replacing certain non-recurring rates associated with Operator Services and Directory Assistance Rate/Reference Information service, which were previously noted as "TBD" status in Exhibit H of Attachment 8: Pricing, with the actual non-recurring rates set forth below:

Operator Services rate/reference information

Rate per initial load	$2,200.00
Rate per subsequent rate change	$1,000.00
Rate per subsequent reference change	$1,000.00

II. This Amendment shall not modify or extend the Effective Date or Term of the underlying Agreement, but rather shall be coterminous with the underlying Agreement.

III. EXCEPT AS MODIFIED HEREIN, ALL OTHER TERMS AND CONDITONS FOR THE UNDERLYING AGREEMENT SHALL REMAIN UNCHANGED AND IN FULL FORCE AND EFFECT, and such terms are hereby incorporated by reference and the Parties hereby reaffirm other terms and provisions thereof.

IV. This Amendment shall be filed with and subject to approval by the California Public Utilities Commission.

IN WITNESS WHEREOF, the Parties hereto have caused this Amendment to be executed on the date shown below by their respective duly authorized representatives.

*SBC Pacific Bell Telephone Company by SBC Communications, Inc., its authorized agent	AT&T Communications of California, Inc., TCG-Los Angeles, TCG-San Diego, TCG-San Francisco, and AT&T Broadband Of California, LLC
By: _____	By: _____
Printed: _____	Printed: _____
Title: President – Industry Markets	Title: _____
Date: _____	Date: _____

*On January 25, 1999, the United States Supreme Court issued its opinion in *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366 (1999) (and on remand *Iowa Utilities Board v. FCC*, 219 F.3d 744 (8th Cir. 2000)) and on June 1, 1999, the United States Supreme Court issued its opinion in *Ameritech v. FCC*, No. 98-1381, 1999 WL 116994, 1999 Lexis 3671 (June 1, 1999). In addition, on July 18, 2000, the United States Court of Appeals for the Eighth Circuit issued its opinion in *Iowa Utilities Board v. FCC,* No. 96-3321, 2000 Lexis 17234 (July 18, 2000), which is the subject of a pending appeal before the Supreme Court. In addition, on November 5, 1999, the FCC issued its Third Report and Order and Fourth Further Notice of Proposed Rulemaking in CC Docket No. 96-96 (FCC 99-238), including the FCC's Supplemental Order issued *In the Matter of the Local Competition Provisions of the Telecommunications Act of 1996*, in CC Docket No. 96-98 (FCC 99-370) (rel. November 24, 1999), which is the subject of a pending request for reconsideration and a pending appeal. By executing this amendment, Pacific does not waive any of its rights, remedies or arguments with respect to any such decisions or proceedings and any remands thereof, including its right to seek legal review or a stay of such decisions and its rights contained in the Interconnection Agreement. Pacific further notes that on April 27, 2001, the FCC released its Order on Remand and Report and Order in CC Dockets No. 96-98 and 99-68, *In the Matter of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-bound Traffic* (the "ISP Intercarrier Compensation Order.") By executing this Amendment and carrying out the intercarrier compensation rates, terms and conditions herein, Pacific does not waive any of its rights, and expressly reserves all of its rights, under the ISP Intercarrier Compensation Order, including but not limited to its right to exercise its option at any time in the future to invoke the Intervening Law or Change of Law provisions and to adopt on a date specified by Pacific the FCC ISP terminating compensation plan, after which date ISP-bound traffic will be subject to the FCC's prescribed terminating compensation rates, and other terms and conditions.

Attachment B

ATTACHMENT 19

NEGOTIATED APPENDIX RECIPROCAL COMPENSATION (AFTER FCC ORDER NO. 01-131)

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APPENDIX RECIPROCAL COMPENSATION

This Appendix provides for Reciprocal Compensation rates, terms, and conditions for all intercarrier telecommunications traffic exchanged pursuant to the underlying Interconnection Agreement ("Agreement") between CLEC as a Competitive Local Exchange Carrier in this state (hereafter, "CLEC") and one of the following SBC Communications Inc.-owned Incumbent Local Exchange Carriers (hereafter, "ILEC"): **Illinois Bell Telephone, Indiana Bell Telephone Company Incorporated, Michigan Bell Telephone Company d/b/a Ameritech Michigan, Nevada Bell Telephone Company (a Nevada corporation), The Ohio Bell Telephone Company, Pacific Bell Telephone Company (a California corporation), The Southern New England Telephone Company (a Connecticut corporation), Southwestern Bell Telephone Company (a Missouri corporation), and/or Wisconsin Bell, Inc. d/b/a Ameritech Wisconsin** (but only to the extent that the agent for the applicable SBC-owned ILEC executed the underlying Agreement for such SBC-owned ILEC). The Parties hereby agree as follows:

WHEREAS, CLEC obtained the underlying Agreement by requesting adoption of an existing Agreement with ILEC pursuant to Section 252(i) of the Federal Telecommunications Act of 1996 (known as the "Most Favored Nations" or "MFN" provision of the Act); and

WHEREAS, on April 18, 2001, the Federal Communications Commission (FCC) adopted its "Order on Remand and Report and Order" in its Intercarrier Compensation proceeding regarding traffic to Internet Service Providers (ISPs) (hereafter, the "ISP Intercarrier Compensation Order")[1] which was remanded in *WorldCom, Inc. v. FCC,* No. 01-1218 (D.C. Cir. 2002); and

WHEREAS, the FCC in that Order suspended MFN requests affecting ISP and other Internet-bound traffic, stating in pertinent part:

> *Because we now exercise our authority under section 201 to determine the appropriate intercarrier compensation for ISP-bound traffic, however, state commissions will no longer have authority to address this issue. For this same reason, as of the date this Order is published in the Federal Register, carriers may no longer invoke section 252(i) to opt into an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic[footnote omitted]. Section 252(i) applies only to agreements arbitrated or approved by state commissions pursuant to section 252; it has no application in the context of an*

1 *In the Matter of Implementation of the Local Competition Provisions in the Federal Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic;* CC Docket Nos. 96-98 and 99-68; FCC Order No. 01-131 (released April 27, 2001).

*intercarrier compensation regime set by this [Federal Communications] Commission pursuant to section 201 [footnote omitted].*2

AND, WHEREAS the rates, terms and conditions for ISP traffic are legitimately-related to all other rates, terms and conditions for intercarrier compensation under the Agreement and have been negotiated in their entirety in this Appendix.

NOW, THEREFORE, ILEC and CLEC agree to the following rates, terms and conditions for all intercarrier traffic, including ISP and Internet-bound traffic, for the duration of the underlying Agreement, intending this document to be executed, filed, and approved as a negotiated Appendix separate from the underlying MFN Agreement.

1.0 APPENDIX SCOPE AND TERM

1.1 This Appendix sets forth the rates, terms and conditions for Reciprocal Compensation of intercarrier telecommunications traffic between ILEC and CLEC, but only to the extent they are interconnected and exchanging calls pursuant to a fully executed, underlying Interconnection Agreement approved by the applicable state or federal regulatory agency for telecommunications traffic in this state.

1.2 The compensation arrangement for the joint provision of Feature Group A (FGA) Services shall be subject to the underlying Interconnection Agreement or as otherwise mutually agreed by the Parties.

1.3 The provisions of this Appendix apply to calls originated over the originating carrier's facilities or over Unbundled Network Elements.

1.4 The provisions of this Appendix do not apply to traffic originated over services provided under local Resale service.

1.5 This Appendix is intended to supercede and replace any and all Appendices, Attachments, Rate Schedules, or other sections of the underlying Interconnection Agreement that set forth the rates, terms and conditions for Reciprocal Compensation of intercarrier telecommunications traffic between ILEC and CLEC. Any inconsistencies between the provisions of this Appendix and other provisions of the underlying Interconnection Agreement shall be governed by the provisions of this Appendix.

1.6 The Parties agree that this Appendix also governs the exchange, routing and rating of all intercarrier ISP and Internet-bound traffic between ILEC and CLEC in this state. The terms "ISPs" and "Internet" shall be given the same meaning as used in

2 ISP Intercarrier Compensation Order, para 82 (emphasis added).

the underlying Agreement, and if not defined there, shall be given the same meaning as found in the ISP Compensation Order and the Telecommunications Act of 1996.

1.7 The Parties agree that this Appendix shall be coterminous with the underlying Agreement and shall not extend or alter the term and termination provisions of the Agreement, subject to the exceptions in subsection 1.7.1 below.

1.7.1 Retroactive Application back to the Effective Date of the Underlying MFN. The Parties recognize that an MFN interconnection agreement often receives speedier state approvals than the negotiated Appendix which will be affixed to that interconnection agreement. To the extent that the date of state approval of the underlying MFN interconnection agreement precedes the date of state approval of this Appendix, the Parties agree that the rates, terms and conditions of the Appendix will, upon state approval, apply retroactively to the date of state approval of the underlying MFN Agreement.

2.0 ILEC DESIGNATIONS

2.1 SBC Communications Inc. (SBC) means the holding company which owns the following ILECs: Illinois Bell Telephone Company, Indiana Bell Telephone Company Incorporated, Michigan Bell Telephone Company, Nevada Bell Telephone Company, The Ohio Bell Telephone Company, Pacific Bell Telephone Company, The Southern New England Telephone Company, Southwestern Bell Telephone Company and Wisconsin Bell, Inc. d/b/a Ameritech Wisconsin.

2.2 **SBC-13STATE** - As used herein, **SBC-13STATE** means the applicable above listed ILEC(s) doing business in Arkansas, California, Connecticut, Illinois, Indiana, Kansas, Michigan, Missouri, Nevada, Ohio, Oklahoma, Texas, and Wisconsin.

2.3 **SBC-12STATE** - As used herein, **SBC-12STATE** means the applicable above listed ILEC(s) doing business in Arkansas, California, Illinois, Indiana, Kansas, Michigan, Missouri, Nevada, Ohio, Oklahoma, Texas, and Wisconsin.

2.4 **SBC-AMERITECH** - As used herein, **SBC-AMERITECH** means the applicable above listed ILEC(s) doing business in Illinois, Indiana, Michigan, Ohio, and Wisconsin.

2.5 **SBC-SWBT** - As used herein, **SBC-SWBT** means the applicable above listed ILEC(s) doing business in Arkansas, Kansas, Missouri, Oklahoma, and Texas.

2.6 **SWBT-MO** - As used herein, **SWBT-MO** means the applicable above listed ILEC doing business in Missouri.

2.7 **SWBT-OK** - As used herein, **SWBT-OK** means the applicable above listed ILEC doing business in Oklahoma.

2.8 **SWBT-KS** - As used herein, **SWBT-KS** means the applicable above listed ILEC doing business in Kansas.

2.9 **SWBT-AR**-As used herein, **SWBT-AR** means the applicable above listed ILEC doing business in Arkansas.

2.10 **SWBT-TX** - As used herein, **SWBT-TX** means the applicable above listed ILEC doing business in Texas.

2.11 **PACIFIC** - As used herein, **PACIFIC** means the applicable above listed ILEC doing business in California.

2.12 **NEVADA** - As used herein, **NEVADA** means the applicable above listed ILEC doing business in Nevada.

2.13 **SNET** - As used herein, **SNET** means the applicable above listed ILEC doing business in Connecticut.

3.0 CLASSIFICATION OF TRAFFIC

3.1 Telecommunications traffic exchanged between CLEC and ILEC will be classified as either Local Calls, Transit Traffic, Optional Calling Area Traffic, IntraLATA Toll Traffic, or InterLATA Toll Traffic. For purposes of this Appendix, calls to ISPs will be rated and routed according to these same classifications, depending on the physical location of the originating and terminating end users.

3.2 For purposes of this Appendix, the Parties agree that "Local Calls" and "Local ISP Calls" will be compensated at the same rates and rate structures, depending on the End Office or Tandem serving arrangement, so long as the originating end user of one Party and the terminating end user or ISP of the other Party are:

(a) both physically located in the same ILEC Local Exchange Area as defined by the ILEC Local (or "General") Exchange Tariff on file with the applicable state commission or regulatory agency; or

(b) both physically located within neighboring ILEC Local Exchange Areas, or within an ILEC exchange and an Independent LEC exchange, that share

a common mandatory local calling area. This includes but is not limited to, mandatory Extended Area Service (EAS), mandatory Extended Local Calling Service (ELCS), or other types of mandatory expanded local calling scopes.

3.3 The Parties agree that, notwithstanding the classification of traffic under this Appendix, either Party is free to define its own "local" calling area(s) for purposes of its provision of telecommunications services to its end users.

3.4 When an End User originates a Local Call which terminates to an End User physically located in the same local exchange area and served on the other Party's physical switch or, if operating in **SBC-12STATE**, through the other Party's Unbundled Network Element (UNE) switch port, the originating Party shall compensate the terminating Party for the transport and termination of Local Calls at the rate(s) provided in this Appendix and Appendix Pricing. In SNET, calls originated over UNEs are not subject to reciprocal compensation since the rates for unbundled local switching reflect and include the costs of call termination.

3.5 The Parties' obligation to pay reciprocal compensation to each other shall commence on the date the Parties agree that the interconnection is complete (i.e., each Party has established its originating trunks as well as all ancillary traffic trunking such as Operator Services, 911 or Mass Calling trunks).

3.6 The compensation arrangements set forth in this Appendix are not applicable to (i) Exchange Access traffic, (ii) Information Service traffic, (iii) traffic originated by one Party on a number ported to its network that terminates to another number ported on that same Party's network or (iv) any other type of traffic found to be exempt from reciprocal compensation by the FCC or the Commission, with the exception of calls to ISPs, which are addressed in this Appendix. All Exchange Access traffic and IntraLATA Toll Traffic shall continue to be governed by the terms and conditions of applicable federal and state tariffs.

3.7 Calls delivered to or from numbers that are assigned to an exchange within a common mandatory local calling area but where the receiving or calling party is physically located outside the common mandatory local calling area of the exchange to which the number is assigned are either Feature Group A (FGA) or Foreign Exchange (FX) and are not Local Calls for intercarrier compensation and are not subject to local reciprocal compensation.

3.8 Private Line Services include private line-like and special access services and are not subject to local reciprocal compensation. Private Line Services are defined as dedicated Telecommunications channels provided between two points or switched

among multiple points and are used for voice, data, audio or video transmission. Private Line services include, but are not limited to, WATS access lines.

3.9 Reciprocal Compensation applies to local traffic that is terminated at either parties' terminating switch. Traffic that is delivered to a CLEC or ISP via Digital Subscriber Line (DSL) service is not subject to intercarrier compensation.

4.0 RESPONSIBILITIES OF THE PARTIES

4.1 Each Party to this Appendix will be responsible for the accuracy and quality of its data as submitted to the respective Parties involved.

4.2 Where SS7 connections exist, each Party will include in the information transmitted to the other for each call being terminated on the other's network, where available, the original and true Calling Party Number (CPN).

4.3 If one Party is passing CPN but the other Party is not properly receiving information, the Parties will work cooperatively to correct the problem.

4.4 Where SS7 connections exist, calls originated by one party and terminated by the other, if the percentage of calls passed with CPN is greater than ninety percent (90%), all calls exchanged without CPN information will be billed as either Local Traffic or intraLATA Toll Traffic in direct proportion to the minutes of use (MOU) of calls exchanged with CPN information. If the percentage of calls passed with CPN is less than ninety percent (90%), all calls passed without CPN will be billed as intraLATA switched access.

4.5 Where the Parties are performing a transiting function as defined in Section 9.0 below, the transiting Party will pass the original and true CPN if it is received from the originating third party. If the original and true CPN is not received from the originating third party, the Party performing the transiting function can not forward the CPN and will not be billed as the default originator.

5.0 LOCAL CALL TERMINATION

5.1 The compensation set forth below will also apply to all Local and Local ISP Calls as defined in section 3.2 of this Appendix, depending on whether the call is terminated directly to an End Office or through a Tandem.

5.2 Bifurcated Rates (Call Set Up and Call Duration). The Parties agree to compensate each other for the termination of Local Calls and Local ISP Calls on a "bifurcated" basis, meaning assessing an initial Call Set Up charge on a per Message basis, and then assessing a separate Call Duration charge on a per Minute of Use (MOU) basis, where ever per Message charges are applicable. The

following rate elements apply, but the corresponding rates are shown in Appendix Reciprocal Compensation Terminating Rates, attached hereto and incorporated by reference as if fully set forth below:

5.3 Tandem Serving Rate Elements:

5.3.1 Tandem Switching - compensation for the use of tandem switching (only) functions.

5.3.2 Tandem Transport - compensation for the transmission facilities between the local tandem and the end offices subtending that tandem.

5.3.3 End Office Switching in a Tandem Serving Arrangement - compensation for the local end office switching and line termination functions necessary to complete the transmission in a tandem-served arrangement. It consists of a call set-up rate (per message) and an call duration (per minute) rate.

5.4 End Office Serving Rate Elements:

5.4.1 End Office Switching - compensation for the local end office switching and line termination functions necessary to complete the transmission in an end office serving arrangement. It consists of a call set-up rate (per message) and an call duration (per minute) rate.

5.5 All ISP and Internet-bound traffic shall be subject to the same terms and conditions regarding switch recordings, Calling Party Number (CPN) signaling, and other usage detail as for other Local Calls under this Appendix. Minutes of use to ISPs may be shown separately on the monthly usage detail, invoices, payment summaries, or other documents exchanged between ILEC and CLEC in the monthly billing cycle.

5.6 All ISP and Internet-bound traffic for a given usage month shall be due and owing at the same time as payments for Local Calls under this Appendix. The parties agree that all terms and conditions regarding disputed minutes of use, nonpayment, partial payment, late payment, interest on outstanding balances, or other billing and payment terms shall apply to ISP and Internet-bound traffic the same as for Local Calls under this Appendix.

6.0 NON-LOCAL CALL TERMINATION

6.1 The Parties recognize and agree that ISP and Internet-bound traffic could also be traded outside of the applicable local calling scope, or routed in ways that could make the rates and rate structure in section 5.0 above not apply, including but not limited to ISP calls that fit the underlying Agreement's definitions of:

- Transit Traffic
- Optional EAS Traffic
- IntraLATA Interexchange Traffic
- InterLATA Interexchange Traffic
- 800, 888, 877, ("8yy") Traffic
- Feature Group A Traffic
- Feature Group D Traffic

6.2 The Parties agree that, for the purposes of this Amendment, either Parties' end users remain free to place ISP calls on a "Non-Local" basis under any of the above classifications. To the extent such "non-Local" ISP calls are placed, the Parties agree that section 5.0 above does not apply, and that the underlying Agreement's rates, terms and conditions for IntraLATA and/or InterLATA calling shall apply, including but not limited to rating and routing according to the terminating parties' Exchange Access intrastate and/or interstate tariffs.

6.3 The Parties agree that physical interconnection, routing, and trunking of ISP calls on an Inter-Exchange basis, either IntraLATA or InterLATA, shall be as specified in the underlying Agreement for all other traffic exchanged, including but not limited to, the need to route over Meet Point Billed trunks.

7.0 OPTIONAL CALLING AREA TRAFFIC -- SWBT-OK, KS, AR, TX

7.1 Compensation for Optional Calling Area (OCA) Traffic is for the termination of intercompany traffic to and from the one-way or two-way optional exchanges(s) and the associated metropolitan area.

7.2 In the context of this Appendix, Optional Calling Areas (OCAs) exist only in the states of Oklahoma, Kansas, Arkansas, and Texas, and are outlined in the applicable state Local Exchange tariffs. This rate is independent of any retail service arrangement established by either Party. CLEC and **SWBT-OK**, **SWBT-KS**, **SWBT-AR**, and **SWBT-TX** are not precluded from establishing its own local calling areas or prices for purposes of retail telephone service; however the terminating rates to be used for any such offering will still be administered as described in this Appendix.

7.3 The state specific OCA Transport and Termination rates are outlined in Appendix Pricing.

8.0 MCA TRAFFIC -- SBC-MO

8.1 For compensation purposes in the state of Missouri, Local Traffic shall be further defined as "Metropolitan Calling Area (MCA) Traffic" and "Non-MCA Traffic."

MCA Traffic is traffic originated by a party providing a local calling scope plan pursuant to the Missouri Public Service Commission Orders in Case No. TO-92-306 and Case No. TO-99-483 (MCA Orders) and the call is a local call based on the calling scope of the originating party pursuant to the MCA Orders. Non-MCA Traffic is all Local Traffic that is not defined as MCA Traffic.

8.1.1 Either party providing Metropolitan Calling Area (MCA) service shall offer the full calling scope prescribed in Case No. TO-92-306, without regard to the identity of the called party's local service provider. The parties may offer additional toll-free outbound calling or other services in conjunction with MCA service, but in any such offering the party shall not identify any calling scope other than that prescribed in Case No. TO-92-306 as "MCA" service.

8.1.2 Pursuant to the Missouri Public Service Commission Order in Case No. TO-99-483, MCA Traffic shall be exchanged on a bill-and-keep intercompany compensation basis meaning that the party originating a call defined as MCA Traffic shall not compensate the terminating party for terminating the call. Furthermore, the Transit Traffic rate element shall not apply to MCA Traffic (i.e., no transiting charges shall be assessed for MCA Traffic).

8.2 The parties agree to use the Local Exchange Routing Guide (LERG) to provision the appropriate MCA NXXs in their networks. The LERG should be updated at least 45 days in advance of opening a new code to allow the other party the ability to make the necessary network modifications. If the Commission orders the parties to use an alternative other than the LERG, the parties will comply with the Commission's final order.

8.3 If CLEC provides service via resale or in conjunction with ported numbers in the MCA, the appropriate MCA NXXs will be updated by SWBT.

9.0 TRANSIT TRAFFIC COMPENSATION

9.1 Transiting Service allows one Party to send Local, Optional, intraLATA Toll Traffic, and 800 intraLATA Toll Traffic to a third party network through the other Party's tandem. A Transiting rate element applies to all MOUs between a Party and third party networks that transits a **SBC-13STATE** network. The originating Party is responsible for payment of the appropriate rates unless otherwise specified. The Transiting rate element is only applicable when calls do not originate with (or terminate to) the transit Party's End User. Pursuant to the Missouri Public Service Commission Order in Case No. TO-99-483, the Transit Traffic rate element shall not apply to MCA Traffic (i.e., no transiting charges shall be assessed for MCA Traffic) for **SWBT-MO**. The rates that **SBC-13STATE** shall charge for transiting CLEC traffic are outlined in Appendix Pricing.

9.2 The Parties agree to enter into their own agreement with third party Telecommunications Carriers prior to delivering traffic for transiting to the third party. In the event one Party originates traffic that transits the second Party's network to reach a third party Telecommunications Carrier with whom the originating Party does not have a traffic Interexchange agreement, then originating Party will indemnify the second Party against any and all charges levied by such third party telecommunications carrier, including any termination charges related to such traffic and any attorneys fees and expenses. The terminating party and the tandem provider will bill their respective portions of the charges directly to the originating party, and neither the terminating party nor the tandem provider will be required to function as a billing intermediary, e.g. clearinghouse.

9.3 The CLEC shall not bill **SBC-13STATE** for terminating any Transit traffic, whether identified or unidentified, i.e. whether **SBC-13STATE** is sent CPN or is not sent CPN by the originating company.

9.4 In those **SBC-13STATE**s where Primary Toll Carrier (PTC) arrangements are mandated, for intraLATA Toll Traffic which is subject to a PTC arrangement and where **SBC-13STATE** is the PTC, **SBC-13STATE** shall deliver such intraLATA Toll Traffic to the terminating carrier in accordance with the terms and conditions of such PTC arrangement. Upon receipt of verifiable Primary Toll records, **SBC-13STATE** shall reimburse the terminating carrier at **SBC-13STATE**'s applicable tariffed terminating switched access rates. When transport mileage cannot be determined, an average transit transport mileage shall be applied as set forth in Appendix Pricing.

9.5 CLEC will establish sufficient direct trunk groups between CLEC and a Third Party's network when CLEC's traffic volumes to said Third Party require twenty-four (24) or more trunks.

10.0 OPTIONAL CALLING AREA TRANSIT TRAFFIC -- SWBT-MO, SWBT-KS, SWBT-AR, SWBT-TX

10.1 In the states of Texas, Missouri, Kansas, and Arkansas, the Optional Area Transit Traffic rate element applies when one End User is in a **SBC-SWBT** one-way or two-way optional exchange and the other End User is within the **SWBT-KS**, **SWBT-AR**, and/or **SWBT-TX** local or mandatory exchanges. The Parties agree to apply the Optional Area Transit rate to traffic terminating to third party Independent LEC that shares a common mandatory local calling area with all **SWBT-MO, SWBT-KS, SWBT-AR**, and **SWBT-TX** exchanges included in a specific metropolitan exchange area. The Optional Area Transit Traffic rates that will be billed are outlined in Appendix Pricing. The specific NXXs and associated calling scopes can be located in the applicable state Local Exchange tariff.

11.0 INTRALATA 800 TRAFFIC

11.1 The Parties shall provide to each other intraLATA 800 Access Detail Usage Data for Customer billing and intraLATA 800 Copy Detail Usage Data for access billing in Exchange Message Interface (EMI) format. On a monthly basis the Parties agree to provide this data to each other at no charge. In the event of errors, omissions, or inaccuracies in data received from either Party, the liability of the Party providing such data shall be limited to the provision of corrected data only. If the originating Party does not send an End User billable record to the terminating Party, the originating Party will not bill the terminating Party any interconnection charges for this traffic.

11.2 IntraLATA 800 Traffic calls are billed to and paid for by the called or terminating Party, regardless of which Party performs the 800 query. Billing shall be based on originating and terminating NPA/NXX.

12.0 MEET-POINT-BILLING (MPB) and SWITCHED ACCESS TRAFFIC COMPENSATION

12.1 Intercarrier compensation for Switched Access Traffic shall be on a MPB basis as described below.

12.2 The Parties will establish MPB arrangements in order to provide Switched Access Services to IXC and ESPs via the respective carrier's Tandem Office Switch switches in accordance with the MPB guidelines adopted by and either contained

in, or upon approval to be added in future to the Ordering and Billing Forum's MECOD and MECAB documents.

12.3 Billing to Interexchange Carriers (IXCs) and ESPs for the Switched Exchange Access Services jointly provided by the Parties via MPB arrangements shall be according to the multiple bill/single tariff method. As described in the MECAB document, each Party will render a bill in accordance with its own tariff for that portion of the service it provides. Each Party will bill its own network access service rates to the IXC. The residual interconnection charge (RIC), if any, will be billed by the Party providing the end office function. For the purpose of this Appendix, CLEC is the Initial Billing Company (IBC) and **SBC-13STATE** is the Subsequent Billing Company.

12.4 The Parties will maintain provisions in their respective federal and state access tariffs, or provisions within the National Exchange Carrier Association (NECA) Tariff No. 4, or any successor tariff, sufficient to reflect this MPB arrangement, including MPB percentages.

12.5 As detailed in the MECAB document, the Parties will, in accordance with appropriate billing cycle intervals defined herein, exchange all information necessary to accurately, reliably and promptly bill third parties for Switched Access Services traffic jointly handled by the Parties via the Meet Point arrangement. Information shall be exchanged in a mutually acceptable electronic file transfer protocol. Where the EMI records cannot be transferred due to a transmission failure, records can be provided via a mutually acceptable medium. The initial billing company (IBC) will provide the information to the subsequent billing company within ten (10) working days of sending the IBC's bills. The exchange of records to accommodate MPB will be on a reciprocal, no charge basis.

12.6 MPB shall also apply to all jointly provided MOU traffic bearing the 900, or toll free NPAs (e.g., 800, 877, 866, 888 NPAs, or any other non-geographic NPAs) which may likewise be designated for such traffic in the future where the responsible party is an IXC or ESP. When ILEC performs 800 database queries, ILEC will charge the end office provider for the database query in accordance with standard industry practices.

12.7 Each Party shall coordinate and exchange the billing account reference (BAR) and billing account cross reference (BACR) numbers for the Meet Point Billing service. Each Party shall notify the other if the level of billing or other BAR/BACR elements change, resulting in a new BAR/BACR number.

12.8 For purposes of this Appendix the Party to whom the End Office Switch belongs is the IBC and the Party to whom the Tandem Office Switch belongs is the secondary billing company. The secondary billing company will provide the IBC with the Exchange Access detailed usage data within thirty (30) days of the recording date. The IBC will provide to the secondary billing company the Exchange Access summary usage data within ten (10) working days of the IBC's bill date to the IXC and/or ESP. **SBC-13STATE** acknowledges that currently there is no charge for Summary Usage Data Records but that such a charge may be appropriate. At CLEC's request, **SBC-13STATE** will negotiate a mutual and reciprocal charge for provision of Summary Usage Data Records.

12.9 **SBC-13STATE** and CLEC agree to provide the other Party with notification of any discovered errors within ten (10) business days of the discovery.

12.10 In the event of a loss of data, both Parties shall cooperate to reconstruct the lost data within sixty (60) days of notification and if such reconstruction is not possible, shall accept a reasonable estimate of the lost data, based upon no more than three (3) to twelve (12) consecutive months of prior usage data.

13.0 INTRALATA TOLL TRAFFIC COMPENSATION

13.1 For intrastate intraLATA toll traffic, compensation for termination of intercompany traffic will be at terminating access rates for Message Telephone Service (MTS) and originating access rates for 800 Service, including the Carrier Common Line (CCL) charge where applicable, as set forth in each Party's Intrastate Access Service Tariff, but not to exceed the compensation contained in an ILEC's tariff in whose exchange area the End User is located. For interstate intraLATA intercompany service traffic, compensation for termination of intercompany traffic will be at terminating access rates for MTS and originating access rates for 800 Service including the CCL charge, as set forth in each Party's interstate Access Service Tariff, but not to exceed the compensation contained in the ILEC's tariff in whose exchange area the End User is located. Common transport, (both fixed and variable), as well as tandem switching and end office rates apply only in those cases where a Party's tandem is used to terminate traffic.

14.0 BILLING FOR MUTUAL COMPENSATION -- SBC-SWBT

14.1 In **SBC-SWBT** other than for traffic described in Section 6.0 above, each Party shall deliver monthly settlement statements for terminating the other Party's traffic based on the following:

14.2 Each Party shall, unless otherwise agreed, adhere to the detailed technical descriptions and requirements for the recording, record exchange, and billing of traffic using the guidelines as set forth in the Technical Exhibit Settlement

Procedures (TESP). Each Party will transmit the summarized originating minutes of usage within fifteen (15) business days following the prior month's close of business for all traffic including local, transiting, and optional EAS via the 92-type record process to the transiting and/or terminating Party for subsequent monthly intercompany settlement billing. This information will also be utilized by the Parties for use in verifying and auditing to confirm the jurisdictional nature of Local Calls and is required from the originating Party under the terms of this Appendix.

14.3 If originating records are not received within sixty (60) days, upon written notification the Party not receiving the originating records will bill all MOU for that month at Switched Access rates based upon a seven (7) day traffic study.

14.5 The Parties will not render invoice nor payment to each other for the transport and termination of calls for a particular month's usage until both Parties have received the originating 92-type summary records CLEC for that same month's usage.

14.6 On a monthly basis, each Party will record its originating MOU including identification of the originating and terminating NXX for all intercompany calls.

14.7 Each Party will transmit the summarized originating MOU above to the transiting and/or terminating Party for subsequent monthly intercompany settlement billing.

14.8 MOUs for the rates contained herein will be measured in seconds by call type, and accumulated each billing period into one (1) minute increments for billing purposes in accordance with industry rounding standards.

14.9 Where CLEC has direct End Office Switch and Tandem Office Switch interconnection arrangements with **SBC-13STATE**s, **SBC-13STATE**s will multiply the Tandem Office Switch routed terminating MOU and End Office Switch routed terminating MOUs by the appropriate rates in order to determine the total monthly billing to each Party.

15.0 BILLING FOR MUTUAL COMPENSATION -- SBC-AMERITECH, NEVADA, PACIFIC, SNET

15.1 In **SBC-AMERITECH**, **NEVADA**, **PACIFIC**, and **SNET**, each Party will calculate terminating interconnection minutes of use based on standard Automatic Message Accounting (AMA) recordings made within each Party's network. These recordings are the basis for each Party to generate bills to the other Party. For purposes of reciprocal compensation only, measurement of minutes of use over Local Interconnection Trunk Groups shall be in actual conversation seconds. The total conversation seconds over each individual Local Interconnection Trunk Group will be totaled for the entire monthly bill and then rounded to the next whole minute.

15.2 Each Party will provide to the other, within fifteen (15) calendar days, after the end of each quarter, a usage report with the following information regarding traffic terminated over the Local Interconnection Trunks:

15.2.1 Total traffic volume described in terms of minutes and messages and by call type (local, toll, and other) terminated to each other over the Local Interconnection Trunk Groups, and

15.2.1.1 Percent Local Usage (PLU) is calculated by dividing the Local MOU delivered to a party for termination by the total MOU delivered to a Party for termination.

15.2.2 Upon thirty (30) days written notice, each Party must provide the other the ability and opportunity to conduct an annual audit to ensure the proper billing of traffic between the Parties' networks. The Parties agree to retain records of call detail for six (6) months from when the calls were initially reported to the other Party. The audit will be conducted during normal business hours at an office designated by the Party being audited. Audit requests shall not be submitted more frequently than once per calendar year for each call detail type unless a subsequent audit is required. Audits shall be performed by a mutually acceptable independent auditor paid for by the Party requesting the audit. Based upon the audit, previous compensation, billing and/or settlements will be adjusted for the past twelve (12) months. Also, if the PLU is adjusted based upon the audit results, the adjusted PLU will apply for the nine (9) month period following the completion of the audit. If, as a result of the audit, either Party has overstated the PLU or underreported the call detail usage by twenty percent (20%) or more, that Party shall reimburse the auditing Party for the cost of the audit and will pay for the cost of a subsequent audit which is to happen within nine (9) months of the initial audit.

16.0 RESERVATION OF RIGHTS AND SPECIFIC INTERVENING LAW TERMS

16.1 The Parties acknowledge that on April 27, 2001, the FCC released its Order on Remand and Report and Order in CC Dockets No. 96-98 and 99-68, *In the Matter of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-bound Traffic* (the "ISP Compensation Order") which was remanded in *WorldCom, Inc. v. FCC,* No. 01-1218 (D.C. Cir. 2002). The Parties agree that by executing this Appendix and carrying out the intercarrier compensation rates, terms and conditions herein, neither Party waives any of its rights, and expressly reserves all of its rights, under the ISP Compensation Order, or any other regulatory, legislative or judicial action including but not limited to the ILEC's option to invoke on a date specified by ILEC the FCC's ISP terminating compensation plan, after which date ISP-bound traffic will be subject to the FCC's prescribed terminating compensation rates, and other terms and conditions.

16.2 ILEC agrees to provide 20 days advance written notice to the person designated to receive official contract notices in the underlying Interconnection Agreement of the date upon which the ILEC designates that the FCC's ISP terminating compensation plan shall begin in this state. CLEC agrees that on the date designated by ILEC, the Parties will begin billing Reciprocal Compensation to each other at the rates, terms and conditions specified in the FCC's terminating compensation plan.

16.3 ILEC and CLEC agree to carry out the FCC terminating compensation plan on the date designated by ILEC without waiving, and expressly reserving, all appellate rights to contest FCC, judicial, legislative, or other regulatory rulings regarding ISP and Internet-bound traffic, including but not limited to, appeals of the FCC's ISP Compensation Order. By agreeing to this Appendix, both Parties reserve the right to advocate their respective positions before courts, state or federal commissions, or legislative bodies.

16.4 Should a regulatory agency, court or legislature change or nullify the ILEC's designated date to begin billing under the FCC's ISP terminating compensation plan, then the Parties also agree that any necessary billing true ups, reimbursements, or other accounting adjustments shall be made symmetrically and to the same date that the FCC terminating compensation plan was deemed applicable to all traffic in that state exchanged under section 251(b)(5) of the Act. By way of interpretation, and without limiting the application of the foregoing, the Parties intend for retroactive compensation adjustments, to the extent they are ordered by Intervening Law, to apply uniformly to all traffic among ILEC, CLEC

and Commercial Mobile Radio Service (CMRS) carriers in the state where traffic is exchanged as Local Calls within the meaning of this Appendix.

16.5 The Parties further acknowledge that federal or state court challenges could be sustained against the FCC's ISP Compensation Order in particular, or against ISP intercarrier compensation generally. In particular, a court could order an injunction, stay or other retroactive ruling on ISP compensation back to the effective date of the FCC's ISP Compensation Order. Alternatively, a court could vacate the underlying Order upon which the compensation was based, and the FCC (either on remand or on its own motion) could rule that past traffic should be paid at different rates, terms or conditions.

16.6 Because of the possibilities in section 16.5, the Parties agree that should the ISP Compensation Order be modified or reversed in such a manner that prior intercarrier compensation was paid under rates, terms or conditions later found to be null and void, then the Parties agree that, in addition to negotiating appropriate amendments to conform to such modification or reversal, the Parties will also agree that any billing true ups, reimbursements, or other accounting adjustments on past traffic shall be made uniformly and on the same date as for all traffic exchanged under section 251(b)(5) of the Act. By way of interpretation, and without limiting the application of the foregoing, the Parties intend for retroactive compensation adjustments, to apply to all traffic among ILEC, CLEC, and CMRS carriers in the state where traffic is exchanged as Local Calls within the meaning of this Appendix.

16.7 The Parties further acknowledge that the FCC has issued a Notice of Proposed Rulemaking on the topic of Intercarrier Compensation generally. *See, In the Matter of Developing a Unified Intercarrier Compensation Regime*, CC Docket 01-92; established in Notice of Proposed Rulemaking Order No. 01-132, April 27, 2001. In the event that a final, legally binding FCC Order is issued upon the conclusion of that NPRM proceeding and during the term of this Appendix, the Parties agree to conform this Agreement to the compensation procedures set forth in that Order.

16.8 The parties agree to that the foregoing rates, terms, and conditions for the exchange of ISP-bound and Internet-bound traffic are subject to all rules, regulations, and interpretations of that traffic as Information Access pursuant to section 201 of the Act and FCC implementing orders, as opposed to sections 251 and 252 of the Act.

16.9 The Parties reserve the right to raise the appropriate treatment of Voice Over Internet Protocol (VOIP) or other Internet Telephony traffic under the Dispute Resolution provisions of this Interconnection Agreement. The Parties further

agree that this Appendix shall not be construed against either Party as a "meeting of the minds" that VOIP or Internet Telephony traffic is or is not local traffic subject to reciprocal compensation. By entering into the Appendix, both Parties reserve the right to advocate their respective positions before state or federal commissions whether in bilateral complaint dockets, arbitrations under Sec. 252 of the Act, commission established rulemaking dockets, or in any legal challenges stemming from such proceedings.

17.0 ADDITIONAL TERMS AND CONDITIONS

17.1 Legitimately Related Terms. Every interconnection, service and network element provided here shall be subject to all rates, terms and conditions contained in the underlying Interconnection Agreement which are legitimately related to such interconnection, service or network element. Without limiting the general applicability of the foregoing, the following terms and conditions of the General Terms and Conditions are specifically agreed by the Parties to be legitimately related to, and to be applicable to, each interconnection, service and network element provided hereunder: definitions, interpretation, construction and severability; notice of changes; general responsibilities of the Parties; effective date, term and termination; fraud; deposits; billing and payment of charges; non-payment and procedures for disconnection; dispute resolution; audits; disclaimer of representations and warranties; limitation of liability; indemnification; remedies; intellectual property; publicity and use of trademarks or service marks; no license; confidentiality; intervening law; governing law; regulatory approval; changes in End User local exchange service provider selection; compliance and certification; law enforcement; no third party beneficiaries; disclaimer of agency; relationship of the Parties/independent contractor; subcontracting; assignment; responsibility for environmental contamination; force majeure; taxes; non-waiver; network maintenance and management; signaling; transmission of traffic to third parties; customer inquiries; expenses; conflicts of interest; survival; scope of agreement; amendments and modifications; and entire agreement.

17.2 Entire Agreement. This Reciprocal Compensation Appendix is intended to be read in conjunction with the underlying Interconnection Agreement between ILEC and CLEC, but that as to the Reciprocal Compensation rates, terms and conditions, this Appendix constitutes the entire agreement between the Parties on these issues, and there are no other oral agreements or understandings between them on Reciprocal Compensation that are not incorporated into this Appendix.

GENERIC TERMINOLOGY	OANAD TERMINOLOGY		Monthly Recurring and/or Resale Discount %	NRC Initial "@" INDICATES TO REFER TO THE NONRECURRING PRICE SHEET FOR RATES	NRC Additional
RECIPROCAL COMPENSATION-LOCAL TRAFFIC TERMINATION			**USAGE**		
End Office Local Termination - Interoffice - Terminating					
Set up charge, per call		/2/	$ 0.002142		
Duration charge, per MOU		/2/	$ 0.000572		
Tandem Switching - Shared Transport					
Setup per Call		/2/	$ 0.000155		
Setup per Completed Message		/2/	$ 0.000234		
Holding Time per MOU		/2/	$ 0.000139		
Switched Transport - Common					
Fixed Mileage per MOU (Fixed Mileage)			$ 0.001330		
Variable Mileage per MOU per Mile (Variable Mileage)			$ 0.000021		
TRANSITING-LOCAL TRAFFIC					
Setup per completion (Setup per Call)			$ 0.0011300		
Holding term per MOU (MOU)			$ 0.0027700		

/2/ **The Parties acknowledge and agree that the interim rates adopted in CPUC Order# 02-05-042 are subject to adjustment, either up or down, from the effective date of this order until final rates are adopted.**

Exhibit 3

Application of Vicera Communications, Inc. d/b/a Genesis Communications International (U-5477-C) to Expand Its Certificate of Public Convenience and Necessity To Provide Limited Facilities-Based Local Exchange Telecommunications Services Within the Service Territories of Pacific Bell and Verizon, Decision 02-10-016, California Public Utilities Commission (Oct. 3, 2002)

Decision 02-10-016 October 3, 2002

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Vicera Communications, Inc. d/b/a Genesis Communications International (U-5477-C) to Expand Its Certificate of Public Convenience and Necessity To Provide Limited Facilities-Based Local Exchange Telecommunications Services Within the Service Territories of Pacific Bell and Verizon.	Application 02-06-022 (Filed June 11, 2002)

O P I N I O N

I. Summary

Vycera Communications, Inc. d/b/a Genesis Communications International (Applicant) seeks a certificate of public convenience and necessity (CPCN) under Pub. Util. Code § 1001 for authority to provide limited facilities-based local exchange telecommunications services as a competitive local carrier (CLC).[1] Applicant was previously authorized to resell local exchange and interexchange services.[2] By this decision, we grant the requested authority subject to the terms and conditions set forth below.

[1] A CLC is a common carrier that is issued a CPCN to provide local exchange telecommunications service for a geographic area specified by such carrier.

[2] Applicant was formerly known as Vicera Communications, Inc. d/b/a Genesis Communications International.

II. Background

In prior decisions, we authorized the provision of competitive local exchange service within the service territories of Pacific Bell Telephone Company (Pacific), Verizon California Inc. (Verizon), Roseville Telephone Company (RTC) and Citizens Telecommunications Company of California, Inc. (CTC).

Applicant, a California corporation requests authority to operate as a limited facilities-based provider of local exchange services within Pacific and Verizon's service territories.

Applicant's principal place of business is located at 12750 High Bluff Drive, Suite 200, San Diego, California 92130-2083.

III. Financial Qualifications

To be granted a CPCN for authority to provide facilities-based and resold local exchange service, an applicant must demonstrate that it has $100,000 cash or cash equivalent to meet the firm's start-up expenses. The applicant must also demonstrate that it has sufficient additional resources to cover all deposits required by other telecommunications carriers in order to provide service in California.[3] Applicant provided audited financial statements that demonstrate that it meets the financial requirements.

IV. Technical Qualifications

To be granted a CPCN for authority to provide local exchange service, an applicant must make a reasonable showing of technical expertise in telecommunications or a related business. Applicant was previously authorized

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[3] The financial standards for certification to operate as a CLC are set forth in D.95-12-056, Appendix C, Rule 4.B.

to resell interexchange and local exchange services by Decision (D.) 95-06-045 and D.96-02-072, respectively. Therefore, Applicant has the necessary expertise.

Applicant represents that no one associated with or employed by Applicant as an affiliate, officer, director, partner, or owner of more than 10% of Applicant was previously associated with a telecommunications carrier that filed for bankruptcy or went out of business, or was sanctioned by the Federal Communications Commission or any state regulatory agency for failure to comply with any regulatory statute, rule, or order.

V. California Environmental Quality Act (CEQA)

The CEQA requires the Commission as the designated lead agency to assess the potential environmental impact of a project in order that adverse effects are avoided, alternatives are investigated, and environmental quality is restored or enhanced to the fullest extent possible. Since Applicant states that it will not be constructing any facilities for the purpose of providing local exchange services, except for equipment to be installed in existing buildings or structures, it can be seen with certainty that there is no possibility that granting this application will have an adverse impact upon the environment. Applicant must file for additional authority, and submit to any necessary CEQA review, before it can construct facilities.

VI. Request to File Under Seal

Applicant requests that the financial information filed with this application be kept under seal. The financial information consists of its financial statements, and estimated customer base. Applicant represents that the information is proprietary and sensitive. The information, if revealed, would place Applicant at

an unfair business disadvantage. We have granted similar requests in the past and will do so here.

VII. Categorization and Need for Hearings

In Resolution ALJ 176-3090 dated June 27, 2002, the Commission preliminarily categorized this application as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. There is no apparent reason why the application should not be granted. Given these developments, a public hearing is not necessary, and it is not necessary to disturb the preliminary determinations.

VIII. Comments on Draft Decision

This is an uncontested matter in which the decision grants the requested relief. Therefore, pursuant to Pub. Util. Code § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being waived.

IX. Conclusion

We conclude that the application conforms to our rules for certification as a CLC. Accordingly, we shall grant Applicant a CPCN to provide limited facilities-based local exchange service in Pacific and Verizon's service territories of subject to compliance with the terms and conditions set forth herein.

X. Assignment of Proceeding

Carl Wood is the Assigned Commissioner and Jeffrey O'Donnell is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. A notice of the filing of the application appeared in the Daily Calendar on June 20, 2002.
2. There were no protests to this application.
3. A hearing is not required.

4. A notice of the filing of the application appeared in the Daily Calendar on June 20, 2002.

5. Applicant has a minimum of $100,000 of cash or cash equivalent that is reasonably liquid and readily available to meet its start-up expenses.

6. Applicant has sufficient additional cash or cash equivalent to cover any deposits that may be required by other telecommunications carriers in order to provide the proposed service.

7. Applicant's management possesses sufficient experience and knowledge to provide local exchange services to the public.

8. Applicant does not propose to construct any facilities, except for equipment to be installed in existing buildings or structures, in order to provide the proposed service.

9. Public disclosure of the financial information filed under seal would place Applicant at an unfair business disadvantage.

Conclusions of Law

1. Applicant has the financial ability to provide the proposed service.

2. Applicant has made a reasonable showing of technical expertise in, or related to, telecommunications.

3. Public convenience and necessity require the competitive local exchange services to be offered by Applicant, subject to the terms and conditions set forth herein.

4. The application should be granted to the extent set forth below.

5. Applicant, once granted a CPCN to operate as a CLC, should be subject to the applicable Commission rules, decisions, General Orders and statutes that pertain to California public utilities.

6. Since Applicant does not propose to construct any facilities, except for equipment to be installed in existing buildings or structures, it can be seen with certainty that granting it authority to provide local exchange services will not have a significant adverse effect upon the environment.

7. Because of the public interest in competitive local exchange services, the following order should be effective immediately.

8. Applicant's request to file its financial information under seal should be granted for two years.

O R D E R

IT IS ORDERED that:

1. A certificate of public convenience and necessity (CPCN) is granted to Vycera Communications, Inc. d/b/a Genesis Communications International (Applicant) to provide limited facilities-based local exchange services in the service territories of Pacific Bell Telephone Company and Verizon California Inc., subject to the terms and conditions set forth below.

2. The certificate granted and the authority to render service under the rates, charges, and rules authorized herein will expire if not exercised within 12 months after the effective date of this order.

3. The corporate identification number assigned to Applicant, U-5477-C, shall be included in the caption of all original filings with this Commission, and in the titles of other pleadings filed in existing cases.

4. Applicant shall comply with all applicable rules adopted in the Local Exchange Competition proceeding (Rulemaking 95-04-043/Investigation 95-04-044), as well as all other applicable Commission rules, decisions, GOs and statutes that pertain to California public utilities, subject to the exemptions granted in this decision.

5. Applicant shall comply with the requirements applicable to competitive local exchange carriers included in Attachment A to this decision.

6. Applicant is not authorized to construct facilities, except for equipment to be installed in existing buildings or structures.

7. Applicant's request to have the financial information filed with this application kept under seal is granted for two years from the effective date of this decision. During that period the information shall not be made accessible or disclosed to anyone other than the Commission staff except on the further order or ruling of the Commission, the Assigned Commissioner, the assigned Administrative Law Judge (ALJ), or the ALJ then designated as Law and Motion Judge.

8. If Applicant believes that further protection of the information kept under seal is needed, it may file a motion stating the justification for further withholding of the information from public inspection, or for such other relief as the Commission rules may then provide. This motion shall be filed no later than one month before the expiration date.

9. This proceeding is closed.

This order is effective today.

Dated October 3, 2002, at San Francisco, California.

LORETTA M. LYNCH
President
HENRY M. DUQUE
CARL W. WOOD
GEOFFREY F. BROWN
MICHAEL R. PEEVEY
Commissioners

ATTACHMENT A

REQUIREMENTS APPLICABLE TO COMPETITIVE LOCAL EXCHANGE CARRIERS

1. Applicant shall file a written acceptance of the certificate granted in this proceeding.

2. Applicant is subject to:

   a. The current 1.45% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the Universal Lifeline Telephone Service Trust Administrative Committee Fund (Pub. Util. Code § 879; Resolution T-16594, October 10, 2001);

   b. The current 0.300% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California Relay Service and Communications Devices Fund (Pub. Util. Code § 2881; D.98-12-073 and Resolution T-16663, August 22, 2002);

   c. The user fee provided in Pub. Util. Code §§ 431-435, which is 0.11% of gross intrastate revenue (Resolution M-4804);

   d. The current surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California High Cost Fund-A (Pub. Util. Code § 739.3; D.96-10-066, pp. 3-4, App. B, Rule 1.C; set by Resolution T-16550 at 0.360%, October 25, 2001);

   e. The current 1.42% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California High Cost Fund-B (D.96-10-066, p. 191, App. B, Rule 6.F., Resolution T-16554, October 25, 2001); and

   f. The current 0.300% surcharge applicable to all intrastate services except for those excluded by D.94-09-065, as modified by D.95-02-050, to fund the California Teleconnect Fund (D.96-10-066, p. 88, App. B, Rule 8.G, Resolution T-16584, October 10, 2001).

3. Applicant is a competitive local exchange carrier (CLC). The effectiveness of its future tariffs is subject to the schedules set forth in Appendix C, Section 4.E of Decision (D.) 95-12-056:

> "E. CLCs shall be subject to the following tariff and contract filing, revision and service pricing standards:
>
> "(1) Uniform rate reductions for existing tariff services shall become effective on five (5) working days' notice. Customer notification is not required for rate decreases.
>
> "(2) Uniform major rate increases for existing tariff services shall become effective on thirty (30) days' notice to the Commission, and shall require bill inserts, or first class mail notice to customers at least 30 days in advance of the pending rate increase.
>
> "(3) Uniform minor rate increases, as defined in D.90-11-029, shall become effective on not less than (5) working days' notice to the Commission. Customer notification is not required for such minor rate increases.
>
> "(4) Advice letter filings for new services and for all other types of tariff revisions, except changes in text not affecting rates or relocations of text in the tariff schedules, shall become effective on forty (40) days' notice.
>
> "(5) Advice letter filings revising the text or location of text material which do not result in an increase in any rate or charge shall become effective on not less than five (5) days' notice to the Commission."
>
> "(6) Contracts shall be subject to GO 96-A rules for NDIECS, except interconnection contracts.
>
> "(7) CLCs shall file tariffs in accordance with PU Code § 876."

4. Applicant may deviate from the following provisions of GO 96-A:

(a) paragraph II.C.(1)(b), which requires consecutive sheet numbering and

prohibits the reuse of sheet numbers; and (b) paragraph II.C.(4), which requires that "a separate sheet or series of sheets should be used for each rule." Tariff filings incorporating these deviations shall be subject to the approval of the Commission's Telecommunications Division. Tariff filings shall reflect all fees and surcharges to which Applicant is subject, as reflected in 2 above.

5. Applicant shall file a service area map as part of its initial tariff.

6. Prior to initiating service, Applicant shall provide the Commission's Consumer Services Division with the name and address of its designated contact person(s) for purposes of resolving consumer complaints. This information shall be updated if the name or telephone number changes, or at least annually.

7. Applicant shall notify this Commission in writing of the date that local exchange service is first rendered to the public, no later than five days after service first begins.

8. Applicant shall keep its books and records in accordance with the Generally Accepted Accounting Principles.

9. In the event Applicant's books and records are required for inspection by the Commission or its staff, it shall either produce such records at the Commission's offices or reimburse the Commission for the reasonable costs incurred in having Commission staff travel to its office.

10. Applicant shall file an annual report, in compliance with GO 104-A, on a calendar-year basis with the information contained in Attachment B to this decision.

11. Applicant shall ensure that its employees comply with the provisions of Public Utilities (Pub. Util.) Code § 2889.5 regarding solicitation of customers.

12. Within 60 days of the effective date of this order, Applicant shall comply with Pub. Util. Code § 708, Employee Identification Cards, and notify the Director of the Telecommunications Division in writing of its compliance.
13. If Applicant is 90 days or more late in filing an annual report, or in remitting the surcharges and fee listed in 3 above, the Commission's Telecommunications Division shall prepare for Commission consideration a resolution that revokes Applicant's CPCN unless it has received written permission from the Telecommunications Division to file or remit late.
14. Applicant shall comply with all applicable rules adopted in the Local Exchange Competition proceeding (Rulemaking 95-04-043/Investigation 95-04-044), as well as all other applicable Commission rules, decisions, General Orders and statutes that pertain to California public utilities, subject to the exemptions granted in this decision.
15. Applicant is exempt from General Order 96-A, subsections III.G(1) and (2), and Commission Rule of Practice and Procedure 18(b).
16. Applicant is exempt from Pub. Util. Code §§ 816-830.
17. Applicant is exempt from the requirements of Pub. Util. Code § 851 for the transfer or encumbrance of property whenever such transfer or encumbrance serves to secure debt.
18. Applicant shall send a copy of this decision to concerned local permitting agencies not later than 30 days from the date of this order.

(END OF ATTACHMENT A)

ATTACHMENT B

ANNUAL REPORT

An original and two copies shall be filed with the California Public Utilities Commission, 505 Van Ness Avenue, Room 3251, San Francisco, CA 94102-3298, no later than March 31st of the year following the calendar year for which the annual report is submitted.

Failure to file this information on time may result in a penalty as provided for in §§ 2107 and 2108 of the Public Utilities Code.

For answers to any questions concerning this report, call (415) 703-1961.

1. Exact legal name and U # of the reporting utility.
2. Address.
3. Name, title, address, and telephone number of the person to be contacted concerning the reported information.
4. Name and title of the officer having custody of the general books of account and the address of the office where such books are kept.
5. Type of organization (*e.g.*, corporation, partnership, sole proprietorship, etc.).

   If incorporated, specify:

   a. Date of filing articles of incorporation with the Secretary of State.
   b. State in which incorporated.
6. Number and date of the Commission decision granting the CPCN.
7. Date operations were begun.
8. Description of other business activities in which the utility is engaged.
9. List of all affiliated companies and their relationship to the utility. State if affiliate is a:

   a. Regulated public utility.
   b. Publicly held corporation.
10. Balance sheet as of December 31st of the year for which information is submitted.
11. Income statement for California operations for the calendar year for which information is submitted.

(END OF ATTACHMENT B)

Exhibit 4

Response to Application By Pacific Bell Telephone Company for Arbitration with Vycera Communications, Inc., Application No. A0209018, filed Oct. 7, 2002

SWIDLER BERLIN SHEREFF FRIEDMAN, LLP
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October 4, 2002

VIA OVERNIGHT DELIVERY

California Public Utilities Commission
State Building
Docket Office
505 Van Ness Avenue
San Francisco, CA 94102

Re: Response to Application by Pacific Bell Telephone Company for Arbitration with Vycera Communications, Inc.

Dear Sir or Madam:

Enclosed for filing are an original and seven (7) copies of the Response to Application by Pacific Bell Telephone Company for Arbitration with Vycera Communications, Inc. Please date-stamp the enclosed extra copy of this filing and return it in the self-addressed, postage prepaid envelope provided. Should you have any questions concerning this filing, please contact Rogena Harris at (202) 295-8303.

Respectfully submitted,

Katherine A. Rolph
Rogena Harris
Counsel for Vycera Communications, Inc.

Enclosures (w/ attachments)
cc: Derek Gietzen (Vycera)
David P. Discher (Pacific Bell Telephone Company, via FedEx)

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Pacific Bell Telephone Company's (U 1001 C) Application for Arbitration of Advice Letter No. 57 Filed by Vycera Communications, Inc. f/k/a Genesis Communications International, Inc. ("Vycera") (U-5477-C) Regarding Vycera's Request to Adopt the Interconnection Agreement between AT&T Communications of California, Inc. and Pacific Bell Telephone Company.	**Application No. A0209018 (filed September 18, 2002)**

RESPONSE TO APPLICATION BY PACIFIC BELL TELEPHONE COMPANY FOR ARBITRATION WITH VYCERA COMMUNICATIONS, INC.

This responds to Pacific Bell Telephone Company's ("SBC Pacific Bell") Application for Arbitration of Advice Letter No. 57 Filed by Vycera Communications, Inc. f/k/a Genesis Communications International, Inc., U-5477-C ("Vycera") ("Application for Arbitration"). In Advice Letter No. 57, Vycera filed its notice of adoption of the August 14, 2000 Interconnection Agreement between SBC Pacific Bell and AT&T Communications of California, Inc. ("AT&T Agreement"). SBC Pacific Bell refused to permit the adoption unless Vycera agreed to an extensive amendment of the agreement and agreed to postpone the effective date of the adoption. SBC Pacific Bell's Application for Arbitration is without legal basis and should be denied.

Vycera is a competitive local exchange carrier in California, providing resold local exchange telecommunications services in the service territories of SBC Pacific Bell, Verizon California Inc. ("Verizon"), Roseville Telephone Company ("RTC"), and Citizens

Telecommunications Company of California, Inc. ("CTC") since early 1996.[1] Vycera has an application currently pending at the California Public Utilities Commission to expand its Certificate of Public Convenience and Necessity to include the authority to provide limited facilities-based local exchange telecommunications services in the service territories of SBC Pacific Bell and Verizon. Vycera's application for limited facilities-based local exchange service was filed June 11, 2002; its application for limited facilities-based authority was on the California Public Utilities Commission's ("Commission") Consent Agenda for October 3, 2002; Vycera believes its partial facilities-based certification was granted on October 3, 2002, however it has not yet received formal notification of same.

I. Overview

47 U.S.C. § 252(i) provides:

> A local exchange carrier shall make available any interconnection service, or network element provided under an agreement approved under this section to which it is a party to any other requesting telecommunications carrier upon the same terms and conditions as provided in the agreement.

We will address SBC Pacific Bell's legal arguments in detail below, but in short, Vycera's position is that it is legally entitled to adopt the AT&T Agreement 1) *as is*, and 2) *now*. SBC Pacific Bell's position is that Vycera should only be permitted to adopt the AT&T Agreement 1) *after agreeing to extensive revisions demanded by SBC Pacific Bell,*[2] and 2) *later*.

---

[1] Vycera obtained the authority to resell local exchange services on February 23, 1996, in Decision No. 96-02-072. Vycera is also authorized to provide resold interexchange telecommunications services pursuant to its Certificate granted in Decision No. 95-06-045 on June 21, 1995. (Genesis Communications International, Inc. changed its name to Vicera Communications, Inc., and later to Vycera Communications, Inc.)

[2] Vycera was told that "the reciprocal compensation provisions of the AT&T agreement" meant Sections 3, 5.1, 5.2, 5.3, 5.4 of the underlying AT&T Agreement, Attachment 18 (Interconnection) of the Agreement, and associated rates. In its Application, SBC Pacific Bell states that "[t]he terms and conditions that are legitimately related to the rates for ISP-bound traffic are contained in Sections 2, 3, and 5 of Attachment 18 of the AT&T Agreement and involve compensation for call termination." Application for Arbitration at 6. Vycera was sent a twenty-one page draft (Application for Arbitration, Attachment B) as a proposed replacement for the AT&T Agreement sections SBC Pacific Bell wanted Vycera to except from its adoption notice "in order to assist Vycera in acquiring a full agreement with Pacific."

This dispute is purely one of law; there is no factual dispute. The parties disagree as to the meaning and legal effect of 1) the FCC's *Order on Remand and Report and Order,* released April 27, 2001[3] ("*FCC Intercarrier Compensation for ISP-Bound Traffic Order*"), and 2) the California Rules Implementing the Provisions of Section 252 of the Telecommunications Act of 1996 ("California Rules").[4]

II. SBC Pacific Bell Has Not Pled Grounds Which, if True, Would Overcome Vycera's Right to Opt-In to the AT&T Agreement

Rule 7 of the California Rules sets out the "Process for Adopting a Previously Approved Agreement." Rule 7.2 provides:

> Within 15 days of its receipt of the Advice Letter or Letter of Intent, the ILEC shall either send the requesting carrier a letter approving its request or file a request for arbitration based solely on the requirements in § 51.809:
>
> a. Any individual interconnection, service, or network element arrangement contained in any agreement approved by the Commission pursuant to Section 252 of the Telecommunications Act of 1996, must be made available upon the same rates, terms, and conditions as those provided in the agreement.
>
> b. <u>The obligations of section (a) above shall not apply where the ILEC proves to the state commission that:</u>
>
> > <u>(1) the costs of providing a particular interconnection, service, or element to the requesting telecommunications carrier are greater than the costs of providing it to the telecommunications carrier that originally negotiated the agreement.</u>
> >
> > <u>(2) the provision of a particular interconnection, service, or element to the requesting carrier is not technically feasible</u>.
>
> c. Individual interconnection service, or network element arrangements shall remain available for use by telecommunications carriers pursuant to this section for a reasonable period of time after the approved agreement is available for public inspection under 252(f) of the Act.
> (Emphasis added.)

---

[3] *In the Matters of Implementation of Local Competition Provisions of Telecommunications Act of 1996 and Inter-Carrier Compensation for ISP-Bound Traffic*, CC Dkt. Nos. 96-98 and 99-68, *Order on Remand and Report and Order*, FCC 01-131 (rel. April 27, 2001) ("*FCC Intercarrier Compensation for ISP-Bound Traffic Order*").

[4] California Rules Implementing the Provisions of Section 252 of the Telecommunications Act of 1996, CPUC Res. ALJ-181, Oct. 5, 2000 ("California Rules").

Moreover, per California Rule 7.3.1, the ILEC has the burden of proof in this proceeding.[5]

As a threshold matter, SBC Pacific Bell has not made the requisite showing under either 7.2(b)(1) or 7.2(b)(2) necessary to overcome Vycera's right to opt-in to the AT&T agreement. SBC Pacific Bell has made no claim that providing interconnection to Vycera will cost more than providing it to AT&T, the first ground which could overcome Vycera's right to opt-in to the AT&T Agreement. With regard to Rule 7.2(b)(2), SBC Pacific Bell engages in artful pleading, attempting to convince the Commission that "the provision of a particular interconnection, service, or element to the requesting carrier is not technically feasible" by stating that because Vycera has not obtained its partial facilities-based certification, Vycera's opt-in is "not technically feasible." SBC Pacific Bell's tortured interpretation of Rule 7.2(b)(2) ignores the word "particular" in Rule 7.2(b)(2) and redefines the word "technical." SBC Pacific Bell has cited no authority for its linguistic gymnastics, nor has it persuasively argued for such an interpretation. Moreover, once Vycera's application to expand its certification to include partial facilities-based certification is granted, which it believes occurred on October 3, 2002, no such argument can be possibly serve as a ground for this Application for Arbitration.

III. The FCC's April 2001 Order's Interim Compensation Regime for ISP-Bound Traffic Is Not in Effect in SBC Pacific Bell Territory in California

SBC Pacific Bell predicates its demand that Vycera agree to extensive revisions to the AT&T Agreement upon the *FCC Intercarrier Compensation for ISP-Bound Traffic Order*, wherein the FCC established a comprehensive interim regime to govern intercarrier compensation for internet service provider ("ISP")-bound traffic, to be effective until the FCC resolves issues

---

[5] *Id.*, Rule 7.3.1:

> In any application for arbitration filed pursuant to Rule 7, the ILEC has the burden of proof that the carrier's request does not meet the requirements of § 51.809. The ILEC's request for arbitration must include facts and evidence that its request for arbitration is consistent with the requirements of § 51.809 and Rule 7.2.

raised in a separate intercarrier compensation Notice of Proposed Rulemaking.[6] However: the FCC's interim compensation regime for ISP-bound traffic applies within a state "*only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate" in the state,[7] which SBC Pacific Bell has not done in California.[8] (Section 251(b)(5) traffic includes, among other things, intra-MTA CMRS traffic.)[9]

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[6] *FCC Intercarrier Compensation for ISP-Bound Traffic Order* at ¶¶ 2, 66, 77.

[7] *Id.* at ¶ 89.

[8] The fact that SBC Pacific Bell has not yet offered to exchange all traffic subject to section 251(b)(5) at the same rate is evidenced by a number of things, including a recital within the proposed reciprocal compensation amendment it wanted Vycera to sign in September 2002 prior to Vycera's being allowed to opt in to any part of the AT&T Agreement. *See* Application for Arbitration, p. 7. The reciprocal compensation amendment proposed to Vycera by SBC Pacific Bell can be found at Attachment B to the Application for Arbitration, and is entitled "Negotiated Appendix Reciprocal Compensation." Section 16.1 of the proposed amendment states:

> The Parties acknowledge that on April 27, 2001, the FCC released its Order on Remand and Report and Order in CC Dockets No. 96-98 and 99-68, *In the Matter of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-bound Traffic* (the "ISP Compensation Order") which was remanded in *WorldCom, Inc.* v. FCC, No. 01-1218 (D.C. Cir. 2002). The Parties agree that by executing this Appendix and carrying out the intercarrier compensation rates, terms and conditions herein, neither Party waives any of its rights, under the ISP Compensation Order, or any other regulatory, legislative or judicial action including but not limited to the ILEC's option to invoke on a date specified by ILEC the FCC's ISP terminating compensation plan, after which date ISP-bound traffic will be subject to the FCC's prescribed terminating compensation rates, and other terms and conditions.

Section 16.2 of SBC Pacific Bell's proposed reciprocal compensation amendment goes on to state:

> ILEC agrees to provide 20 days advance written notice to the person designated to receive official contract notices in the underlying Interconnection Agreement of the date upon which the ILEC designates that the FCC's ISP terminating compensation plan shall begin in this state. CLEC agrees that on the date designated by ILEC, the Parties will begin billing Reciprocal Compensation to each other at the rates, terms and conditions specified in the FCC's terminating compensation plan.

Also See Amendment No. 3 to the AT&T Agreement at Application for Arbitration, Attachment A, which recites:

> Pacific further notes that on April 27, 2001, the FCC released its Order on Remand and Report and Order in CC Dockets No. 96-98 and 99-68, *In the Matter of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-bound Traffic* (the "ISP Intercarrier Compensation Order.") By executing this Amendment and carrying out the intercarrier compensation rates, terms and conditions herein, Pacific does not waive any of its rights, and expressly reserves all of its rights, under the ISP Intercarrier Compensation Order, <u>including but not limited to its right to exercise its option at any time in the future to invoke the Intervening Law or Change of Law provisions and to adopt on a date specified by Pacific the FCC ISP terminating compensation plan, after which date ISP-bound traffic will be subject to the FCC's prescribed terminating compensation rates, and other terms and conditions</u>. (Emphasis added.)

The FCC's interim regime for compensation for ISP-bound traffic, which is available within states where the incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate, significantly reduced the level of compensation to carriers currently serving ISPs; capped the growth of compensable minutes for those carriers; eliminated all terminating compensation for ISP-bound traffic for carriers entering new markets; and adopted a rebuttable presumption that traffic delivered to a carrier, pursuant to a particular contract, that exceeded a 3:1 ratio of terminating to originating traffic was ISP-bound traffic that is subject to the compensation mechanism set forth in the Order.[10] As part of its interim regime, the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* said, *inter alia*, "carriers may no longer invoke section 252(i) to opt in to an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic" (emphasis added).[11]

The FCC went to great lengths to explain the reason behind its mandate that the interim regime for intercarrier compensation for ISP-bound traffic did not apply within a state unless the incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate. As the FCC noted, ILECs want rates for ISP-bound traffic to be low, because typically ILECs pay out more reciprocal compensation to CLECs (because of ISP-bound traffic) than they receive. The ILECs do not like low reciprocal compensation rates for CMRS traffic (CMRS traffic is included

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Also see SBC Communications Inc.'s Annual Report for 2001, dated February 8, 2002 (Attachment 1), p. 16, Reciprocal Compensation, which references the *FCC Intercarrier Compensation for ISP-Bound Traffic Order*, referring to it as the "April 2001 order," and states that:

> The FCC transition plan is optional for incumbent local exchange carriers and in order to opt into the plan, incumbents must offer to exchange local and wireless traffic at the same compensation rate as internet traffic. To date, none of our wireline subsidiaries have opted into the transition plan.

Vycera is unaware of SBC Pacific Bell exercising such an option subsequent to its signing of the AT&T Agreement, nor has SBC Pacific Bell alleged in its Application for Arbitration or supporting testimony that it has done so. At no time has SBC Pacific Bell offered to Vycera an agreement incorporating (as opposed to preserving the right to adopt) the FCC ISP terminating compensation plan.

[9] *FCC Intercarrier Compensation for ISP-Bound Traffic Order* at ¶ 89, n. 177.

in 251(b)(5) traffic),[12] because typically ILECs receive more reciprocal compensation payments for CMRS traffic than they pay out (*i.e.,* wireless customers make more outgoing calls).[13] The FCC, foreseeing that ILECs might try to have their "intercarrier compensation cake" and eat it, too, said:

> 89. It would be unwise as a policy matter, and patently unfair, to allow incumbent LECs to benefit from reduced intercarrier compensation rates for ISP-bound traffic, with respect to which they are net payors, while permitting them to exchange traffic at state reciprocal compensation rates, which are much higher than the caps we adopt here, when the traffic imbalance is reversed. [FN 176] Because we are concerned about the superior bargaining power of incumbent LECs, we will not allow them to "pick and choose" intercarrier compensation regimes, depending on the nature of the traffic exchanged with another carrier. The rate caps for ISP-bound traffic that we adopt here apply, therefore, *only*[14] if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) [FN 177] at the same rate. Thus, if the applicable rate cap is $.0010/mou, the ILEC must offer to exchange section 251(b)(5) traffic at that same rate. Similarly, if an ILEC wishes to continue to exchange ISP-bound traffic on a bill and keep basis in a state that has ordered bill and keep, it must offer to exchange all section 251(b)(5) traffic on a bill and keep basis. [FN 178] For those incumbent LECs that choose *not* to offer to exchange section 251(b)(5) traffic subject to the same rate caps we adopt for ISP-bound traffic, we order them to exchange ISP-bound traffic at the state-approved or state-arbitrated reciprocal compensation rates reflected in their contracts. [FN 179] This mirroring rule insures that incumbent LECs ill pay the same rates for ISP-bound traffic that they receive for section 251(b)(5) traffic. (Underlined emphasis added.)[15]

Thus, the FCC allows an ILEC to choose, on a state-by-state basis,[16] whether to avail itself of the benefits available to it under the interim compensation regime for ISP-bound traffic as set out in the *FCC Intercarrier Compensation for ISP-Bound Traffic Order.* Since SBC Pacific Bell has not offered to exchange all traffic subject to section 251(b)(5) at the same rate within California,[17] the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* and its interim compensation regime

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[10] *Id.* at ¶ 79.
[11] *Id.* at ¶ 82.
[12] *Id.* at n. 177.
[13] *Id.* at ¶ 89, n. 177.
[14] It is worth noting that the emphasis on the word "only" here is the FCC's, not Vycera's.
[15] *Also see id.* at ¶ 8.
[16] *Id.* at ¶ 89, n. 179.
[17] *See* n. 8, *supra.*

for ISP-bound traffic, upon which SBC Pacific Bell's demands to Vycera are predicated, have no relevance in SBC Pacific Bell territory in California.

IV. SBC Pacific Bell's Position that Vycera Cannot Opt In to Any Portion of the AT&T Agreement Unless It First Agrees to Extensive Revisions Is Wrong for Five Reasons.

A. As explained above, the FCC's interim compensation regime for ISP-bound traffic, upon which SBC Pacific Bell's Application for Arbitration is predicated, does not apply in SBC Pacific Bell territory in California at all at this time because SBC Pacific Bell has not offered to exchange all 251(b)(5) traffic at the same rate. Therefore, its Application for Arbitration should be denied.

B. Even if the FCC's interim compensation regime for ISP-bound traffic did apply in SBC Pacific Bell territory in California, Vycera would still be entitled to opt in to all provisions of the AT&T Agreement, as is.

Let us assume that tomorrow, SBC Pacific Bell agrees to exchange all traffic subject to section 251(b)(5) in California at the same rate, so that the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* would apply in its territory in California. SBC Pacific Bell is arguing that the FCC's statement that "carriers may no longer invoke section 252(i) to opt in to an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic" (emphasis added) should be interpreted to require a twenty-one page amendment to the AT&T Agreement that must be completely "negotiated" during the 15-day period between the CLEC's notice of opt-in and the effective date. On its face, the FCC's language would not preclude opt-in to any part of the AT&T Agreement except for the "rates paid for the exchange of ISP-bound traffic." As explained more fully below, because the AT&T Agreement already excludes compensation where prohibited by FCC Order, no part of the AT&T Agreement can be excluded from opt-in.

If and when the *FCC Intercarrier Compensation for ISP-Bound Traffic Order's* interim compensation regime for ISP-bound traffic applies in SBC Pacific Bell territory in California, the relevant provisions would be:

> [C]arriers may no longer invoke section 252(i) to opt in to an existing interconnection agreement with regard to the rates paid for the exchange of ISP-bound traffic.[18] (Emphasis added.)

and

> Finally, a different rule applies in the case where carriers are not exchanging traffic pursuant to interconnection agreements prior to adoption of this Order (where, for example, a new carrier enters the market or an existing carrier expands into a market it previously had not served). In such a case, as of the effective date of this Order, carriers shall exchange ISP-bound traffic on a bill-and-keep basis during this interim period.[19]

The AT&T Agreement already says that "[t]he compensation arrangements set forth in this Attachment [the Interconnection Attachment, Attachment 18] are not applicable to . . . any other type of traffic found to be exempt from reciprocal compensation by the FCC or the Commission."[20] Thus, if the *FCC Intercarrier Compensation for ISP-Bound Traffic Order*'s interim compensation regime for ISP-bound traffic applied in California, the rate for to be paid Vycera for ISP-bound traffic would be $0.00 (bill-and-keep), Vycera being a carrier not exchanging traffic pursuant to interconnection agreements prior to adoption of the FCC Order (Vycera has only provided services to date on a resale basis). The AT&T Agreement already excludes reciprocal compensation payments for ISP-bound traffic to the extent that ISP-bound traffic is exempt pursuant to FCC or CPUC order.[21]

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[18] *Id.* at ¶ 82.
[19] *Id.* at ¶ 81.
[20] AT&T Agreement, Attachment 18, Section 3.4.
[21] To the extent that SBC Pacific Bell mounts an argument that the clause in the current AT&T Agreement which already precludes payment for traffic if prohibited by FCC order is "unclear," which Vycera strongly believes it is not, now is not the time to debate that point. That time would come if, in the future, one of the parties demanded compensation for ISP-bound traffic, and the other party claimed it was not payable. That may never happen.

C. SBC Pacific Bell's proposed twenty-one pages of revisions are **not** "reasonably related" to the "rates paid for the exchange of ISP-bound traffic."

SBC Pacific Bell argues that twenty-one pages of revisions must be made to the AT&T Agreement because they are "reasonably related" to the rates paid for the exchange of ISP-bound traffic.[22] The twenty-one pages of revisions proposed by SBC Pacific Bell reasonably relate only to SBC Pacific Bell's effort to find a semi-plausible basis upon which to lure anxious CLECs, who cannot offer services without an interconnection agreement in place, into agreeing to higher rates and terms far less favorable than those to which they are legally entitled. For example, the rates for "Transiting-Local Traffic" (not a reciprocal compensation rate) that SBC Pacific Bell has smuggled into its proposed Reciprocal Compensation Amendment ($0.0011300 setup per call, $0.0027700 holding term per MOU)[23] are far higher that those applicable under the AT&T Agreement ($0.000750 setup per attempt, $0.0011300 setup per completed message, $0.000670 holding time per MOU).[24] Because Carriers such as Vycera offering local service via UNE-P do not provide transit switching, only Vycera would be paying the higher charges for "Transiting-Local Traffic."

There is no legal basis, and it would be colossally unfair, to permit SBC Pacific Bell to make Vycera undergo the expensive process of picking through all twenty-one-pages of the SBC Pacific Bell-drafted amendment trying to find and understand every nuanced instance of a worsening in its contractual position. SBC Pacific Bell does not want to make the AT&T Agreement available to CLECs in its entirety, as it is required to do by law, because the AT&T Agreement is a good one for CLECs and SBC Pacific Bell prefers to make the opt-in process

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[22] *FCC Intercarrier Compensation for ISP-Bound Traffic Order* at ¶ 82.

[23] Application for Arbitration, Attachment B, "Negotiated Appendix Reciprocal Compensation (After FCC Order No. 01-131)," at p. 21, Appendix Pricing.

[24] AT&T Agreement, Attachment 8 Pricing: Appendix C, Section 3.1; Section 5.4; Appendix A-1, p. 1.

expensive, complicated, time-consuming, and to secure for itself twenty-one pages of future SBC-favorable litigation fodder.

D. The *FCC Intercarrier Compensation for ISP-Bound Traffic Order*, although it has not been vacated and so is currently in effect, was remanded to the FCC for further proceedings by the D.C. Circuit Court of Appeals in May, 2002.[25] In the May 2002 Order, the D.C. Circuit found that the FCC could not use § 251(g) as a legal basis for its authority to "carve out" from 47 U.S.C. § 251(b)(5) calls made to ISPs (§ 251(b)(5) requires all LECs to establish reciprocal compensation arrangements). The D.C. Circuit, having found that no legal basis for the FCC's establishment of rules for intercarrier compensation for ISP-bound traffic had yet been established, stated:

> Having found that § 251(g) does not provide a basis for the Commission's action, we make no further determinations. . . . Nor do we decide whether the Commission may adopt bill-and-keep for ISP-bound calls pursuant to § 251(b)(5). . . Because we can't yet know the legal basis for the Commission's ultimate rules, or even what those rules may prove to be, we have no meaningful context in which to assess these explicitly transitional measures.

Thus, no one knows at this time if the provisions of the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* will ultimately have any applicability at all, a fact SBC Pacific Bell recited in the proposed reciprocal compensation amendment (at Application for Arbitration, Attachment B) it wanted Vycera to agree to as a condition of allowing Vycera to adopt any portion of the AT&T Agreement.[26] Application for Arbitration, p. 7. In the meantime, SBC Pacific Bell is attempting to get CLECs to give up rights via contract amendment that CLECs have not definitely lost pursuant to FCC orders or court decision.

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[25] *WorldCom, Inc. v. FCC*, 288 F3d 429 (D.C. Cir. 2002).

[26] *See* Application for Arbitration, Attachment B, Negotiated Appendix Reciprocal Compensation (After FCC Order No. 01-131), Section 16.5, wherein SBC Pacific Bell recites:

> The Parties further acknowledge that federal or state court challenges could be sustained against the FCC's ISP Compensation Order in particular, or against ISP intercarrier compensation generally. In particular, a court could order an injunction, stay or other retroactive ruling on ISP compensation back to the effective date of the FCC's ISP Compensation Order. Alternatively, a court could vacate the underlying Order upon which the compensation was based, and the FCC (either on remand or on its own motion) could rule that past traffic should be paid at different rates, terms or conditions.

E. SBC Pacific Bell's assertion that Vycera cannot adopt the terms in the AT&T Agreement mandating the payment of inter-carrier compensation for ISP-bound traffic because those terms are "stale" within the meaning of 47 C.F.R. § 51.809(c) and "prohibited by operation of law" is without legal basis.

SBC Pacific Bell also argues that Vycera cannot opt-in to the terms in the AT&T Agreement mandating the payment of inter-carrier compensation for ISP-bound traffic (which SBC Pacific Bell claims means Sections 2, 3, and 5 of Attachment 18 of the AT&T Agreement)[27] because those terms are "stale" within the meaning of 47 C.F.R. § 51.809(c), stating that such is "prohibited by operation of law." As explained more fully below, this argument is premised upon 1) an ill-conceived footnote 2) in an order that has been remanded (the *FCC Intercarrier Compensation for ISP-Bound Traffic Order)* 3) whose terms regarding compensation for ISP-bound traffic do not apply in California because SBC Pacific Bell has not yet offered to exchange all 252(i) traffic at the same rate (and when and if such terms ever do apply in California, will only relate to rates for ISP-bound traffic, not to twenty-one pages of new interconnection terms as SBC Pacific Bell argues).

47 C.F.R. § 51.809(c) provides that:

> Individual interconnection service, or network element arrangements shall remain available for use by telecommunications carriers pursuant to this section for a reasonable period of time after the approved agreement is available for public inspection under 252 (f) of the Act.

SBC Pacific Bell bases its argument that the terms in the AT&T Agreement mandating the payment of inter-carrier compensation for ISP-bound traffic are "stale" within the meaning of 47 C.F.R. § 51.809(c) on Footnote 155 of the *FCC Intercarrier Compensation for ISP-Bound Traffic Order*. Footnote 155 says:

[27] See n. 2, *infra*.

> 155 In any event, our rule implementing section 252(i) requires incumbent LECs to make available "[i]ndividual interconnection, service, or network element arrangements" to requesting telecommunications carriers only "for a reasonable period of time." 47 C.F.R. § 51.809(c). We conclude that any "reasonable period of time" for making available rates applicable to the exchange of ISP-bound traffic expires upon the Commission's adoption in this Order of an intercarrier compensation mechanism for ISP-bound traffic.

As noted earlier, the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* used 251(g) as authority to promulgate its interim compensation regime for ISP-bound traffic, which the D.C. Circuit has said provides no legal basis for same. Footnote 155 was apparently tossed in to the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* as an additional legal basis for one piece of the FCC's interim regime, but it was not a legal basis about which the FCC was confident enough to put in the main text, possibly because it recognized the difficulty inherent in rationalizing a statement that rates applicable to the exchange of ISP-bound traffic entered into even one day prior to publication of its order were "stale." In any event, to the extent the *FCC Intercarrier Compensation for ISP-Bound Traffic Order* applies at all, and to the extent that there is any tension between two statements within the *Order*, clearly the statement in the main text, the very heart of the *Order*, partially italicized for emphasis, that the regime for ISP-bound traffic applies within a state "*only* if an incumbent LEC offers to exchange all traffic subject to section 251(b)(5) at the same rate" in the state[28] takes precedence over any language in a footnote.

V. SBC Pacific Bell Has Wrongfully Delayed the Effective Date of Vycera's Adoption

In anticipation of the grant of its request for expanded authority to include limited facilities-based authority, Vycera notified the Commission and SBC Pacific Bell of its election to adopt the AT&T agreement in its entirety, which SBC Pacific Bell received on September 3, 2002.[29] SBC Pacific Bell has refused, one of its stated reasons being that Vycera has not yet obtained its partial facilities-based certification.

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[28] *FCC Intercarrier Compensation for ISP-Bound Traffic Order* at ¶ 89.
[29] Advice Letter No. 57, dated August 30, 2002.

The California Rules regarding the 252(i) process are set out in Resolution ALJ-181, which revised Resolution ALJ-178 Implementing the Provisions of Section 252 of the Telecommunication Act of 1996. California Rule 1.3 states:

> Only those carriers which have already been granted a Certificate of Public Convenience and Necessity (CPCN) for providing local exchange service, <u>or which have an application pending</u> at this Commission for a CPCN for providing local exchange service, are entitled to make use of the Section 252 processes described in these rules.

In Resolution ALJ-181, the Commission stated:

> We also require that any potential Competitive Local Exchange Carrier which intends to make use of these rules must have been granted a Certificate of Public Convenience and Necessity (CPCN), <u>or at least have filed an application for a CPCN, prior to</u> applying to have an interconnection dispute mediated, or <u>an agreement approved</u> or arbitrated. Commission resources are scarce, and we want to assure ourselves that any carrier that makes use of these processes fully intends to enter the local market in California. (Emphasis added.)

CPUC Res. ALJ-181 at p. 2.

Vycera has been a California CLEC since 1996, and has had an application to expand its authority to include partial facilities-based certification pending since June 11, 2002. Under the California rules, Vycera, <u>having filed its application for CPCN</u>, was clearly entitled to opt in to the AT&T agreement prior to finally receiving its partial facilities-based certification. Vycera cannot offer service using UNE-P until it receives its partial facilities-based authorization from the California Commission. However, the California Rules provide, at a minimum, that Vycera can opt-in to an appropriate interconnection agreement with SBC Pacific Bell upon applying for its partial facilities-based certification. There is no reason, other than SBC Pacific Bell's anti-competitive desire to delay competitors from being able to offer their services to California consumers, why Vycera should not have an interconnection agreement in effect and in place so that Vycera could be ready to offer partial facilities-based service immediately upon its expanded certification being granted.

VI. SBC Pacific Bell Refuses to Implement Any Part of Vycera's Adoption of the AT&T Agreement, For Which There is No Legal Basis.

In yet another attempt at delay, SBC Pacific Bell argues that it should not be required to allow Vycera to opt in to any part of the AT&T Agreement, because it "should not be asked to implement the entire agreement" in view of the fact that "[a]n interconnection agreement that does not contain critical reciprocal compensation provisions is not a comprehensive agreement that can be implemented because it lacks the mechanism for payment of traffic exchanged between the parties." (Again, SBC Pacific Bell's argument to exclude anything from this opt-in is based on the phrase "rates paid for the exchange of ISP-bound traffic.") In other words, SBC Pacific Bell has been holding the entire AT&T Agreement hostage, saying that Vycera must agree to less than it is legally entitled to or Vycera can't have an interconnection agreement at all.

The Commission's Rules provide:

> Should the ILEC file for arbitration, the ILEC shall immediately honor the adoption of those terms not subject to objection pursuant to Rule 7.2, effective as of the date of the filing of the arbitration request. Furthermore, to the extent the ILEC seeks arbitration of the costs of a particular interconnection, service, or element, the ILEC shall immediately honor such provisions subject to retroactive price true-up back to the date when the arbitration request was filed, based on the Commission's resolution of the arbitration. The effective date of other disputed issues will be set in the arbitration process and could be made effective retroactive to the date when the arbitration request was filed.[30]

As set out above, Vycera is legally entitled to opt in to the entire AT&T Agreement. Even if it were not, pursuant to Rule 7.3.2, SBC Pacific Bell should be required to acknowledge adoption of the AT&T Agreement immediately subject to retroactive price true-up for the rates for ISP-bound traffic.

[30] California Rules, Rule 7.3.2.

VII. Conclusion

For the foregoing reasons, Vycera respectfully requests that SBC Pacific Bell's Application for Arbitration be denied in its entirety, and that SBC Pacific Bell be ordered to commence billing Vycera at UNE-P rates, not resale rates, effective the date Vycera received its partial facilities-based certification.

Respectfully submitted,

Vycera Communications, Inc.

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Its Counsel

Date: October 4, 2002

Attachment 1

SBC Communications Inc. Annual Report 2001

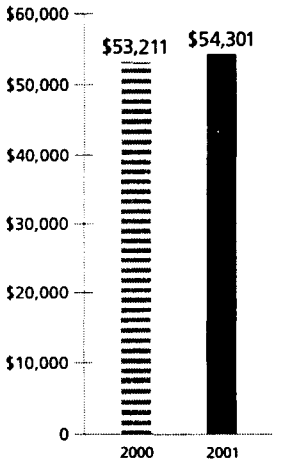
SBC Communications Inc.

ANNUAL REPORT
2001

OPERATING REVENUES

Dollars in millions

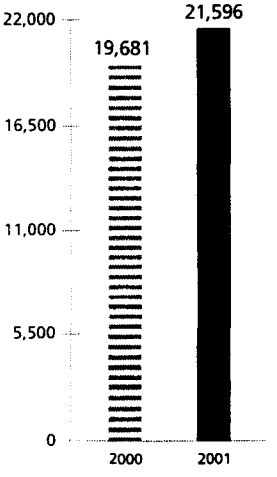
Excluding one-time items (see page 5). 2001 and the fourth quarter of 2000 reflect 60 percent proportional consolidation of Cingular Wireless' actual revenues.



WIRELESS SUBSCRIBERS

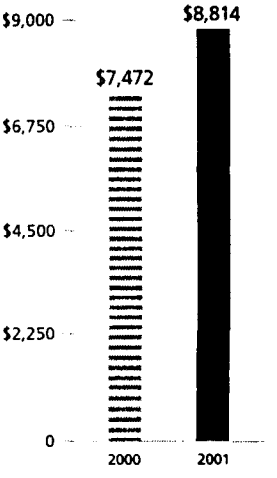
In thousands

Total customers of Cingular Wireless



DATA REVENUES

Dollars in millions



DEAR FELLOW INVESTOR:

The year 2001 challenged our nation and our industry. Our country's economic woes were magnified by September's terrorist attacks, creating uncertainty and concern throughout the communities we serve. However, these challenging times brought out the best in SBC, as our team of more than 190,000 employees reacted swiftly to a fast-changing, difficult environment and took the decisive actions needed to best serve our customers and shareowners.

I never am completely satisfied with our results, but given the circumstances, I am proud of our performance in 2001. We remained committed to our long-term strategy of building a company with the size, skills and financial power to excel in good times and remain solid during tough times. Simply put, SBC has the strongest balance sheet, cash flows and credit ratings in our industry, and we are well-positioned for future growth, particularly when the economy turns around.

LOOKING BACK AT 2001

The weak U.S. economy was only one factor that made last year difficult. We operated in a difficult and uncertain regulatory environment that hampered our data/broadband and long-distance businesses, and our operations saw the impact of additional competition at the local level.

Despite these factors and the generally unfavorable conditions throughout the telecom sector, SBC's scale, advanced network, customer service, product mix and financial health enabled your employee team to turn in a solid financial performance last year:

- Net income of $8.0 billion, before one-time items, up 2.7 percent
- $14.8 billion in operating cash flow, an increase of 5.3 percent
- $8.8 billion in total data revenues, up 18.0 percent
- $3.5 billion in dividend payments in a year where many companies cut the amount of earnings distributed to shareowners

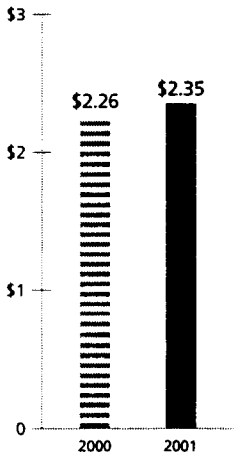
In the fourth quarter, the SBC Board of Directors approved a share-repurchase program that authorizes SBC to buy back up to 100 million shares of its common stock; this follows a repurchase program approved in 2000 under which SBC bought back more than 97 million shares.

Our focus throughout the year centered on:

- **Continued commitment to our growth drivers.** Through acquisitions and strategic partnerships over the past several years, we have assembled the right assets to create a growth platform that will serve the company well into the future. The three legs of our growth platform — data/broadband, long distance and wireless communications — performed well last year. These areas offer the greatest opportunities for SBC to grow by leveraging our advanced networks against a large customer base.
- **Disciplined expense management.** We sought to offset the impact of a difficult economy by focusing on what we could control, namely capital spending and operating costs. We slowed capital expenditures when economic and regulatory issues created too much uncertainty as to whether capital invested in expanding broadband would generate the kinds of returns our shareowners expect. Also, we took advantage of SBC's size and scope to cut costs. While many cost-cutting decisions were fairly simple ones, we were forced to make the most difficult decision of all — eliminating several thousand jobs in the second half of the year. I'm proud to report that all of this was accomplished during a year in which SBC registered its best residential customer service performance in company history.
- **Making the right long-term decisions.** We believe in staying focused on core business segments that have the greatest potential for SBC to generate acceptable returns for our shareowners. That is why last year we sold noncore assets such as Ameritech's security-monitoring and cable television businesses. We also divested certain international investments such as our stakes in diAx (Switzerland) and TransAsia Telecommunications (Taiwan).

DILUTED EARNINGS PER SHARE

Before extraordinary items and one-time items (see page 5)



LONG-TERM STRATEGY SERVES SBC WELL

The passage of the Telecommunications Act of 1996 unleashed changes that still reverberate through the industry. At the time, we anticipated that access lines would become even more valuable, that data would surpass voice as the predominant service, that wireless would become even more important to every consumer's daily life, and that many customers would prefer the option of choosing one carrier for all of their services.

We prepared for that day by acquiring access lines through groundbreaking mergers, by investing billions into new data networks, by working hard to get into long distance, and through creative partnerships, such as with Cingular and Yahoo!, to expand our set of products and services.

That strategy has served SBC well. Although SBC is still very much a work in progress, we have positioned the company for the environment we foresaw years ago. Even more important, we positioned the company for the environment that few predicted.

SBC's scale, scope, financial health, market position, diversification and employee talent are exactly the strengths we depended on to see us through 2001.

GROWTH DRIVERS DELIVER

SBC is strongly positioned to compete in our markets in the three key areas of data/broadband, long distance and wireless.

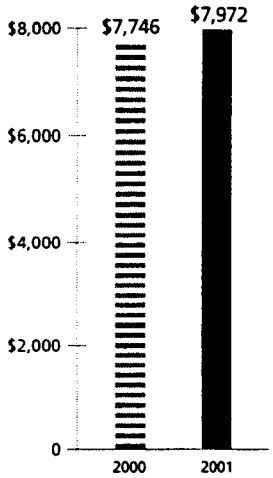
- **Data.** Clearly, economic and regulatory conditions negatively affected our data business during 2001, but we remain very optimistic about future data revenue growth. We are also positioned well for broadband growth, as we can provide DSL Internet services to about 25 million customer locations, up 37 percent from the year before. As we add additional data products and, importantly, gain long-distance freedom in additional states, we'll be able to attract more large-business customers. While data revenue growth slowed in 2001, the business still added an incremental $1.3 billion in revenue compared with 2000. Our November 2001 acquisition of Prodigy Communications and strategic alliance with Yahoo! have further strengthened SBC's data capabilities.

- **Long Distance.** Opportunities are equally clear with our second growth driver. Our long-distance business, while growing slower than expected due to continued delays in the regulatory approval process, showed solid results in 2001, including a total of $2.9 billion in revenues. In fact, our entry into the market in four new states made SBC the first former regional Bell company to provide long-distance service in each of its original states. Last year we gained approval to provide long-distance services to customers in Arkansas, Kansas, Missouri and Oklahoma. We ended 2001 with 4.9 million long-distance customers in six states. The potential revenues are significant once we can offer long distance in our seven other states, including California — the nation's biggest long-distance market. Because we have network, sales and billing platforms already in place for local telephone service, adding long distance is a very attractive business opportunity for us. Additionally, research shows that a significant proportion of consumers want to buy local and long-distance service from the same company. In fact, 60 percent of our long-distance customers buy the service bundled with local service. We think SBC is perfectly positioned to be a company that consumers and businesses can look to for both local and long-distance service.
- **Wireless.** Our wireless joint venture, Cingular Wireless, continues to grow as it now serves an area with a population of 219 million people, has 21.6 million subscribers, has 27,000 retail sales outlets, and has a well-recognized, nationwide brand less than two years after being launched. In 2001, Cingular generated $14.3 billion in total revenue, which was a 12.8 percent increase over the previous year on a pro forma basis. Also, Cingular improved its profitability and took several strategic steps to expand into new markets. The biggest move was an agreement with VoiceStream Wireless Corp., which gives Cingular access to the lucrative New York market while investing a nominal amount of capital because Cingular will share VoiceStream's network just as they will share Cingular's in California and Nevada. Cingular also is expanding into new markets such as Salt Lake City, and we continue to consolidate assets and centralized functions from the previous SBC Wireless and BellSouth Wireless operations, generating even more cost savings. Finally, Cingular is at the forefront of the high-speed wireless data explosion, and in 2001 became the first wireless provider to offer customers high-speed data services that are 10 times faster than current technologies used by other U.S. companies.

EARNINGS

Dollars in millions

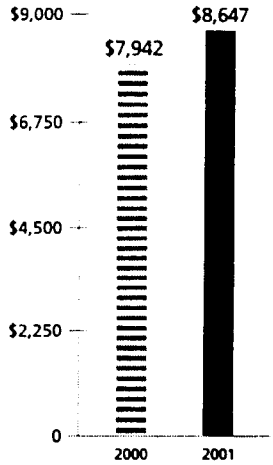
Before extraordinary items and one-time items (see page 5)



WIRELESS OPERATING REVENUES

Dollars in millions

2001 and the fourth quarter of 2000 reflect 60 percent proportional consolidation of Cingular Wireless' actual revenues.



REGULATORY OUTLOOK

As I have mentioned, we worked through a challenging regulatory environment in 2001, yet we made good progress by becoming the first company to gain long-distance approval in an entire region. We are optimistic that the regulatory process will move forward at a pace that would allow us to begin providing long-distance service in California and Nevada by midyear 2002. Also, we continue to make solid progress with our efforts to win regulatory approval to provide long distance in the former Ameritech region.

We view 2002 as an opportunity for a fresh start on the broadband regulatory front. FCC Chairman Michael K. Powell has made several encouraging statements about the need to minimally regulate broadband for the benefit of consumers, which of course is a viewpoint shared by SBC. Regulatory parity between SBC and cable companies such as AT&T Comcast and AOL Time Warner will give consumers real competition and real benefits in the broadband services market. We're hopeful that parity will be achieved in 2002 through Congress or the FCC.

Additionally, we have retooled portions of our management structure that most frequently and directly interact with regulators. One such change was bringing in one of the nation's most respected public affairs and business leaders, former U.S. Commerce Secretary William M. Daley, as president of SBC. His career takes on the intersection of policy and business like no other.

We have worked hard to position SBC to capitalize on the opportunities that can result from a more pro-consumer, pro-investment regulatory environment. Under the right conditions, we believe that there is significant potential for growth in long-distance and data services, and we will pursue those opportunities in ways that make sense for our customers and create value for our shareowners.

AMERITECH UPDATE

Since my letter to you in last year's annual report, we have dramatically improved the quality of service we are providing to our Ameritech customers. In the vast majority of cases, we are restoring service in less than 24 hours and installing new access lines within five business days. We invested nearly $2.9 billion in technology infrastructure improvements in the Ameritech region during 2001 and have expanded the data services offered to customers in the five-state region.

WHAT YOU SHOULD EXPECT FROM SBC

We have been very consistent about our view of 2002, which is that the economic effects of last year likely will linger through 2002, making it difficult for us to generate meaningful growth. While some economists believe the U.S. economy could begin recovering in 2002, we remain cautious and do not plan to alter our strategy of tight expense control and reduced capital expenditures. Also, in 2002 we will continue to face strong competition in our local and long-distance markets.

We remain committed to managing SBC with the long-term goal of growth and a short-term goal of maintaining maximum financial strength and flexibility until the economic shocks of 2001 fade away. You should expect your company to stay intensely focused on expense control, maintaining profit margins and free cash flow, rigorous financial discipline in operational decisions, spending our capital in the right places, and continued commitment to our growth drivers — data/broadband, long distance and wireless.

I am very proud of the way our company and our country faced the challenges of the past year, and I am equally confident in SBC's long-term potential for growth, business leadership and generating value for you, our shareowners.

Sincerely,

Edward E. Whitacre Jr.

Edward E. Whitacre Jr.
Chairman and Chief Executive Officer
February 8, 2002

SELECTED FINANCIAL AND OPERATING DATA

Dollars in millions except per share amounts

At December 31 or for the year ended:	2001	2000	1999	1998	1997
***Financial Data*[1]**					
Operating revenues	**$45,908**	$51,374	$49,531	$46,241	$43,126
Operating expenses	**$35,020**	$40,631	$37,933	$35,018	$35,524
Operating income	**$10,888**	$10,743	$11,598	$11,223	$ 7,602
Interest expense	**$ 1,599**	$ 1,592	$ 1,430	$ 1,605	$ 1,550
Equity in net income of affiliates	**$ 1,595**	$ 897	$ 912	$ 613	$ 437
Other income (expense) – net	**$ (209)**	$ 2,561	$ (354)	$ 1,702	$ (93)
Income taxes	**$ 4,097**	$ 4,921	$ 4,280	$ 4,380	$ 2,451
Income before extraordinary items and cumulative effect of accounting change	**$ 7,260**	$ 7,967	$ 6,573	$ 7,735	$ 4,087
Net income[2]	**$ 7,242**	$ 7,967	$ 8,159	$ 7,690	$ 4,087
Earnings per common share: Income before extraordinary items and cumulative effect of accounting change	**$ 2.16**	$ 2.35	$ 1.93	$ 2.27	$ 1.21
Net income[2]	**$ 2.15**	$ 2.35	$ 2.39	$ 2.26	$ 1.21
Earnings per common share – assuming dilution: Income before extraordinary items and cumulative effect of accounting change	**$ 2.14**	$ 2.32	$ 1.90	$ 2.24	$ 1.20
Net income[2]	**$ 2.13**	$ 2.32	$ 2.36	$ 2.23	$ 1.20
Total assets	**$96,322**	$98,651	$83,215	$74,966	$69,917
Long-term debt	**$17,133**	$15,492	$17,475	$17,170	$17,787
Construction and capital expenditures	**$11,189**	$13,124	$10,304	$ 8,882	$ 8,856
Free cash flow[3]	**$ 3,616**	$ 942	$ 6,370	$ 4,108	$ 2,721
Dividends declared per common share[4]	**$ 1.025**	$ 1.015	$ 0.975	$ 0.935	$ 0.895
Book value per common share	**$ 9.69**	$ 9.00	$ 7.87	$ 6.69	$ 5.26
Ratio of earnings to fixed charges	**6.14**	6.95	6.52	6.79	4.10
Debt ratio	**44.6%**	45.2%	42.9%	47.3%	54.9%
Weighted average common shares outstanding (000,000)	**3,366**	3,392	3,409	3,406	3,391
Weighted average common shares outstanding with dilution (000,000)	**3,396**	3,433	3,458	3,450	3,420
End of period common shares outstanding (000,000)	**3,354**	3,386	3,395	3,406	3,398
Operating Data					
Network access lines in service (000)	**59,532**	61,250	60,697	58,980	56,707
Access minutes of use (000,000)	**283,164**	281,581	264,010	247,597	228,300
Wireless customers (000) – Cingular/SBC[5]	**21,596**	19,681	11,151	8,686	7,556
Number of employees	**193,420**	220,090	204,530	200,380	202,440

[1]Amounts in the above table have been prepared in accordance with accounting principles generally accepted in the United States. Certain one-time items are included in the results for each year presented but are excluded when management evaluates our results of operations. See Results of Operations for a summary of the 2001, 2000 and 1999 one-time items. In 1998, results include the incremental operating impacts attributable to the operations of the overlapping Ameritech Corporation (Ameritech) wireless properties sold in 1999, charges related to strategic initiatives resulting from the merger integration process with Southern New England Telecommunications Corp. (SNET) and charges to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores. Additionally, we recognized a gain on the sale of Telecom Corporation of New Zealand Limited shares; gains from the sale of certain noncore businesses, principally the required disposition of our investment in MTN, a cellular company in South Africa; and gains from the sale of certain telephone and directory assets. Excluding these items, SBC Communications Inc. (SBC) reported an adjusted income before extraordinary item and cumulative effect of accounting change of $6,611, or $1.92 diluted earnings per share, and an adjusted net income of $6,566, or $1.90 diluted earning per share in 1998. In 1997, results include the incremental operating impacts attributable to the operations of the overlapping Ameritech wireless properties sold in 1999, charges resulting from the merger integration process with Pacific Telesis Group (PAC), and charges related to a work force restructuring at Belgacom S.A. Additionally, we recognized gains from the sale of our interests in Bell Communications Research, Inc. and from settlement gains at PAC associated with lump sum pension payments for 1996 retirements. Excluding these items, SBC reported an adjusted net income of $5,836, or $1.71 diluted earnings per share in 1997.

[2]Amounts include the following extraordinary items and cumulative effect of accounting change: 2001, loss related to the early extinguishment of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts; 1999, gain on the sale of overlapping cellular properties and change in directory accounting at Ameritech; 1998, early retirement of debt and change in directory accounting at SNET.

[3]Free cash flow is net cash provided by operating activities less construction and capital expenditures.

[4]Dividends declared by SBC's Board of Directors; these amounts do not include dividends declared and paid by Ameritech, SNET and PAC prior to their respective mergers.

[5]All periods exclude customers from the overlapping Ameritech wireless properties sold in 1999. Beginning in 2000, the number presented is the total customers served by Cingular Wireless, in which we own a 60% equity interest.

Throughout this document, SBC Communications Inc. is referred to as "we" or "SBC". We are a holding company whose subsidiaries and affiliates operate in the communications services industry. Our subsidiaries and affiliates provide wireline and wireless telecommunications services and equipment and directory advertising services both domestically and worldwide.

You should read this discussion in conjunction with the consolidated financial statements and the accompanying notes. A reference to a Note in this section refers to the accompanying Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Overview

Reported financial results are summarized as follows:

				Percent Change	
	2001	2000	1999	2001 vs. 2000	2000 vs. 1999
Operating revenues	**$45,908**	$51,374	$49,531	**(10.6)%**	3.7%
Operating expenses	**35,020**	40,631	37,933	**(13.8)**	7.1
Operating income	**10,888**	10,743	11,598	**1.3**	(7.4)
Income before extraordinary items and cumulative effect of accounting change	**7,260**	7,967	6,573	**(8.9)**	21.2
Extraordinary items	**(18)**	—	1,379	**—**	—
Cumulative effect of accounting change	**—**	—	207	**—**	—
Net income	**7,242**	7,967	8,159	**(9.1)**	(2.4)
Diluted earnings per share	**2.13**	2.32	2.36	**(8.2)**	(1.7)

In 2001, we incurred an extraordinary loss related to the early redemption of $1,000 of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. In 1999, we recognized an extraordinary gain on the sale of overlapping cellular properties relating to the Ameritech Corporation (Ameritech) merger (see Note 3), and a cumulative effect of accounting change related to accounting for directory revenues and expenses (see Note 1).

Our reported operating revenues, expenses and income were lower in 2001 and in the fourth quarter of 2000 primarily due to the contribution of our wireless properties to Cingular Wireless (Cingular). This contribution resulted in a change in the way we account for Cingular's revenues and expenses from operating results to equity in net income of affiliates. In addition, sales of nonstrategic assets in 2001, including our Ameritech security monitoring and cable operations, lowered revenues but also decreased expenses by a greater amount, thereby increasing 2001 operating income. Also included in income before extraordinary items and cumulative effect of accounting change were certain one-time items that were incurred in 2001, 2000 and 1999. For internal management reporting purposes, we exclude (i.e., normalize) the one-time items from our results and analyze them separately.

The net effect of excluding the normalizing items was to increase net income by $712 in 2001, decrease net income by $221 in 2000 and increase net income by $866 in 1999. In addition to the normalizing items, for internal management purposes, we include the 60% proportional consolidation of Cingular in our 2001 and fourth quarter of 2000 normalized results (see the columns labeled "Cingular" in the tables below). The proportional consolidation of Cingular changes our normalized revenues, expenses, operating income and nonoperating items, but does not change our net income. The following tables reconcile our reported results to our normalized results and list the normalizing items for 2001, 2000 and 1999. Following the tables are explanations of the normalizing items.

2001		Normalizing Items									
	Reported	A	B	C	D	E	F	G	H	Cingular	Normalized
Operating revenues	**$45,908**	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ 8,393	**$54,301**
Operating expenses	**35,020**	1,097	—	—	(316)	—	—	(197)	(619)	6,884	**41,869**
Operating income	**10,888**	(1,097)	—	—	316	—	—	197	619	1,509	**12,432**
Interest expense	**1,599**	—	—	—	—	—	—	—	—	159	**1,758**
Interest income	**682**	—	—	—	—	—	—	—	—	(308)	**374**
Equity in net income of affiliates	**1,595**	—	—	—	—	49	197	—	—	(1,038)	**803**
Other income (expense) – net	**(209)**	—	401	(120)	—	341	—	—	—	1	**414**
Income before income taxes	**11,357**	(1,097)	401	(120)	316	390	197	197	619	5	**12,265**
Income taxes	**4,097**	(409)	140	(42)	111	128	—	69	194	5	**4,293**
Income before extraordinary items and cumulative effect of accounting change	**$ 7,260**	$ (688)	$261	$ (78)	$ 205	$262	$197	$ 128	$ 425	$ —	**$ 7,972**

2000		Normalizing Items								
	Reported	I	J	K	L	M	N	O	Cingular	Normalized
Operating revenues	$51,374	$ —	$ —	$ —	$ —	$ —	$ 23	$ —	$1,814	$53,211
Operating expenses	40,631	—	—	506	(1,183)	(132)	(596)	—	1,592	40,818
Operating income	10,743	—	—	(506)	1,183	132	619	—	222	12,393
Interest expense	1,592	—	—	—	—	—	—	—	46	1,638
Interest income	279	—	—	—	—	—	—	—	(92)	187
Equity in net income of affiliates	897	(68)	—	(6)	—	—	110	—	(72)	861
Other income (expense) – net	2,561	(1,818)	(238)	—	22	—	242	(357)	(14)	398
Income before income taxes	12,888	(1,886)	(238)	(512)	1,205	132	971	(357)	(2)	12,201
Income taxes	4,921	(638)	(83)	(184)	405	—	294	(258)	(2)	4,455
Income before extraordinary items and cumulative effect of accounting change	$ 7,967	$(1,248)	$(155)	$(328)	$ 800	$ 132	$ 677	$ (99)	$ —	$ 7,746

1999		Normalizing Items					
	Reported	P	Q	R	S	T	Normalized
Operating revenues	$49,531	$ 176	$(705)	$ —	$ —	$ —	$49,002
Operating expenses	37,933	(1,591)	(473)	566	—	44	36,479
Operating income	11,598	1,767	(232)	(566)	—	(44)	12,523
Interest expense	1,430	(1)	(11)	—	—	—	1,418
Interest income	127	—	—	—	—	—	127
Equity in net income of affiliates	912	—	—	—	(131)	—	781
Other income (expense) – net	(354)	(2)	24	—	—	—	(332)
Income before income taxes	10,853	1,766	(197)	(566)	(131)	(44)	11,681
Income taxes	4,280	309	(78)	(198)	(54)	(17)	4,242
Income before extraordinary items and cumulative effect of accounting change	$ 6,573	$ 1,457	$(119)	$(368)	$ (77)	$(27)	$ 7,439

Normalizing items for 2001:

A. Pension settlement gains related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.

B. Combined charges primarily related to valuation adjustments of Williams Communications Group Inc. as well as certain other cost investments accounted for under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115). The charges resulted from an evaluation that the decline was other than temporary (see Note 3).

C. Reduction of a valuation allowance on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.

D. Combined charges related to impairment of our cable operations.

E. A charge indicated by a transaction pending as of December 31, 2001, to reduce the direct and indirect book value of our investment in Telecom Américas.

F. A charge for costs related to TDC A/S's (TDC) (formerly known as Tele Danmark A/S) decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.

G. A charge representing a proposed settlement agreement with the Illinois Commerce Commission (ICC) related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.

H. Combined charges associated with our comprehensive review of operations in the fourth quarter of 2001, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

Normalizing items for 2000:

I. Gains related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates, and from the contribution of our investment in ATL – Algar Telecom Leste S.A. (ATL), a Brazilian telecommunications company, to Telecom Américas.

J. Gains on the sale of Teléfonos de Mexico, S.A. de C.V. (Telmex) L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the Debt Exchangeable for Common Stock (DECS).

K. Pension settlement gains associated with pension litigation, first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program

net of enhanced pension and postretirement benefits associated with that program (see Note 12).

L. Costs associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.

M. A charge related to in-process research and development from the March 2000 acquisition of Sterling Commerce, Inc. (Sterling) (see Note 3).

N. Combined charges related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115, and the restructure of agreements with Prodigy Communications Corporation (Prodigy), including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment (see Note 3).

O. Gains primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

Normalizing items for 1999:

P. Charges including recognition of impairment of long-lived assets, adjustments to the estimate of allowance for doubtful accounts, estimation of deferred taxes on international investments, wireless conversion costs and other items (see Note 2).

Q. Elimination of income from the incremental impacts of overlapping wireless properties sold in October 1999 relating to the Ameritech merger.

R. Pension settlement gains associated with lump sum pension payments that exceeded the projected service and interest costs.

S. Gains recognized from the sale of property by an international equity affiliate.

T. A reduction related to a portion of a first-quarter 1998 charge to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores.

Normalized financial results are summarized as follows:

				Percent Change	
	2001	2000	1999	2001 vs. 2000	2000 vs. 1999
Operating revenues	**$54,301**	$53,211	$49,002	**2.0%**	**8.6%**
Operating expenses	**41,869**	40,818	36,479	**2.6**	**11.9**
Operating income	**12,432**	12,393	12,523	**0.3**	**(1.0)**
Income before extraordinary items and cumulative effect of accounting change	**7,972**	7,746	7,439	**2.9**	**4.1**
Diluted earnings per share, before extraordinary items and cumulative effect of accounting change	**2.35**	2.26	2.15	**4.0**	**5.1**

Normalized operating revenues increased in 2001 and 2000 primarily due to growth in demand for data communications, wireless, interLATA (Local Access and Transport Area) long distance and directory services. In 2001, the revenue increase was partially offset by declines in our core telephone operations, including the impact of our decision to de-emphasize low-margin equipment. Sales of nonstrategic assets, including our Ameritech security monitoring and cable operations, also partially offset the revenue increases in 2001. The slowing revenue growth rate reflects the ongoing impact of a weak United States (U.S.) economy, challenging federal and state regulatory environments and increased competition. We expect that these factors will continue to dampen business and consumer demand, and our revenue in 2002.

Normalized operating expenses increased in 2001 and 2000 primarily due to the higher level of investments made for new products and services, including Digital Subscriber Line (DSL) and interLATA long distance, and to restore the quality of service in the Ameritech region. Expenses also increased in 2001 due to an increase in our provision for uncollectible accounts for companies that went out of business and customers with a higher credit risk due to the adverse U.S. economic environment. Partially offsetting the expense increases in 2001 were cost savings from employee reductions, the scale-back of our national expansion initiative, and favorable expense comparisons to 2000 now that we are beyond the first year of our initial launch of DSL.

Growth of our diluted earnings per share, before extraordinary items and cumulative effect of accounting change, in 2001 was greater than our operating income growth primarily due to a decreasing effective tax rate and a decline in our weighted average common shares outstanding from our purchases of approximately 47 million shares of our common stock. In 2000 our diluted earnings per share increased while our operating income declined primarily due to reduced mark-to-market expense on the DECS securities and increased gains on sales of multiple smaller investments as compared to 1999. The current U.S. economy, combined with a challenging regulatory and competitive environment, will continue to put significant pressure on our results in 2002.

Segment Results

Our segments are strategic business units that offer different products and services and are managed accordingly. We evaluate performance based on income before income taxes adjusted for the normalizing (e.g., one-time) items that we describe in the "Overview" section. We have five reportable segments that reflect the current management of our business: (1) wireline; (2) wireless; (3) directory; (4) international; and (5) other.

In the second quarter of 2001, we moved the results of the SBC Services unit from the other segment to the wireline segment because the SBC Services unit now primarily supports the wireline segment. We have restated all prior

period information for this change, and this had no effect on our consolidated results.

The ***wireline segment***, which accounted for approximately 75% of our total normalized operating revenues in 2001, provides landline telecommunications services, including local, network access and long distance services, messaging and Internet services and sells customer premise and private business exchange equipment.

Prior to the fourth quarter of 2000, the ***wireless segment***, which accounted for approximately 16% of our total normalized operating revenues in 2001, included our consolidated businesses that provided wireless telecommunications services and sold wireless equipment. In October 2000, we contributed substantially all of our wireless businesses to Cingular and began reporting results from Cingular's operations as equity in net income of affiliates in the Consolidated Financial Statements. However, for internal management purposes, we analyze Cingular's results using proportional consolidation and therefore will discuss Cingular's results on that basis for segment reporting. Cingular offers both wireless voice and data communications services across most of the U.S., providing cellular and PCS services.

The ***directory segment***, which accounted for approximately 8% of our total normalized operating revenues in 2001, includes all directory operations, including Yellow and White Pages advertising and electronic publishing. All investments with primarily international operations are included in the ***international segment***. The ***other segment*** includes all corporate operations and Ameritech's paging, cable television and SecurityLink operations. SecurityLink was sold in January 2001, and we sold Ameritech New Media, Ameritech's cable television operations, in November 2001.

Wireline

Normalized Results

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating revenues					
Local service	**$22,735**	$22,057	$19,526	**3.1%**	13.0%
Network access	**10,459**	10,491	10,184	**(0.3)**	3.0
Long distance service	**2,914**	2,930	3,348	**(0.5)**	(12.5)
Other	**4,579**	4,413	4,314	**3.8**	2.3
Total Operating Revenues	**40,687**	39,891	37,372	**2.0**	6.7
Operating expenses					
Operations and support	**24,041**	23,472	21,422	**2.4**	9.6
Depreciation and amortization	**8,381**	7,867	6,828	**6.5**	15.2
Total Operating Expenses	**32,422**	31,339	28,250	**3.5**	10.9
Operating Income	**8,265**	8,552	9,122	**(3.4)**	(6.2)
Interest Expense	**1,205**	1,298	1,188	**(7.2)**	9.3
Other Income (Expense) – Net	**31**	72	114	**(56.9)**	(36.8)
Income Before Income Taxes	**$ 7,091**	$ 7,326	$ 8,048	**(3.2)%**	(9.0)%

The results of our wireline segment during 2001 reflect the impacts of the weak U.S. economy, regulatory uncertainty and increasing competition. The decline in revenue growth during 2001 was partially offset by a slowing trend in expense growth, primarily from reductions in work force and other employee-related costs. In 2002 we expect a continued slowdown in the revenue growth rate as we continue to face regulatory challenges and strong competition in our local and long distance markets. In response to our declining revenue trend, we will continue to control expenses where possible.

Local service revenues increased $678, or 3.1%, in 2001 and $2,531, or 13.0%, in 2000. Access line revenue steadily declined during 2001 as a result of a slowing U.S. economy, increased competition, and technology substitution from wireless and high-speed access service. The access line revenue decrease was approximately $634 in 2001. Access lines served at the end of 2001 decreased by 2.8% compared to 2000. And, although total access lines in service at the end of 2000 increased by approximately 1%, this was a declining trend when compared to the increase of 3% during 1999. Partially offsetting the access line revenue decrease, the continued rollout of DSL increased local service revenues in 2001 by approximately $319, and our DSL customers increased to approximately 1,333,000 as compared to 767,000 at the end of 2000. Certain other data-related revenues including data equipment sales and network integration services increased in 2001. However, these data revenues declined sequentially during the second half of the year primarily due to our decision to de-emphasize low-margin equipment as a component in data solutions. Wholesale revenues, which include unbundled network elements and resale services, increased approximately $352 during 2001. Revenues from vertical services such as Caller ID, voice mail and other enhanced services and vertical service packages increased by approximately $127 during

2001; however, the sequential quarterly growth rate has been declining to flat since the first quarter.

During 2000, excluding the operations of Sterling, acquired in March 2000, local service revenue increased approximately 10.9% over the prior year. Approximately $619 of that increase was attributable to increased demand from business customers for network integration and Internet services. Demand for DSL and dial-up Internet services in the residential market increased local service revenues by approximately $164 in 2000. Increased demand for wholesale services accounted for approximately $389 of the increase in 2000. Additionally, directory assistance revenues increased approximately $75 in 2000, primarily due to price increases in California, Illinois and Texas, while vertical services revenues increased by approximately 10% to more than $3.7 billion in 2000, up from more than $3.3 billion in 1999.

During 2001, Illinois legislation caused an increase in revenues of approximately $139, and as discussed below, this legislation increased operations and support expenses and decreased interest expense resulting in a net increase of $68 in pre-tax income. During 2000, local service revenues increased as a result of regulatory actions that decreased one or more other types of operating revenues. The introduction of extended area service plans and the September 1999 Texas Universal Service Fund (TUSF) rate rebalancing collectively increased local service revenues in 2000 by approximately $140. However, these regulatory actions had only a nominal effect on overall revenue during 2000 because they decreased intrastate network access revenues by approximately $95 and decreased long distance revenues by approximately $22. The Texas Public Utility Commission stated that the TUSF was intended, among other things, to help support the provision of basic local telephone service to high-cost rural areas.

Network access revenues decreased $32, or 0.3%, in 2001 and increased $307, or 3.0%, in 2000. The decrease in 2001 was primarily due to decreases in switched access revenue related to decreased demand, the continuing impact of the July 2000 implementation of the Coalition for Affordable Local and Long Distance Service (CALLS) proposal, and state regulatory access rate reductions in Texas. These rate reductions were partially offset by continued demand for our high-capacity data transport services.

The increase in 2000 was due primarily to demand for special access and switched data transport services, as well as higher network usage by alternative providers of intraLATA toll services. The increase in 2000 was partially offset by a decrease of $293 due to the impact of CALLS. Also offsetting the 2000 increase were the effects of the TUSF described in local service above of $95 as well as other state regulatory rate reductions of $183.

Long distance service revenues decreased $16, or 0.5%, in 2001 and $418, or 12.5%, in 2000. During 2001, long distance service revenues decreased approximately $197 due to competitive losses resulting from intraLATA dialing parity and $146 attributable to competitive pricing actions in the Ameritech region. These losses were partially offset by an increase of approximately $322 resulting from our 2001 entry into the Arkansas, Kansas, Missouri and Oklahoma interLATA long distance markets in addition to our previous entry into the Texas and Connecticut markets. Competition will continue to affect our intraLATA markets as we seek interLATA long distance approval in the remainder of our 13-state area.

In 2000, competitive losses of approximately $329, primarily resulting from dialing parity implementation, decreased long distance service revenues. Regulatory actions related to the continued introduction of extended area service plans, as discussed in local service, decreased revenues approximately $22. These decreases were partially offset by approximately $64 from the entry into the Texas long distance market for interLATA and interstate services and $31 due to price increases in Illinois, Indiana, Michigan and Ohio.

Other operating revenues increased $166, or 3.8%, in 2001 and $99, or 2.3%, in 2000. Price increases added revenue of approximately $112 in 2001. Continued declines in the payphone business decreased other operating revenues by approximately $52 in 2001 and $124 in 2000. Sales of nonregulated products and services increased in 2001, but at a slower rate than in 2000 due to a decline in demand related to the weakness of the U.S. economy.

Operations and support expenses increased $569, or 2.4%, in 2001 and $2,050, or 9.6%, in 2000. Our provision for uncollectible accounts increased approximately $540 in 2001 for companies that went out of business and customers with a higher credit risk due to the adverse U.S. economic environment. Costs to restore the quality of service in the Ameritech region increased approximately $260 in 2001. The Illinois legislation discussed above in local service caused a one-time increase in expenses of approximately $84 in 2001, which includes a reversal of approximately $26 in the fourth quarter of 2001 of expenses we no longer expect to incur. Costs associated with our continued rollout of DSL increased approximately $120 in 2001 compared to an increase of $930 in 2000, primarily due to growth in subscribers and favorable expense comparisons to 2000 now that we are beyond the first year of our initial launch of DSL. Costs associated with data equipment sales, network integration and e-commerce services increased approximately $70 in 2001, significantly lower than the increase of $850 in 2000, primarily due to our decision to de-emphasize low-margin equipment, and acquisitions in 2000. Costs associated with our national expansion initiative decreased approximately $90 in 2001, reflecting the initiative's scale-back, compared to an increase of $300 in 2000. InterLATA long distance service expenses increased by approximately $320 in 2001 compared to $260 in 2000 primarily reflecting our entry into four new states. The acquisition of Prodigy (see Note 3) late in 2001 increased expenses approximately $50.

Costs associated with reciprocal compensation decreased approximately $185 in 2001 and $175 in 2000 as we signed new contracts with lower rates and favorable settlement agreements with carriers, partially offset by growth in minutes of use on our network. Expenses decreased approximately $635 in 2001 due to work force reductions, early retirements, lower personnel benefit costs, reduced outsourcing and advertising costs, and gains from certain employee postretirement plans. This compared to employee-related expense increases of approximately $130 in 2000 to meet demand for our new products and services. In addition,

2001 included a reduction in taxes of approximately $92, primarily related to settlements and lower property tax appraisals.

We expect our personnel benefits costs to increase in 2002 due primarily to reduced investment portfolio returns, higher medical claim costs and lower interest rates. We expect that the Prodigy acquisition and increased personnel benefits costs will add between $650 and $850 to operations and support expenses in 2002.

Depreciation and amortization expenses increased $514, or 6.5%, in 2001 and $1,039, or 15.2%, in 2000. The majority of the increase in 2001 was related to higher plant levels from the build-out of our broadband network and launch of new products and services, including DSL and Internet data centers. Approximately $308 of the 2000 increase was related to higher plant levels. Our acquisition of Sterling in 2000 increased expenses approximately $100 and $263 in 2001 and 2000. Amortization of capitalized software also increased approximately $148 in 2001 and $198 in 2000.

Amortization expense of goodwill was approximately $161 in 2001. Goodwill will no longer be amortized in 2002 when we adopt new accounting standards (see Note 1).

Wireless

Normalized Results

	2001	2000	1999	Percent Change 2001 vs. 2000	Percent Change 2000 vs. 1999
Operating revenues					
Subscriber revenue	**$7,307**	$6,480	$5,308	**12.8%**	22.1%
Other	**1,340**	1,462	1,317	**(8.3)**	11.0
Total Operating Revenues	**8,647**	7,942	6,625	**8.9**	19.9
Operating expenses					
Operations and support	**5,957**	5,348	4,464	**11.4**	19.8
Depreciation and amortization	**1,232**	1,083	918	**13.8**	18.0
Total Operating Expenses	**7,189**	6,431	5,382	**11.8**	19.5
Operating Income	**1,458**	1,511	1,243	**(3.5)**	21.6
Interest Expense	**538**	424	226	**26.9**	87.6
Equity in Net Income of Affiliates	**(11)**	12	42	**—**	(71.4)
Other Income (Expense) – Net	**33**	(120)	(176)	**—**	31.8
Income Before Income Taxes	**$ 942**	$ 979	$ 883	**(3.8)%**	10.9%

We account for our 60% economic interest in Cingular under the equity method of accounting. However, we use proportional consolidation in order to evaluate the results of Cingular for internal management purposes. In the table above, Cingular's proportional results are included in 2001 and the fourth quarter of 2000 along with the residual wireless properties we hold that have not been contributed. The first nine months of 2000 and all of 1999 include the historical results of our comparable wireless operations.

During 2001, at the expense of customer additions, Cingular focused on policies that had the effect of shifting subscribers from analog plans to digital plans which typically have higher margins. Cingular's expenses increased due to marketing of its new brand after beginning operations in the fourth quarter 2000. Partially offsetting the increased brand costs were synergies and economies of scale created by the formation of Cingular.

Subscriber revenues increased $827, or 12.8%, in 2001 and $1,172, or 22.1%, in 2000. The 2001 increase was primarily related to growth in customer base accompanied by existing customers shifting to higher monthly rate plans, increased minutes of use and the sale of higher access rate plans to new customers. During 2001, Cingular focused on policies that had the effect of shifting subscribers from analog plans to digital plans. For 2002, as Cingular's digital network and rate plan offerings continue to expand, they expect continued erosion in their analog customer base. Cingular's net customer additions during 2001 were approximately 1,987,000, excluding approximately 72,000 customers sold to minority partners. At December 31, 2001, Cingular had approximately 21,596,000 customers.

The 2000 increase in subscriber revenues resulted from the 1999 acquisitions of Comcast Cellular Corporation (Comcast) and Cellular Communication of Puerto Rico, Inc. (CCPR), with the remaining increase due to net customer additions.

Other revenues decreased $122, or 8.3%, in 2001 and increased $145, or 11.0%, in 2000. The 2001 decrease was due to a decline in roaming revenues from other carriers, reflecting the continued build-out of competitors' networks, which resulted in fewer minutes on Cingular's network and lower negotiated rates with other carriers. Equipment revenues also declined due to a lower customer growth rate in 2001. The 2000 increase was primarily due to higher equipment sales resulting from a higher customer growth rate in 2000.

Operations and support expenses increased $609, or 11.4%, in 2001 and $884, or 19.8%, in 2000. The 2001 increase was primarily due to increased minutes of use on the network, increased long distance expenses as more plans include free long distance, and the Cingular national branding campaign that was completed in 2001. These increases were partially offset by new long distance rates with BellSouth Corporation (BellSouth) and SBC Long Distance that became effective June 2001, and administrative cost savings gained through the formation of Cingular. The 2000 increase reflects increased minutes of use on the system due to the growth in number of customers served during 2000.

Depreciation and amortization expenses increased by $149, or 13.8%, in 2001 and $165, or 18.0%, in 2000 primarily related to higher plant levels. The 2000 increase was partially offset by a decrease of approximately $35 resulting from a purchase price allocation true-up adjustment related to the 1999 acquisitions of Comcast and CCPR.

Our 60% share of Cingular's amortization expense on goodwill and wireless licenses was approximately $182 in 2001. Goodwill and wireless licenses will no longer be amortized in 2002 upon adoption of new accounting standards (see Note 1).

Directory

Normalized Results

				Percent Change	
	2001	2000	1999	2001 vs. 2000	2000 vs. 1999
Operating Revenues	**$4,468**	$4,340	$4,126	**2.9%**	5.2%
Operating expenses					
Operations and support	**1,898**	2,008	2,081	**(5.5)**	(3.5)
Depreciation and amortization	**36**	32	33	**12.5**	(3.0)
Total Operating Expenses	**1,934**	2,040	2,114	**(5.2)**	(3.5)
Operating Income	**2,534**	2,300	2,012	**10.2**	14.3
Other Income (Expense) – Net	**9**	61	(1)	**(85.2)**	—
Income Before Income Taxes	**$2,543**	$2,361	$2,011	**7.7%**	17.4%

Our directory results in 2001 and 2000 included increased demand for directory advertising services and decreased expenses from merger initiatives and cost-containment efforts. However, the growth rate has slowed due to increased competition, increased bad debt expenses and a weak U.S. economy.

Operating revenues increased $128, or 2.9%, in 2001 and $214, or 5.2%, in 2000. A change in the timing of directory publications contributed approximately $79 in 2001 and $33 in 2000 to the increase in revenues. The remaining increases in 2001 and 2000 related to increased demand for directory advertising services. The 2001 growth rate was lower than the growth rate for 2000, reflecting the impacts of a weaker U.S. economy and increased competition.

Operations and support expenses decreased $110, or 5.5%, in 2001 and $73, or 3.5%, in 2000. The decreased expenses in 2001 were due primarily to lower compensation-related expenses, as a result of merger initiatives, a 2000 pension and retirement program, and cost-containment efforts. Offsetting these decreases was an increase in bad debt expense for companies that went out of business or are a higher credit risk due to the weak U.S. economy. The decreased expenses in 2000 were primarily related to cost savings from the merger integration process with Ameritech.

International

Normalized Results

				Percent Change	
	2001	2000	1999	2001 vs. 2000	2000 vs. 1999
Operating Revenues	**$ 185**	$ 328	$255	**(43.6)%**	28.6%
Operating Expenses	**241**	475	266	**(49.3)**	78.6
Operating Income (Loss)	**(56)**	(147)	(11)	**61.9**	—
Interest Expense	**49**	174	235	**(71.8)**	(26.0)
Equity in Net Income of Affiliates	**800**	862	739	**(7.2)**	16.6
Other Income (Expense) – Net	**369**	389	209	**(5.1)**	86.1
Income Before Income Taxes	**$1,064**	$ 930	$702	**14.4%**	32.5%

Our international results for 2001 reflect our prior sale of various international investments through decreased interest expense, and lower operating expenses due to the first-quarter 2001 completion of the depreciation of certain property, plant and equipment. These savings were offset by reduced operating results at our international affiliates and lower management fee revenues. We expect our international affiliates will continue to feel the impact of a weak global economy and increasing competition.

Operating revenues decreased $143, or 43.6%, in 2001 and increased $73, or 28.6%, in 2000. Revenues declined approximately $87 due to lower volume-related long distance revenues and the September 2001 disposition of Ameritech Global Gateway Services (AGGS). Directory advertising revenues declined approximately $41 due to the December 2000 sale of our German directory investment, Wer Liefert Was (WLW), and the remaining decrease was due to lower management fee revenues. We expect future operating revenues to decrease as a result of the 2001 sale of AGGS. The 2000 increase was primarily due to higher volume-related long distance revenues.

Operating expenses decreased $234, or 49.3%, in 2001 and increased $209, or 78.6%, in 2000. The 2001 decrease was primarily due to AGGS, through both lower long distance activity and the September 2001 disposition, and our December 2000 sale of WLW. Additionally, depreciation expense declined due to certain property, plant and equipment being fully depreciated during the first quarter of 2001. We expect future operating expenses to decrease as a result of the 2001 sale of AGGS. The 2000 increase was largely due to the costs associated with the higher long distance volumes during 2000 and to an increase in corporate support charges.

Equity in net income of affiliates decreased $62, or 7.2%, in 2001 and increased $123, or 16.6%, in 2000. The 2001 decrease includes a decrease of approximately $295 from Belgacom S.A. (Belgacom) and TDC, primarily related to decreased earnings from their foreign affiliates and the inclusion in 2000 results of the gain on the sale of Telenordia. Offsetting this 2001 decrease was a gain of approximately $64 related to Belgacom's fourth-quarter 2001 sale of a portion of its Netherlands wireless operations to an unaffiliated special purpose entity (SPE). Although Belgacom guaranteed approximately $237 of the SPE's debt, the SPE has the right to put the investment to a subsidiary of Deutsche Telekom A.G. at a price that is greater than the amount guaranteed. The third-quarter 2000 sale of our investment in MATÁV reduced earnings approximately $65 in 2001 as compared to 2000. Lower income from South American wireless companies held by América Móvil S.A. de C.V., certain true-up adjustments in 2000 at Telmex and our smaller ownership percentage at these affiliates resulted in a decrease of approximately $26. Offsetting these decreases were increases of approximately $92 resulting from wireless subscriber growth, higher average revenue per customer and Cegetel S.A.'s (Cegetel) second-quarter 2001 sale of AOL France. Bell Canada's first-quarter 2001 gain on their disposition of an Internet service provider subsidiary and improved operating results contributed approximately $74 to the increase in 2001. Also offsetting the decrease was the elimination of losses, on a comparative basis, of approximately $139 resulting from the first-quarter 2001 disposition of diAx A.G. (diAx), a Swiss mobile landline operator, and the exchange of our equity investment in ATL for a cost investment in Telecom Américas.

The 2000 increase includes increased equity in net income, including our share of certain disposition gains, of approximately $219 from investments in Telmex, TDC, and Belgacom. A full 12 months of operations from Bell Canada in 2000 resulted in approximately $48 higher equity income than the seven months of operations in 1999. Our investment in Cegetel produced positive equity income for the first time in 2000 leading to an increase of approximately $17 over prior year equity losses. Offsetting these increases were reductions to equity in net income of approximately $35 as a result of the sale of our investment in the Aurec companies in Israel and MATÁV, a Hungarian telecommunications company. Our investment in diAx contributed approximately $32 in increased losses in equity income due to increased operating losses, as well as severance accruals and other one-time adjustments. Our investment in Telkom SA Limited (Telkom) had approximately $20 in lower equity income from the prior year due mainly to one-time adjustments. Additionally, our investment in ATL had equity losses of approximately $80.

Our earnings from foreign affiliates will continue to be sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded under accounting principles generally accepted in the United States (GAAP), which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries, such as inflation adjustments.

Amortization expense of embedded goodwill on our international equity investments was approximately $134 in 2001. In addition, we estimate our international holdings had between $45 and $65 of their own goodwill amortization expense in 2001. Goodwill will no longer be amortized when our international investees adopt new U.S. accounting standards (see Note 1).

Other

Normalized Results

	2001	2000	1999	Percent Change 2001 vs. 2000	Percent Change 2000 vs. 1999
Operating Revenues	$ 589	$1,100	$1,138	(46.5)%	(3.3)%
Operating Expenses	358	923	981	(61.2)	(5.9)
Operating Income	231	177	157	30.5	12.7
Interest Expense	883	895	701	(1.3)	27.7
Other Income (Expense) – Net	1,277	1,323	581	(3.5)	—
Income Before Income Taxes	$ 625	$ 605	$ 37	3.3%	—%

Our other segment results in 2001 reflect the sales of nonstrategic assets, including our Ameritech security monitoring and cable operations.

Operating revenues decreased $511, or 46.5%, in 2001 and $38, or 3.3%, for 2000. The decrease in 2001 is primarily due to the January 2001 sale of SecurityLink. In November 2001, we sold Ameritech New Media, Ameritech's cable television operations that reported $151 in revenues during 2001. We expect 2002 revenues to decline as a result of this disposition activity. The remaining revenues in this segment are primarily the result of corporate operations.

Operating expenses decreased $565, or 61.2%, in 2001 and $58, or 5.9%, in 2000. The decreases in 2001 and 2000 relate to the sale of nonstrategic assets and their associated expenses. The 2001 decrease is primarily due to the sale of SecurityLink. Ameritech New Media, whose sale is mentioned above, reported operating expenses of approximately $160 in 2001. We expect 2002 expenses to decline as a result of these sales.

Consolidated Results

The following discussion is based on consolidated results as reported under GAAP. It does not include the impacts of the normalizing items.

Interest expense increased $7, or 0.4%, in 2001 and increased $162, or 11.3%, in 2000. The 2001 increase was primarily due to interest accrued on payables to Cingular. Prior to the fourth quarter of 2000, our other segment recorded interest expense on notes payable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular this interest expense is no longer eliminated. However, this does not have a material impact on our net income because the interest expense is mostly offset when we record our share of equity income in Cingular. In the second quarter of 2001 we completed a net debt settlement agreement with Cingular and are no longer incurring this expense (see Note 7). Also contributing to the increase was debt issued to redeem the Trust Originated Preferred Securities (TOPrS), the interest on which was reported as other income (expense) – net, and higher commercial paper borrowings. Offsetting these increases were lower composite rates and the reversal of an accrual of approximately $23 related to items resolved by the June 2001 Illinois legislation discussed in local service. The 2000 increase was primarily due to higher composite rates and increased debt levels.

Interest income increased $403 in 2001 and $152 in 2000. The increases were primarily due to the income accrued from Cingular. Prior to the fourth quarter of 2000, our other segment recorded interest income on notes receivable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular, this interest income is no longer eliminated. However, this does not have a material impact on our net income because the interest income is mostly offset when we record our share of equity income in Cingular.

Other income (expense) – net includes items that we normalized as previously described in the "Overview" section. These normalizing items totaled $623, $2,163 and $22 in 2001, 2000 and 1999. In addition to those items, results for 2001 included gains on the sale of investments of approximately $476, consisting of the sale of our investment in TransAsia Telecommunications, Smith Security, Amdocs Limited (Amdocs) shares and other investments. These gains were partially offset by a loss of approximately $61 on the sale of Ameritech New Media. Additional offsets came from dividends paid on preferred securities issued by Ameritech subsidiaries of approximately $33 and minority interest of $16. The amount of our 2001 minority interest expense significantly declined from 2000 due to the contribution of most of our wireless properties to Cingular in the fourth quarter of 2000. Included in 2001 are net gains of approximately $23 recognized for mark-to-market adjustments on shares of Amdocs, one of our equity investees, which were granted to executives as deferred compensation. An offsetting deferred compensation expense was recorded in operations and support expense. Additionally, in 2001, we recognized an expense of approximately $581 related to an endowment of Amdocs shares to the SBC Foundation and income of approximately $575 from the related mark-to-market adjustment on the Amdocs shares, for a net expense of $6. Also included in 2001 is approximately $32, which represents consideration for modifications to our agreement with SpectraSite Communications Inc. (SpectraSite).

Results for 2000 include gains of approximately $87 that were recognized for mark-to-market adjustments on shares of Amdocs used for deferred compensation. An offsetting deferred compensation expense was recorded in operations and support expense. Results for 2000 also include gains of approximately $295 on the sales of our interests in WLW, the Aurec companies in Israel and certain cost investments. Additionally, we sold our remaining Telmex L shares not related to the DECS for a gain, which was partially offset by appreciation in the market value of Telmex L shares underlying the DECS, for a net gain of approximately $117. These gains were partially offset by lower income from our wireless minority interest and dividends paid on preferred securities issued by Ameritech subsidiaries of approximately $208.

Results for 1999 include a gain from the sale of Amdocs shares of approximately $92 and gains of $63 representing dividends and mark-to-market adjustments on Amdocs shares used for contributions to the SBC Foundation and deferred compensation. Results for 1999 also include a gain of approximately $59 on the sale of our investment in Chile and a gain of $81 on the sales of certain discontinued plant and other investments. These gains were offset by increased expenses related to higher appreciation in the market value of Telmex L shares underlying the DECS than in the comparable periods of 1998, net of gains recognized from the sale of certain Telmex L shares, of approximately $296, and dividends paid on preferred securities issued by Ameritech subsidiaries, losses on forward exchange contracts and other nonoperating items of $76. In addition, higher wireless minority interest resulted in approximately $287 of expense.

Income taxes for 2001, 2000 and 1999 reflect the tax effect of the normalizing items previously described in the "Overview" section. Excluding these items, income taxes in 2001 were lower than 2000 primarily due to contributions to the SBC Foundation in the first quarter of 2001. Income taxes in 2000 were higher than 1999 primarily due to higher income before income taxes. The decrease in the effective tax rate for 2001 was primarily due to contributions to the SBC Foundation in the first quarter of 2001. With the adoption of new accounting standards (see Note 1) in 2002, nondeductible amortization expense will decline, and therefore, we expect to see a decline in our effective tax rate for 2002.

Extraordinary items in 2001 included an extraordinary loss of $18, net of taxes of $10, related to the early redemption of $1,000 of the TOPrS (see Note 9). Results in 1999 included an extraordinary gain of $1,379, net of taxes of $960, on the sale of overlapping wireless properties in October 1999 due to the Ameritech merger (see Note 3).

Cumulative effect of accounting change includes a change in the method of recognizing directory publishing revenues and related expenses at Ameritech, effective January 1, 1999 (see Note 1). The cumulative after-tax effect of applying the new method to prior years was recognized as of January 1, 1999, as a one-time, noncash gain applicable to continuing operations of $207, or $0.06 per share, net of deferred taxes of $125.

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

Overview

Despite passage of the Telecommunications Act of 1996 (Telecom Act), the U.S. telecommunications industry, including DSL and other advanced services, continues, in many respects, to operate as a heavily regulated industry. The expected transition from an industry overseen by multiple regulatory bodies to a market-driven industry monitored by state and federal agencies has been slow. Our wireline subsidiaries remain subject to regulation by state regulatory commissions for intrastate services and by the FCC for interstate services. This continuing difficult and uncertain regulatory environment combined with the recent downturn in the U.S. economy presents challenges for our business.

Expected Growth Areas

We expect the wireline segment to remain the most significant portion of our business and have also discussed trends affecting this segment (see "Wireline" under "Segment Results" above). Over the next few years we expect an increasing percentage of our business to come from two areas within the wireline segment – data/broadband and long distance – and our wireless segment.

Data/Broadband In October 1999, we announced plans to upgrade our network to make broadband services available to approximately 80% of our U.S. wireline customers over the four years through 2003 (Project Pronto). Due to the weakening U.S. economy and uncertain regulatory environment noted above, in October 2001 we announced a scale-back in our broadband deployment plans. At December 31, 2001, we had approximately 1.3 million DSL subscribers, and more than half, or 25 million, of our wireline customer locations were DSL-capable. Additionally, we have spent approximately $3.2 billion as of December 31, 2001, for fiber, electronics and other technology for Project Pronto. The build-out will include transferring certain portions of our existing copper network to a new fiber network. Over the deployment period, marketing costs will be incurred depending on the rate of customer sign-ups and installations.

Long Distance We offer landline interLATA long distance services to customers in selected areas outside our wireline subsidiaries' operating areas. Further, we offer interLATA long distance services to customers in Texas, Kansas, Oklahoma, Arkansas, Missouri and Connecticut. The FCC approved our application to provide interLATA long distance service for calls originating in Kansas and Oklahoma effective March 7, 2001, and in Arkansas and Missouri on November 16, 2001. We officially launched service under the SBC Southwestern Bell brand in those states on the effective approval dates or shortly thereafter, offering domestic residential and business long distance services as well as international calling plans. We continue to seek long distance approval in our other in-region states

and have filed applications with state commissions in California, Illinois, Michigan, Nevada and Ohio. See "State Regulation" below for the status of our state applications.

In October 2001, the FCC completed its re-examination of certain information contained in our previously approved Kansas and Oklahoma long distance applications and found that we did not intentionally provide false information. However, the FCC proposed that we pay approximately $3 for alleged collateral violations related to those applications. This FCC ruling is still pending and has no effect on our ability to continue to offer long distance service in either state.

Wireless In October 2000, Cingular began operations as the second-largest wireless provider in the U.S. (see Note 7). Cingular's top priorities for 2002 include geographic expansion, including expansion into New York City through an infrastructure-sharing agreement with VoiceStream Wireless Corporation (VoiceStream), further rollout of wireless data services, overlaying GSM voice and GPRS high-speed data technology over its existing networks and integration of operations to strengthen its competitive position and realize cost synergies. The fastest-growing area of the wireless business is data. Although data revenues are not currently a significant portion of Cingular's total revenues, Cingular plans to accelerate the development of this business. In late 2001, Cingular launched GPRS in Seattle, Las Vegas, eastern Tennessee, coastal Georgia and the Carolinas and plans to launch GPRS in California by mid-2002. In January 2002, Cingular announced the formation of a joint venture with AT&T Wireless Services Inc. (AT&T Wireless) that is expected to allow Cingular to extend its GSM/GPRS network coverage along interstate highways in the upper Midwestern and Western sections of the U.S. Cingular expects the new networks to be operational by the first quarter of 2003. Additionally, Cingular has announced it will begin upgrading its network to third-generation (3G) wireless data technology by introducing Enhanced Data Rates for Global Evolution (EDGE). EDGE technology is Cingular's choice for a 3G wireless communications standard that will allow customers to access the Internet from their wireless devices at higher speeds than in the past. This upgrade is expected to be completed by early 2004. During 2002, Cingular expects to spend approximately $4.5 billion for ongoing capital expenditures and to begin overlaying its existing network with GSM voice and GPRS/EDGE data technology.

REGULATORY ENVIRONMENT

Wireline

Federal Regulation Under the Telecom Act, before being permitted to offer landline interLATA long distance service in any state within the 12-state region encompassed by the regulated operating areas of Southwestern Bell Telephone Company (SWBell), Pacific Bell Telephone Company (PacBell), Ameritech and Nevada Bell (these areas with the addition of Southern New England Telecommunications Corp.'s (SNET) area are referred to as our 13-state area), we are required to apply for and obtain state-specific approval from the FCC. The FCC's approval, which involves consultation with the U.S. Department of Justice and the appropriate state commission, requires favorable determinations that our wireline subsidiaries have entered into interconnection agreement(s) that satisfy a 14-point "competitive checklist" or, alternatively, the subsidiaries have a statement of terms and conditions effective in that state under which they offer the "competitive checklist" items. The FCC also must make favorable public interest and structural separation determinations in connection with each application. See "State Regulation" below for the status of our state applications.

Interconnection – Collocation Under the Telecom Act, regional Bell operating companies were required to allow competitors to put equipment in their offices "necessary" for connecting to the local network. In March 1999, the FCC issued rules allowing competitors to install any equipment that is "used" or "useful" for interconnection, even if some equipment has other functions. In August 2001, the FCC issued its order in response to a March 2000 appellate court reversal and remand of the FCC's March 1999 interconnection rules. In its August 2001 order, the FCC required that incumbent local exchange companies, such as our wireline subsidiaries, allow competitors to collocate only equipment that has the primary purpose of interconnecting or accessing local lines. The order also required incumbents to allow competitors to cross-connect with other collocated carriers. In August 2001, we, along with BellSouth, filed a petition for review of this order with the United States Court of Appeals for the District of Columbia (D.C. Court of Appeals) on the grounds that the order exceeds the FCC's jurisdiction and authority. The effect of any future decision on our results of operations and financial position cannot be determined at this time; however, if the August 2001 FCC order stands as written, we do not expect it to have a material effect on our financial position or results of operations.

Interconnection – Pricing In July 2000, the Eighth Circuit Court of Appeals (8th Circuit) struck down FCC rules governing the rates incumbent local exchange carriers, such as our wireline subsidiaries, charge competitors for interconnection and for leasing portions of the incumbents' telephone networks. The decision rejected FCC pricing rules that required incumbents to charge competitors rates based

on hypothetical costs and held that prices should instead be based on actual (but not necessarily historical) costs incurred by carriers to provide interconnection or access to unbundled network elements. In addition, the decision rejected FCC rules governing the amount incumbents must discount services purchased by competitors for resale to end users, holding that the discount should be based on actual, not hypothetical, avoided costs of the incumbents. The 8th Circuit remanded the pricing issues back to the FCC. The 8th Circuit also reaffirmed its prior conclusion that incumbents cannot be required to create new combinations of unbundled network elements for competitors, nor to provide competitors better quality interconnection or access to unbundled network elements than the incumbents provide to themselves. In October 2001, the United States Supreme Court (Supreme Court) heard an appeal of certain portions of the 8th Circuit's ruling, including its invalidation of the FCC's pricing rules and its rule governing new combinations of network elements. A Supreme Court decision is expected during the first half of 2002. Until the Supreme Court issues its decision on the appeal issues, the FCC rules continue in effect. The effect of the future Supreme Court decision, which may include remand of this issue back to the FCC, on our financial position or results of operations cannot currently be determined.

Unbundled Network Elements/Line Sharing In November 1999, the FCC ordered that incumbent local exchange carriers must continue leasing certain parts of their telephone network to competitors at a discount, as well as revised rules that expand the definitions of certain unbundled network elements (UNE). However, the order limited discounted access to switches serving customers with four or more lines under certain conditions. In addition, the FCC declined to regulate mandatory leasing of high-speed Internet and data equipment. In a separate order, the FCC ordered incumbents to share telephone lines with DSL competitors (DSL line sharing order).

Several parties petitioned the FCC for reconsideration of various aspects of the UNE and DSL line sharing orders. In addition, other parties appealed the UNE and DSL line sharing orders to the D.C. Court of Appeals. Several parties also requested that the FCC require our wireline subsidiaries and other incumbents to provide and support line sharing on a UNE platform as well as make DSL a UNE product.

In December 2001, the FCC began evaluating its unbundling rules, seeking to fashion a more targeted approach to unbundling. The FCC plans to consider whether existing UNEs should be changed and whether transition plans are appropriate prior to a change in existing UNE obligations. After considering data, the FCC is expected to issue a series of decisions on unbundling obligations beginning in mid-2002. The effect of this review on our results of operations and financial position cannot be determined at this time; however, we do not expect it to be materially adverse.

National Performance Measures In November 2001, the FCC released notices of proposed rulemaking (NPRMs) regarding the creation of national performance measures and standards for evaluating incumbent local exchange carriers, such as our wireline subsidiaries, performance in the provisioning of UNEs and interstate special access services to competitive local carriers. The FCC offered for comment performance measures and standards that apply to special access services and to facilities that the competitive carriers acquire from incumbents for use in entering the local services market. The FCC has stated it will also consider the imposition of enforcement measures in the event any adopted standards are not met. The effects of these NPRMs on our results of operations and financial position cannot be determined at this time.

Advanced Services In December 2001, the FCC began examining the appropriate rules for the provision of domestic broadband services by incumbent local carriers or their affiliates. This examination was triggered in part by our petition requesting that the FCC classify our separate affiliates offering DSL and other advanced services as nondominant providers and thus relieve us from dominant-carrier regulation of these services. In its review, the FCC plans to consider broadband services offered over cable, satellite and wireless platforms in addition to traditional wireline offerings. The effect of this review on our results of operations and financial position cannot be determined at this time.

Reciprocal Compensation is billed to our wireline subsidiaries by competitors for the termination of certain local exchange traffic to competitors' customers. In February 1999, the FCC declared that Internet traffic is not local traffic, but instead is primarily interstate, subject to interstate jurisdiction. However, the FCC found that existing federal law did not address to what extent, if any, compensation should be paid to competitors that deliver Internet traffic to Internet service providers and initiated a proceeding to establish such rules. In March 2000, the D.C. Court of Appeals vacated the FCC's February 1999 holding that Internet traffic is interstate and remanded the holding to the FCC for a more reasoned explanation of that conclusion. In April 2001, the FCC issued an order and further notice of proposed rulemaking (FNPRM) addressing that remand. In its FNPRM, the FCC launched a broad examination of all forms of inter-carrier compensation as well as proposed to eliminate all reciprocal compensation when the transitional mechanism expires.

Additionally, in its April 2001 order, the FCC ruled that calls to Internet service providers are interstate access and not subject to reciprocal compensation. However, instead of immediately eliminating all compensation, the FCC established a transitional compensation mechanism for exchange of this traffic. Under this mechanism, the per-minute-of-use fee was capped at 0.15 cents during the first six months following the order and declines to 0.07 cents after two years. In addition, the FCC capped the growth of Internet minutes for which carriers may seek compensation. The FCC transition plan is optional for incumbent local exchange carriers and in order to opt into the plan, incumbents must offer to exchange local and wireless traffic at the same compensation rate as Internet traffic. To date, none of our wireline subsidiaries have opted into the transition plan.

Appeals of reciprocal compensation decisions currently are pending before the Supreme Court, the United States Court of Appeals for the Sixth Circuit (6th Circuit) and U.S.

District Courts in Texas, Indiana, Ohio, Wisconsin and California. We have fully accrued expenses for amounts sought by competitors for the termination of Internet traffic to Internet service providers.

Pricing Flexibility In March 2001, the FCC granted our request to (1) offer volume and term discounts under contract for some access services in certain markets and (2) remove special access and dedicated transport services from price cap regulation in certain additional market areas. The market areas covered by this decision include Chicago, Los Angeles and Dallas. We expect this decision to have an immaterial favorable effect on our results of operations and financial position.

Coalition for Affordable Local and Long Distance Service (CALLS) In September 2001, the United States Court of Appeals for the Fifth Circuit (5th Circuit) ruled on appeal of the FCC's May 2000 CALLS order restructuring federal price cap regulation. Although the 5th Circuit upheld the CALLS order in most key respects, it reversed and remanded to the FCC two specific aspects of the order.

- The 5th Circuit held that the FCC failed to sufficiently justify an incremental $650 in universal service funding and remanded to the FCC for further explanation of the amount; and
- held that the FCC failed to show a rational basis for how it derived the 6.5% transitional mechanism, i.e., the productivity factor used to reduce access rates until a targeted average rate is achieved, and remanded to the FCC for an explanation of how the percentage was derived.

The current universal service fund amount and transitional mechanism will remain in effect pending FCC response. The effect of any future FCC order on our results of operations and financial position cannot be determined at this time.

Ameritech Merger In association with its approval of the October 1999 Ameritech merger, the FCC set specific performance and reporting requirements and enforcement provisions that mandate approximately $2.0 billion in potential payments through June 2004 if certain goals are not met. Associated with these conditions, we incurred approximately $94 and $355 in 2001 and 2000 in additional expenses, including payments for failing to meet certain performance measurements, specifically, the "Opening Local Markets to Competition" condition. At December 31, 2001, $1.9 billion in remaining potential payments could be triggered if the "Out-of-Region Competition" and "Opening Local Markets to Competition" conditions discussed below are not met. The following briefly summarizes all the major conditions:

- **Out-of-Region Competition** In accordance with this condition, we will offer local exchange services in 30 new markets across the country. We are required by the FCC to enter these 30 markets as a provider of local services to business and residential customers by April 2002. Failure to meet the FCC condition requirement could result in a payment of up to $40 for each market. Entrance into these new markets did not have a material effect on our results of operations or financial position.

  As of December 31, 2001 we had introduced service in 22 new markets (Boston, Fort Lauderdale, Miami, New York, Seattle, Atlanta, Denver, Minneapolis, Philadelphia, Phoenix, Baltimore, Bergen-Passaic, Middlesex, Nassau, Newark, Orlando, Salt Lake City, Tampa, Washington D.C., West Palm Beach, Louisville and Charlotte), and plan to enter at least eight more by April 2002. In March of 2001, we scaled back our service offerings in these areas in response to certain economic environment and regulatory factors, while still fulfilling our FCC merger condition requirements.
- **Opening Local Markets to Competition** We are required to file performance measurement data reflecting 20 different categories with the FCC and relevant state commissions on a monthly basis. These performance measurements address functions that the FCC believes may have a particularly direct effect on our local competitors and their customers, such as our response to competitors' requests for information and interconnection.
- **Improving Residential Service** We will offer residential customers a plan with no minimum monthly long distance fees for at least three years after entering the long distance business in that state. In addition, we offer a low-income Lifeline Universal Service plan to low-income residential customers in each state in our 13-state area.
- **Promoting Advanced Services** We established separate subsidiaries to provide advanced services, such as DSL, in order that the subsidiaries be exempt from a Telecom Act provision requiring them to make the services available for resale to competitors. These subsidiaries are required to use the same processes for the ordering and provisioning of our wireline services as competitors, pay an equivalent price for facilities and services and locate at least 10% of their DSL service facilities in low-income areas. See "Data/Broadband" under "Expected Growth Areas" above for further discussion of Project Pronto.

  In January 2001, the D.C. Court of Appeals struck down the FCC merger condition that granted our separate affiliates an exemption from the Telecom Act requirement to offer retail DSL transport and other retail advanced services for resale at a discount. Although the merger condition allows us to partially integrate the affiliates into our telephone companies under such circumstances, we are continuing to maintain the advanced services affiliates as separate companies. We believe this is in the best interest of our customers although we continue to evaluate our operations and customer needs. We do not expect, at this time, that this issue will have a material effect on our results of operations or financial position.

The effects of the FCC decisions on the above topics are dependent on many factors including, but not limited to, the ultimate resolution of the pending appeals; the number and nature of competitors requesting interconnection, unbundling or resale; and the results of the state regulatory commissions' review and handling of related matters within their jurisdictions. Accordingly, we are not able to assess the total potential impact of the FCC orders and proposed rulemakings.

State Regulation The following summarizes state regulation in the 13 states in which our wireline subsidiaries operated at December 31, 2001:

State	Alternative Regulation[1]	Number of Signed Wireline Interconnection Agreements[2]	Long Distance Application Status
Arkansas	Yes	122	Long distance service provided effective November 2001
California	Yes, review pending	237	Decision expected in 2002[3]
Connecticut	Yes	65	Long distance service provided
Illinois	Yes, pending state approval	139	Decision expected in 2002[3]
Indiana	Yes, through 12/2003	131	Filing planned in 2002[4]
Kansas	Yes	123	Long distance service provided effective March 2001
Michigan	Yes	95	Decision expected in 2002[3]
Missouri	Yes	126	Long distance service provided effective December 2001
Nevada	Yes	75	Decision expected in 2002[3]
Ohio	Yes, through 1/2003	133	Decision expected in 2002[3]
Oklahoma	Yes	105	Long distance service provided effective March 2001
Texas	Yes	342	Long distance service provided
Wisconsin	Yes	96	Filing planned in 2002[4]

Notes:

[1] Alternative regulation is other than rate of return regulation.

[2] Interconnection agreements are signed with competitors for the purpose of allowing them to exchange local calls with the incumbent telephone company and, at their option, to resell services and obtain unbundled network elements.

[3] Awaiting determination by state commissions on our compliance with the 14-point competitive checklist. FCC approval is required subsequent to state determination.

[4] Will require approval by the state commission and the FCC.

The following summarizes certain regulatory developments:

Illinois Merger Settlement In December 2001, we entered into an agreement to end the cost-sharing provision of the ICC Ameritech merger order. The annual cost-sharing provision required our Illinois wireline subsidiary to track and report merger-related costs and savings and share 50% of those savings with end-users and carriers. Under terms of the agreement, which is pending ICC approval, we will provide a one-time credit to end-users and carriers of approximately $197 during 2002 in exchange for elimination of any future sharing obligations as well as the requirement to track and report merger costs and savings. The credits were fully accrued at December 31, 2001.

Illinois Legislation The Illinois legislature passed a four-year law, effective June 30, 2001, imposing new requirements on Illinois telecommunications companies, including our Illinois wireline subsidiary. The law (1) requires all local telephone companies to provide wireless phones or cash payments to customers who wait more than five days to get local service repaired or installed, (2) increases the dollar amount the ICC is authorized to levy in fines against companies that violate ICC orders, (3) requires our subsidiary to offer fixed-rate service plans that will result in savings for the average residential customer and (4) requires our subsidiary to offer advanced broadband telecommunications services to at least 80% of its Illinois customers by 2005. Additionally, the law contains numerous provisions affecting competitive access to our wireline network, most notably a requirement that we offer for resale new combinations of unbundled network elements. This issue regarding new combinations is also pending before the Supreme Court and the Supreme Court's decision will likely affect implementation of these unbundling provisions.

Most of the provisions of this legislation will require the ICC to issue specific regulations, prior to implementation, in order to integrate the new legislation with existing alternative regulation laws. This legislation may require us to incur additional expenses to restructure our telecommunications network, which may or may not improve the efficiency of the network, and to improve installation and repair service quality. We are likely to experience a decrease in revenues due to the potentially lower total revenue from average customers generated under fixed-rate service plans as well as due to new rules regarding competitors' access to our network, including the impact of any required new combinations of unbundled network elements offered for resale. The extent of any decrease will depend, among other factors, on the monthly rates that the ICC ultimately authorizes for our service plans and the resulting number of access lines lost to competitors as well as on future ICC and Supreme Court rulings regarding competitive access. As we cannot predict how the ICC will implement the provisions

of this legislation, or the effect of the pending Supreme Court case, the legislation's effect on our future results of operations and financial position is not determinable at this time; however, it is not expected to be material. We are prepared to challenge various provisions of this law depending on ICC interpretation of those provisions.

This legislation increased pre-tax income approximately $68 in 2001, consisting of revenue increases due to the legislation resolving issues pending before the ICC partially offset by refunds and implementation expenses.

Michigan Legislation In July 2000, the Michigan legislature eliminated the monthly intrastate end-user common line (EUCL) charge and implemented price caps for certain telecommunications services. In July 2000, we eliminated the EUCL charge and filed suit in federal court challenging the constitutionality of the legislation. In September 2000, temporary stays of the price cap provision and the EUCL charge elimination were issued. In July 2001, the 6th Circuit ruled that we had demonstrated a substantial likelihood of ultimately showing that the price cap and the EUCL charge elimination were unconstitutional and stayed both provisions pending completion of the litigation. We reinstated the EUCL charge in October 2000, and increased prices for our basic local services in April 2001, both of which are subject to refund if the legislation is upheld. In July 2001, both the State of Michigan and MCI WorldCom, Inc. filed petitions for re-hearing of the 6th Circuit decision. In October 2001, the 6th Circuit decided to delay its decision on the petitions for rehearing until the Supreme Court rules on the 8th Circuit appeal discussed above in "Interconnection."

The law also authorized an expansion of local calling areas so that many short toll calls could be reclassified as local calls and 2001 revenues declined approximately $5 ($27 annualized) associated with the expansion of local calling areas.

California Proceedings In September 2001, the California Public Utilities Commission (CPUC) ruled that our California wireline subsidiary must pay approximately $26 for alleged overly aggressive and deceptive marketing practices related to packages of enhanced services such as Caller ID and call forwarding. We believe these allegations are unwarranted and could hinder our ability to inform consumers about the products and services we offer. The CPUC ruling also ordered us to reduce the commission we pay our customer service employees and prescribes acceptable marketing practices; however, in October 2001, the CPUC agreed to reconsider the provision relating to incentive compensation. We believe this decision is unlawful on a number of grounds and have filed legal challenges to the decision.

CPUC rules allow for an audit of a utility's books every three years. The audit of our California wireline subsidiary began in April 2000, and a report is expected during the first quarter of 2002. The CPUC will consider the results of the audit as it conducts its triennial review of our regulatory framework during 2002 and 2003. It is uncertain at this time what effect the report or changes to our regulatory framework might have on our future results of operations and financial position.

Ohio Service Quality Audit In January 2002, the Public Utilities Commission of Ohio (PUCO) issued a supplemental order adopting many of the recommendations made by an outside consultant that audited our Ohio wireline subsidiary's service quality and marketing practices. The audit covered the period from August 1999 through May 2001. The PUCO ordered us to improve service quality compliance, provide retroactive customer credits in accordance with the original order, and pay the State of Ohio approximately $9, with additional payments possible based on assessment of our past and future service quality compliance. The PUCO also ordered us to deploy advanced services in certain areas of Ohio and provide a temporary discount on certain wholesale services provided to competing carriers. We began providing the customer credits in October 2001. We do not expect the order to have a material effect on our results of operations or financial position.

COMPETITION

Competition continues to increase for telecommunications and information services. Recent changes in legislation and regulation have increased the opportunities for alternative communications service providers. Technological advances have expanded the types and uses of services and products available. As a result, we face increasing competition as well as new opportunities in significant portions of our business. The following discusses recent regulatory events affecting wireline competition.

Wireline

Our wireline subsidiaries expect increased competitive pressure in 2002 and beyond from multiple providers in various markets, including facilities-based local competitors, interexchange carriers and resellers. Substitution of wireless and Internet for traditional local service lines also continues to increase. At this time, we are unable to assess the effect of competition on the industry as a whole, or financially on us, but we expect both losses of market share in local service and gains resulting from new business initiatives, vertical services and new long distance service areas.

State legislative and regulatory developments over the last several years allow increased competition for local exchange services. Companies wishing to provide competitive local service have filed numerous applications with each of the state commissions throughout our 13-state area, and the commission of each state has been approving these applications since late 1995. Under the Telecom Act, companies seeking to interconnect to our wireline subsidiaries' networks and exchange local calls must enter into interconnection agreements with us. These agreements are then subject to approval by the appropriate state commission. We have reached over 1,700 wireline interconnection agreements with competitive local service providers, and most have been approved by the relevant state commission. In addition, other competitors are reselling our local exchange services, and as of December 31, 2001, we had approximately 1.2 million access lines (approximately 2.0% of our total access lines) supporting services of resale competitors throughout our 13-state area, primarily in Texas, California and Illinois.

The CPUC authorized facilities-based local services competition in California effective January 1996 and resale competition effective March 1996. In November 1998, the CPUC issued a decision authorizing our subsidiary to recover local competition implementation costs, and we recovered approximately $44 via a customer surcharge during 2001 and expect to recover approximately $44 in 2002.

The ICC approved Advantage Illinois in 1994, providing a framework for regulating our Illinois wireline subsidiary by capping prices for noncompetitive services. In this order, the ICC approved a price cap on the monthly line charge for residential customers and residential calling rates within local calling areas for an initial five-year period that ended in October 1999. In January 2000 the ICC initiated a review of Advantage Illinois with respect to its effectiveness and whether any modifications are necessary. We expect the ICC to complete this review in mid-2002. The price cap on residential rates will remain in effect until the review is completed.

The Indiana Court of Appeals reversed a portion of the 1997 Indiana Utility Regulatory Commission (IURC) order in October 1999, which had directed Ameritech to reduce rates for basic residential and business services and remanded the rate issue to the IURC. In March 2001, we and the IURC settled the outstanding issues under the 1997 order, including tightened service standards, thus extending alternative regulation in Indiana through December 2003. This agreement is not expected to have a material effect on our results of operations or financial position.

In Connecticut, the Connecticut Department of Public Utility Control (CDPUC) approved a five-year alternative regulation plan for SNET in 1996. In May 2001, the CDPUC issued a decision extending our alternative regulation plan indefinitely and the monitoring period until 2004. In its decision, the CDPUC rejected our request for authority to adjust local residential service rates annually based on the rate of inflation. Additionally, in March 2001, the CDPUC granted our request to close our Connecticut cable television business and we did so in June 2001.

Wireless

Cingular, our wireless joint venture with BellSouth, began operations in October 2000. Cingular serves approximately 21.6 million customers, is the second-largest wireless provider in the U.S., and has approximately 219 million potential customers in 41 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

Cingular targets further geographic expansion through possible spectrum exchanges and auctions. During 2001, Cingular agreed to share infrastructure with VoiceStream. VoiceStream is sharing infrastructure in New York City, St. Louis and Detroit, and Cingular is sharing infrastructure in Los Angeles and San Francisco. Additionally, in January 2002, Cingular announced the formation of a joint venture with AT&T Wireless. See "Wireless" under "Expected Growth Areas" above for further discussion.

Cingular also invested in Salmon PCS (Salmon), a participant in a December 2000/January 2001 FCC auction of wireless spectrum licenses, including licenses held by wireless companies that had previously filed for bankruptcy protection before completing payment. Salmon was the highest bidder on 79 licenses; 45 of those licenses were awarded to Salmon and 34 licenses remain subject to legal and regulatory challenges and possible legislative inquiry. It is unclear how a resolution of these proceedings will affect Cingular. To date, Cingular has provided Salmon equity of approximately $192 and secured loans of approximately $475, including interest. If all the licenses are awarded, it is estimated Cingular would be required to provide Salmon approximately $1.7 billion.

Cingular faces substantial competition in all aspects of its business as competition continues to increase in the wireless communications industry. Cingular competes for customers based principally on service offerings, price, call quality, coverage area and customer service. Cingular's competitors are principally large providers of cellular, PCS and other wireless communications services, but Cingular also competes with smaller companies, as well as dispatch mobile telephone companies, resellers and wireline service providers. Moreover, Cingular may experience significant competition from companies that provide similar services using other communications technologies and services. While some of these technologies and services are now operational, others are being developed or may be developed in the future. See discussion of EDGE technology in "Wireless" under "Expected Growth Areas" above.

Directory

Our directory subsidiaries face competition from over 100 publishers of printed directories in their operating areas. Direct and indirect competition also exists from other advertising media, including newspapers, radio, television and direct mail providers, as well as from directories offered over the Internet.

ACCOUNTING POLICIES AND STANDARDS

Significant Policies Because of the size of the financial statement elements they relate to, some of our accounting policies and estimates have a more significant impact on our financial statements than others:

- How we depreciate assets, including use of composite group depreciation and estimates of useful lives, are described in Notes 1 and 6. We assign useful lives based on periodic studies of actual asset lives. Changes in those lives with significant impact on the financial statements must be disclosed, but no such changes have occurred in the three years ended December 31, 2001.
- Our recording of revenue is described in Note 1, and the associated estimate of bad debts is based on analysis of history and future expectations. As discussed in Results of Operations, the impacts of companies that went out of business and customers with a higher credit risk due to the adverse U.S. economy were reflected in our results through a significant increase in both bad debt expense and allowance for uncollectible accounts in 2001.
- Our actuarial estimates of retiree benefit expense and the associated significant weighted-average assumptions are discussed in Note 11. The most significant of these is the return on assets assumption of 9.5% on nearly $40 billion of pension and other

post-retirement assets (for the year 2001). This assumption reflects our current view of long-term returns. The increase from 8.5% in 2000 reflects our actual long-term results exceeding previous assumptions; our assumption for 2002 is unchanged. For each of the three years ended 2001, our actual 10-year return on investments exceeded 10%, including the effect of the negative returns in 2001. Note 11 also discusses the effects of certain changes in assumptions related to medical trend rates to retiree health care costs. We did not reduce our medical trend rate as originally anticipated in response to actual claim results during 2001.

- Our estimates of income taxes and the significant items giving rise to the deferred assets and liabilities are shown in Note 10. These reflect our assessment of actual future taxes to be paid on items reflected in the financial statements, giving consideration to both timing and probability of these estimates. Actual income taxes could vary from these estimates due to future changes in income tax law or on results from final Internal Revenue Service review of our tax returns.
- Our use of estimates to accrue probable liabilities is noted in Note 1, and significant individual accruals are discussed within the affected area. Included in these items are those that are normalized as described in Note 5 and in the "Overview" section of our Results of Operations discussion.
- Our policy on valuation of intangible assets is described in Note 1. In addition, for cost investments, we evaluate whether mark-to-market declines are temporary and reflected in other comprehensive income, or other-than-temporary and recorded as an expense in the income statement; this evaluation is based on the length of time and the severity of decline in the investment's value. Significant asset and investment valuation adjustments we have made are discussed in Notes 2, 3 and 5.

New Accounting Standards On January 1, 2002, we were required to adopt Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. FAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. Adoption of FAS 142 means that we will stop amortizing goodwill. At least annually, we will test the remaining book value for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairments will be recorded in operating expenses.

For the fourth quarter of 2001, we reviewed the carrying values and lives of our intangible assets, including approximately $3,200 of goodwill, using the criteria of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (FAS 121), which was the current accounting rule for impairment of goodwill. Our review indicated that the estimated future undiscounted cash flows were sufficient to recover the related carrying values, so no impairment was recorded.

Under FAS 142, we will also stop amortizing goodwill recorded on our equity investments. However, we will continue to test this embedded goodwill for impairment under accounting rules for equity investments, which are based on comparisons between fair value and carrying value. In addition, we will adjust the equity in net income of affiliates line item to reflect the impact of adopting these new accounting standards on the operations of our equity investments.

Cingular has determined that the FCC wireless licenses they own have an indefinite useful life because cash flows are expected to continue, and historical practice has shown that Cingular has been able to renew the licenses at each expiration period. Under FAS 142, Cingular will not amortize these wireless licenses until Cingular determines that the licenses have a finite life. Cingular is currently performing the required impairment tests under FAS 142. Cingular held approximately $7,190 of wireless licenses as of December 31, 2001, and has determined that no impairment exists under FAS 121 as of that date.

Our existing and embedded goodwill amortization and our share of Cingular's license amortization was approximately $380 net of tax, or $0.11 per share in 2001. Amortization for these items will not occur in 2002, thus increasing our net income in 2002. Our international holdings are still reviewing the impact of FAS 141 and 142 on their own operations and these reviews will also impact us. Our current estimate of the impact on us of our international holdings ceasing amortization of goodwill is between $45 and $65 net of tax. This amount will also increase our net income in 2002.

During 2002, we will perform the first step of the required FAS 142 impairment tests as of January 1, 2002. This first step requires us to compare the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is one of our operating segments or a discrete component of that segment. If the current fair value is less than the carrying value, then we will perform the second step of the impairment test. This second step requires us to measure the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment.

We have determined that the fair value of our investment in Sterling is less than the carrying value, and are performing the second step of the impairment test. Although we have not yet completed the impairment testing, we expect the impairment to be between $1,500 and $1,900, before taxes. We plan to complete the impairment tests on our direct investments in the first quarter of 2002. We do not expect that all of our international holdings will have completed their own impairment tests by that time. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce our net income in 2002.

On January 1, 2001, we adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires all derivatives to be recorded on the balance sheet at fair value. Our adoption did not have a significant effect on our financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

We had $703 in cash and cash equivalents available at December 31, 2001. Commercial paper borrowings as of December 31, 2001 totaled $6,039. We have lines of credit with several banks totaling $3,700, all of which may be used to support commercial paper borrowings. We had no borrowings outstanding under these lines of credit as of December 31, 2001.

Cash from Operating Activities

During 2001, 2000 and 1999, our primary source of funds continued to be cash generated from operations, as shown in the consolidated statements of cash flows. Net cash provided by operating activities exceeded our construction and capital expenditures during 2001, 2000 and 1999; this excess is referred to as free cash flow, a supplemental measure of liquidity. We generated free cash flow of $3,616, $942 and $6,370 in 2001, 2000 and 1999.

During 2001, we received $495 in cash in addition to SpectraSite stock in exchange for leasing 2,665 communication towers to SpectraSite. In November 2001, we amended our agreement. We agreed to reduce the maximum number of towers to be leased from 3,900 to 3,600, and to extend the schedule for closing on towers until the first quarter of 2004. As consideration for those modifications, we received $35.

In the first quarter of 2001, we received approximately $783 related to the sale of our investment in diAx to TDC. Approximately $565 was recorded as a dividend, due to the nature of our investment in TDC, and was included in undistributed earnings from investments in equity affiliates.

Cash from Investing Activities

To provide high-quality communications services to our customers we must make significant investments in property, plant and equipment. The amount of capital investment is influenced by demand for services and products, continued growth and regulatory commitments.

Our capital expenditures totaled $11,189, $13,124 and $10,304 for 2001, 2000 and 1999. Capital expenditures in the wireline segment, which represented the majority of our total capital expenditures, decreased by 8.5% in 2001 compared to 2000, primarily due to the slowdown of the deployment of our national broadband network. The wireline segment capital expenditures increased by 37.8% in 2000 compared to 1999, primarily attributed to the expansion of our local exchange service into new markets, DSL, digital and broadband network upgrades and regulatory commitments.

In 2002, management expects total capital spending to be between $9,200 and $9,700. We expect these expenditures to relate primarily to our wireline subsidiaries' networks, our broadband initiative, DSL, and support systems for our long distance service.

We received $1,371 from Cingular in 2001 for payment on notes receivable. In 2001, our cash receipts from dispositions exceeded cash expended on acquisitions. In 2000 and 1999, cash expended on acquisitions exceeded receipts from dispositions (see Note 3).

Cash from Financing Activities

Dividends declared by the Board of Directors of SBC were $1.025 per share in 2001, $1.015 per share in 2000 and $0.975 per share in 1999. These per share amounts do not include dividends declared and paid by Ameritech prior to its 1999 merger. The total dividends paid by SBC and Ameritech were $3,448 in 2001, $3,443 in 2000 and $3,312 in 1999. SBC's dividend policy considers both the expectations and requirements of shareowners, internal requirements of SBC and long-term growth opportunities.

In November 2001, our Board of Directors authorized the repurchase of up to 100 million shares of SBC common stock. This is in addition to the January 2000 authorization to repurchase 100 million shares. In 2001, we spent $2,068 on these stock repurchases. As of January 31, 2002, we have repurchased a total of approximately 99 million shares of the 200 million that are authorized. We have also entered into a series of put options on SBC stock with institutional counterparties. We have a maximum potential obligation to purchase 9,000,000 shares of our common stock at a weighted average exercise price of $37.45 per share (see Note 14).

In February 2002, we issued approximately $1,000 of 10-year, 5.875%, global notes. We also issued $2,000 of five-year, 5.75%, global notes and $1,250 of 10-year, 6.25%, global notes in April and March, of 2001. In addition to these global notes, we issued two, variable interest rate, one-year notes, each for $500 in March 2001; $500 of 7.00% notes due 2041; and privately sold $1,000 of 20-year annual Puttable Reset Securities (PURS) in June 2001. For additional information on these debt issuances see Note 8.

During the third quarter of 2001, we redeemed approximately $665 of multiple bonds with maturities up to 40 years and interest rates ranging from 4.4% to 6.9%. We also redeemed approximately $615 of multiple bonds with maturities up to 40 years and interest rates ranging from 5.8% to 8.5% during the second quarter of 2001. In March 2001, we paid the principal amount of each of the DECS, as adjusted by the exchange rate specified in the DECS, in the form of cash that was received from the settlement of our note receivable with characteristics similar to the DECS. For additional information on these debt redemptions see Note 8.

During 2001, we redeemed prior to maturity the $1,000 of the TOPrS. The TOPrS had an original maturity of 30 years and were included on the balance sheet as corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts (see Note 9).

In May 2000, we issued $1,000 in notes through private placement. These notes matured in May 2001. In April 2000, we issued notes for $1,015 that also matured in May 2001.

In December 1999, we called approximately $31 of debt issued by our capital financing subsidiaries that was scheduled to mature in December 2004. The net income effect of retiring this debt did not materially impact our financial statements. During 1999, subsequent to the completion of the acquisitions of Comcast and CCPR, we retired $1,415 of Comcast's and CCPR's long-term debt with no effect on net income. In May 1999, we issued $750 of unsecured 6.25% Eurodollar notes, due May 2009, through our capital financing subsidiaries.

We expect to fund ongoing capital expenditures, the repurchase of stock and merger initiative expenses with cash provided by operations and incremental borrowings.

Other

Our total capital consists of debt (long-term debt and debt maturing within one year), TOPrS (in 2000), and shareowners' equity. Our capital structure does not include debt issued by our International equity investees or Cingular. Total capital increased $1,232 in 2001 and $8,850 in 2000. The 2001 increase was less than the 2000 increase because of lower net income, the redemption of the TOPrS and the repurchase of common shares through our stock repurchase programs. Our debt ratio was 44.6%, 45.2% and 42.9% at December 31, 2001, 2000 and 1999. The debt ratio is affected by the same factors that affect total capital.

Current accounting standards require us to disclose our material obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under contingent commitments, such as debt guarantees. We occasionally enter into third-party debt guarantees, but they are not material. We disclose our contractual long-term debt repayment obligations in Note 8 and our operating lease payments in Note 6. In the ordinary course of business we routinely enter into commercial commitments for various aspects of our operations, such as plant additions and office supplies. However, we do not believe that the commitments will have a material effect on our financial condition, results of operations or cash flows.

MARKET RISK

We are exposed to market risks primarily from changes in interest rates and foreign currency exchange rates. In managing exposure to these fluctuations, we may engage in various hedging transactions that have been authorized according to documented policies and procedures. We do not use derivatives for trading purposes, to generate income or to engage in speculative activity. Our capital costs are directly linked to financial and business risks. We seek to manage the potential negative effects from market volatility and market risk. The majority of our financial instruments are medium- and long-term fixed rate notes and debentures. Fluctuations in market interest rates can lead to significant fluctuations in the fair value of these notes and debentures. It is our policy to manage our debt structure and foreign exchange exposure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. Where appropriate, we will take actions to limit the negative effect of interest and foreign exchange rates, liquidity and counterparty risks on shareowner value.

QUANTITATIVE INFORMATION ABOUT MARKET RISK

Interest Rate Sensitivity The principal amounts by expected maturity, average interest rate and fair value of our liabilities that are exposed to interest rate risk are described in Notes 8 and 9. Following are our interest rate derivatives subject to interest rate risk as of December 31, 2001. The interest rates illustrated in the interest rate swaps section of the table below refer to the average expected rates we would receive and the average expected rates we would pay based on the contracts. The notional amount is the principal amount of the debt subject to the interest rate swap contracts. The fair value represents the amount we would receive if we exited the contracts as of December 31, 2001.

	Maturity							
	2002	2003	2004	2005	2006	After 2006	Total	Fair Value 12/31/01
Interest Rate Derivatives								
Interest Rate Swaps:								
Receive Fixed/Pay Variable Notional Amount	—	—	—	—	$500	$75	$575	$ 5
Variable Rate Payable[1]	2.7%	4.8%	6.2%	6.7%	6.8%	6.2%		
Weighted Average Fixed Rate Receivable	5.7%	5.7%	5.7%	5.7%	5.7%	5.4%		
Receive Variable/Pay Fixed Notional Amount	$ 5	—	—	—	—	—	$ 5	—
Fixed Rate Payable	8.2%	—	—	—	—	—		
Weighted Average Variable Rate Receivable[2]	2.6%	—	—	—	—	—		
Lease Obligations								
Variable Rate Leases[3]	—	—	$81	—	—	—	$ 81	$81
Average Interest Rate[3]	3.8%	5.5%	6.1%	—	—	—		

[1]Interest payable based on Three Month London Interbank Offer Rate (LIBOR) plus or minus a spread.
[2]Interest receivable based on Three Month Commercial Paper Index published by Federal Reserve.
[3]Average interest rate as of December 31, 2001 based on current and implied forward rates for One Month LIBOR plus 30 basis points. The lease obligations require interest payments only until maturity.

The fair value of our interest rate swap contracts was $4 at December 31, 2000. In 2001, we entered into $500 in variable interest rate swap contracts. Of the $995 in variable rate contracts held at December 31, 2000, $920 were canceled during 2001 with no premium or penalty. We also held $25 in fixed interest rate swap contracts at December 31, 2000, of which $20 matured in 2001. In January 2002, we entered into $500 in variable interest rate swap contracts.

QUALITATIVE INFORMATION ABOUT MARKET RISK

Foreign Exchange Risk From time to time we make investments in businesses in foreign countries, are paid dividends, receive proceeds from sales or borrow funds in foreign currency. Before making an investment, or in anticipation of a foreign currency receipt, we often will enter into forward foreign exchange contracts. The contracts are used to provide currency at a fixed rate. Our policy is to measure the risk of adverse currency fluctuations by calculating the potential dollar losses resulting from changes in exchange rates that have a reasonable probability of occurring. We cover the exposure that results from changes that exceed acceptable amounts. We do not speculate in foreign exchange markets.

Interest Rate Risk We issue debt in fixed and floating rate instruments. Interest rate swaps are used for the purpose of controlling interest expense by managing the mix of fixed and floating rate debt. We do not seek to make a profit from changes in interest rates. We manage interest rate sensitivity by measuring potential increases in interest expense that would result from a probable change in interest rates. When the potential increase in interest expense exceeds an acceptable amount, we reduce risk through the issuance of fixed rate (in lieu of variable rate) instruments and purchasing derivatives.

CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties. We claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause our future results to differ materially from those expressed in the forward-looking statements:

- Adverse economic changes in the markets served by SBC or in countries in which SBC has significant investments.
- Changes in available technology and the effects of such changes including product substitutions and deployment costs.
- The final outcome of FCC proceedings, including rulemakings, and judicial review, if any, of such proceedings, including issues relating to jurisdiction.
- The final outcome of state regulatory proceedings in SBC's 13-state area, and judicial review, if any, of such proceedings, including proceedings relating to interconnection terms, access charges, universal service, unbundled network elements and resale rates, SBC's broadband initiative known as Project Pronto, service standards and reciprocal compensation.
- Enactment of additional state, federal and/or foreign regulatory laws and regulations pertaining to our subsidiaries and foreign investments.
- The timing of entry and the extent of competition in the local and intraLATA toll markets in SBC's 13-state area and our entry into the in-region long distance market.
- The impact of the Ameritech transaction, including performance with respect to regulatory requirements, and merger integration efforts.
- The timing, extent and cost of deployment of Project Pronto, its effect on the carrying value of the existing wireline network and the level of consumer demand for offered services.
- The impact of the wireless joint venture with BellSouth, known as Cingular, including marketing and product-development efforts, access to additional spectrum, technological advancements and financial capacity.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially impact our future earnings.

CONSOLIDATED STATEMENTS OF INCOME

Dollars in millions except per share amounts

	2001	2000	1999
Operating Revenues			
Landline local service	**$22,754**	$22,029	$19,432
Wireless subscriber	**155**	4,945	5,851
Network access	**10,459**	10,422	10,094
Long distance service	**3,008**	3,133	3,447
Directory advertising	**4,518**	4,439	4,266
Other	**5,014**	6,406	6,441
Total operating revenues	**45,908**	51,374	49,531
Operating Expenses			
Operations and support	**25,943**	30,883	29,380
Depreciation and amortization	**9,077**	9,748	8,553
Total operating expenses	**35,020**	40,631	37,933
Operating Income	**10,888**	10,743	11,598
Other Income (Expense)			
Interest expense	**(1,599)**	(1,592)	(1,430)
Interest income	**682**	279	127
Equity in net income of affiliates	**1,595**	897	912
Other income (expense) – net	**(209)**	2,561	(354)
Total other income (expense)	**469**	2,145	(745)
Income Before Income Taxes	**11,357**	12,888	10,853
Income taxes	**4,097**	4,921	4,280
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**7,260**	7,967	6,573
Extraordinary items, net of tax	**(18)**	—	1,379
Cumulative effect of accounting change, net of tax	**—**	—	207
Net Income	**$ 7,242**	$ 7,967	$ 8,159
Earnings Per Common Share:			
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**$ 2.16**	$ 2.35	$ 1.93
Net Income	**$ 2.15**	$ 2.35	$ 2.39
Earnings Per Common Share-Assuming Dilution:			
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**$ 2.14**	$ 2.32	$ 1.90
Net Income	**$ 2.13**	$ 2.32	$ 2.36

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

	December 31,	
	2001	2000
Assets		
Current Assets		
Cash and cash equivalents	$ 703	$ 643
Accounts receivable – net of allowances for uncollectibles of $1,254 and $1,016	9,376	10,144
Prepaid expenses	932	550
Deferred income taxes	713	671
Other current assets	856	1,640
Total current assets	12,580	13,648
Property, Plant and Equipment – Net	49,827	47,195
Goodwill – Net of Accumulated Amortization of $461 and $227	3,577	3,719
Investments in Equity Affiliates	11,967	12,378
Notes Receivable From Cingular Wireless	5,924	9,568
Other Assets	12,447	12,143
Total Assets	$96,322	$98,651
Liabilities and Shareowners' Equity		
Current Liabilities		
Debt maturing within one year	$9,033	$10,470
Accounts payable and accrued liabilities	11,459	15,432
Accrued taxes	2,598	3,592
Dividends payable	858	863
Total current liabilities	23,948	30,357
Long-Term Debt	17,133	15,492
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	8,578	6,806
Postemployment benefit obligation	9,839	9,767
Unamortized investment tax credits	274	318
Other noncurrent liabilities	4,059	4,448
Total deferred credits and other noncurrent liabilities	22,750	21,339
Corporation-Obligated Mandatorily Redeemable Preferred Securities Of Subsidiary Trusts#	—	1,000
Shareowners' Equity		
Preferred shares ($1 par value, 10,000,000 authorized: none issued)	—	—
Common shares ($1 par value, 7,000,000,000 authorized: issued 3,433,124,836 at December 31, 2001 and 2000)	3,433	3,433
Capital in excess of par value	11,992	12,125
Retained earnings	22,138	18,341
Guaranteed obligations of employee stock ownership plans (ESOP)	—	(21)
Deferred compensation – leveraged ESOP (LESOP)	—	(37)
Treasury shares (78,908,896 at December 31, 2001 and 46,416,071 at December 31, 2000, at cost)	(3,482)	(2,071)
Accumulated other comprehensive income	(1,590)	(1,307)
Total shareowners' equity	32,491	30,463
Total Liabilities and Shareowners' Equity	$96,322	$98,651

#The trusts contain assets of $1,030 in principal amount of the Subordinated Debentures of Pacific Telesis Group.

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents

	2001	2000	1999
Operating Activities			
Net income	$ 7,242	$ 7,967	$ 8,159
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	9,077	9,748	8,553
Undistributed earnings from investments in equity affiliates	(755)	(521)	(471)
Provision for uncollectible accounts	1,384	885	1,136
Amortization of investment tax credits	(44)	(71)	(85)
Deferred income tax expense	2,117	1,164	1,061
Gain on sales of investments	(498)	(2,902)	(335)
Extraordinary items, net of tax	18	—	(1,379)
Cumulative effect of accounting change, net of tax	—	—	(207)
Changes in operating assets and liabilities:			
Accounts receivable	(672)	(1,892)	(731)
Other current assets	(61)	(446)	335
Accounts payable and accrued liabilities	(2,364)	1,405	2,054
Other – net	(639)	(1,271)	(1,416)
Total adjustments	7,563	6,099	8,515
Net Cash Provided by Operating Activities	14,805	14,066	16,674
Investing Activities			
Construction and capital expenditures	(11,189)	(13,124)	(10,304)
Investments in affiliates	1,482	139	(45)
Purchase of short-term investments	—	(539)	(26)
Proceeds from short-term investments	510	—	31
Dispositions	1,254	4,476	4,867
Acquisitions	(445)	(5,121)	(5,198)
Other	1	(1)	2
Net Cash Used in Investing Activities	(8,387)	(14,170)	(10,673)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	(1,424)	5,169	(787)
Issuance of long-term debt	5,723	1,087	738
Repayment of long-term debt	(4,025)	(1,128)	(2,301)
Early extinguishment of debt and related call premiums	—	—	(31)
Early extinguishment of corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts	(1,000)	—	—
Issuance of common shares	—	—	313
Purchase of treasury shares	(2,068)	(2,255)	(1,169)
Issuance of treasury shares	323	732	318
Redemption of preferred shares of subsidiaries	(470)	—	—
Issuance of preferred shares of subsidiaries	—	—	103
Dividends paid	(3,456)	(3,418)	(3,287)
Other	39	65	(2)
Net Cash Provided by (Used in) Financing Activities	(6,358)	252	(6,105)
Net increase (decrease) in cash and cash equivalents	60	148	(104)
Cash and cash equivalents beginning of year	643	495	599
Cash and Cash Equivalents End of Year	$ 703	$ 643	$ 495

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY

Dollars and shares in millions except per share amounts

	2001		2000		1999	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	3,433	$ 3,433	3,433	$ 3,433	3,434	$ 3,434
Purchase of shares	—	—	—	—	(8)	(8)
Issuance of shares	—	—	—	—	7	7
Balance at end of year	3,433	$ 3,433	3,433	$ 3,433	3,433	$ 3,433
Capital in Excess of Par Value						
Balance at beginning of year		$12,125		$12,453		$12,439
Purchase of shares		—		—		(398)
Issuance of shares		(281)		(678)		215
Other		148		350		197
Balance at end of year		$11,992		$12,125		$12,453
Retained Earnings						
Balance at beginning of year		$18,341		$13,798		$ 8,948
Net income ($2.15, $2.35 and $2.39 per share)		7,242		7,967		8,159
Dividends to shareowners ($1.025, $1.015 and $0.975 per share)		(3,448)		(3,443)		(3,312)
Other		3		19		3
Balance at end of year		$22,138		$18,341		$13,798
Guaranteed Obligations of ESOP						
Balance at beginning of year		$ (21)		$ (106)		$ (261)
Reduction of debt associated with ESOP		21		85		155
Balance at end of year		$ —		$ (21)		$ (106)
Deferred Compensation – LESOP						
Balance at beginning of year		$ (37)		$ (73)		$ (82)
Cost of LESOP trust shares allocated to employees		37		36		9
Balance at end of year		$ —		$ (37)		$ (73)
Treasury Shares						
Balance at beginning of year	(46)	$ (2,071)	(38)	$ (1,717)	(28)	$ (882)
Purchase of shares	(47)	(2,068)	(49)	(2,255)	(23)	(1,169)
Issuance of shares	14	657	41	1,901	13	334
Balance at end of year	(79)	$ (3,482)	(46)	$ (2,071)	(38)	$ (1,717)
Accumulated Other Comprehensive Income, net of tax						
Balance at beginning of year		$ (1,307)		$ (1,062)		$ (822)
Foreign currency translation adjustment, net of taxes of $(172), $(234) and $290		(320)		(435)		(336)
Reclassification adjustment to net income for cumulative translation adjustment on securities sold		—		329		—
Unrealized gains (losses) on available-for-sale securities, net of taxes of $(35), $(22) and $61		(65)		(40)		113
Less reclassification adjustment for net (gains) losses included in net income		5		(99)		(17)
Less reclassification adjustment for loss included in deferred revenue		97		—		—
Other comprehensive income (loss)		(283)		(245)		(240)
Balance at end of year		$ (1,590)		$ (1,307)		$ (1,062)
Total Comprehensive Income						
Net income		$ 7,242		$ 7,967		$ 8,159
Other comprehensive income (loss) per above		(283)		(245)		(240)
Total Comprehensive Income		$ 6,959		$ 7,722		$ 7,919

The accompanying notes are an integral part of the consolidated financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – Throughout this document, SBC Communications Inc. is referred to as "we" or "SBC". The consolidated financial statements include the accounts of SBC and its majority-owned subsidiaries. The statements reflect the merger of one of our subsidiaries with Ameritech Corporation (Ameritech) as a pooling of interests (see Note 2). Our subsidiaries and affiliates operate in the communications services industry both domestically and worldwide providing wireline and wireless telecommunications services and equipment as well as directory advertising and publishing services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships, joint ventures, including Cingular Wireless (Cingular) and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Earnings from certain foreign investments accounted for using the equity method are included for periods ended within up to three months of our year end (see Note 7).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimations of probable losses and expenses. Actual results could differ from those estimates. Certain amounts in prior-period financial statements have been reclassified to conform to the current year's presentation.

Income Taxes – Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Investment tax credits earned prior to their repeal by the Tax Reform Act of 1986 are amortized as reductions in income tax expense over the lives of the assets which gave rise to the credits.

Cash Equivalents – Cash and cash equivalents include all highly liquid investments with original maturities of three months or less, and the carrying amounts approximate fair value.

Deferred Charges – Directory advertising costs are deferred until the directory is published and advertising revenues related to these costs are recognized.

Revenue Recognition – In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101), which we adopted effective January 1, 2000. SAB 101 addresses, among other items, when revenue relating to nonrefundable, upfront fees should be recognized. Upon adoption, we performed a detailed analysis of our activation fees and recorded deferred revenues and associated expenses accordingly. These deferred amounts will be recognized over the average customer life of five years. Expenses, though exceeding revenue, were only deferred to the extent of revenue. Accordingly, these adjustments had no significant effect on operating or net income.

Certain revenues derived from local telephone and wireless services are billed monthly in advance and are recognized the following month when services are provided. Revenues derived from other telecommunications services, principally network access, long distance and wireless airtime usage, are recognized monthly as services are provided.

Cumulative Effect of Accounting Change – Ameritech, prior to January 1, 1999, recognized revenues and expenses related to publishing directories using the "amortization" method, under which revenues and expenses were recognized over the lives of the directories, generally one year. Effective January 1, 1999, for Ameritech, the accounting was changed to the "issue basis" method of accounting, which recognizes the revenues and expenses at the time the related directory is published. The change in methodology was made because the issue basis method is generally followed in the publishing industry, including by our other directory subsidiaries, and better reflects the operating activity of the business.

The cumulative after-tax effect of applying the changes in method to prior years was recognized as of January 1, 1999, as a one-time, noncash gain of $207, or $0.06 per share, net of deferred taxes of $125. Had the current method been applied during prior periods, income before extraordinary items and cumulative effect of accounting change would not have been materially affected.

Property, Plant and Equipment – Property, plant and equipment is stated at cost. The cost of additions and substantial improvements to property, plant and equipment is capitalized. The cost of maintenance and repairs of property, plant and equipment is charged to operating expenses. Property, plant and equipment is depreciated using straight-line methods over their estimated economic lives. Most of our plant is depreciated using composite group depreciation methodology; accordingly, when a portion of our depreciable property, plant and equipment is retired in the ordinary course of business, the gross book value is reclassified to accumulated depreciation; no gain or loss is recognized on the disposition of this plant.

Software Costs – It is our policy to capitalize certain costs incurred in connection with developing or obtaining internal use software. Capitalized software costs are included in Property, Plant and Equipment and are amortized over three years.

Intangible Assets – Intangible assets consist primarily of goodwill and customer lists. These assets are amortized using the straight-line method over periods generally ranging from three to forty years. Management periodically reviews the carrying value and lives of all intangible assets based on expected future cash flows.

On January 1, 2002, we were required to adopt Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. FAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. Adoption of FAS 142 means that we will stop amortizing goodwill. At least annually, we will test the remaining book

value for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairments will be recorded in operating expenses.

For the fourth quarter of 2001, we reviewed the carrying values and lives of our intangible assets, including approximately $3,200 of goodwill, using the criteria of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (FAS 121), which was the current accounting rule for impairment of goodwill. Our review indicated that the estimated future undiscounted cash flows were sufficient to recover the related carrying values, so no impairment was recorded.

Under FAS 142, we will also stop amortizing goodwill recorded on our equity investments. However, we will continue to test this embedded goodwill for impairment under accounting rules for equity investments, which are based on comparisons between fair value and carrying value. In addition, we will adjust the equity in net income of affiliates line item to reflect the impact of adopting these new accounting standards on the operations of our equity investments.

Cingular has determined that the FCC wireless licenses they own have an indefinite useful life because cash flows are expected to continue, and historical practice has shown that Cingular has been able to renew the licenses at each expiration period. Under FAS 142, Cingular will not amortize these wireless licenses until Cingular determines that the licenses have a finite life. Cingular is currently performing the required impairment tests under FAS 142. Cingular held approximately $7,190 of wireless licenses as of December 31, 2001, and has also determined that no impairment exists under FAS 121 as of that date.

Our existing and embedded goodwill amortization and our share of Cingular's license amortization was approximately $380 net of tax, or $0.11 per share in 2001. Amortization for these items will not occur in 2002, thus increasing our net income in 2002. Our international holdings are still reviewing the impact of FAS 141 and 142 on their own operations and these reviews will also impact us. Our current estimate of the impact on us of our international holdings ceasing amortization of goodwill is between $45 and $65 net of tax. This amount also will increase our net income in 2002.

During 2002, we will perform the first step of the required FAS 142 impairment tests as of January 1, 2002. This first step requires us to compare the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is one of our operating segments or a discrete component of that segment. If the current fair value is less than the carrying value, then we will perform the second step of the impairment test. This second step requires us to measure the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment.

We have determined that the fair value of our investment in Sterling is less than the carrying value, and are performing the second step of the impairment test. Although we have not yet completed the impairment testing, we expect the impairment to be between $1,500 and $1,900, before taxes. We plan to complete the impairment tests on our direct investments in the first quarter of 2002. We do not expect that all of our international holdings will have completed their own impairment tests by that time. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce our net income in 2002.

Advertising Costs – Costs for advertising products and services or corporate image are expensed as incurred.

Foreign Currency Translation – Our foreign investees generally report their earnings in their own local currencies. We translate our share of their foreign assets and liabilities at exchange rates in effect at the balance sheet dates. The resulting foreign currency translation adjustments are recorded as a separate component of accumulated other comprehensive income in the accompanying consolidated balance sheets (other components of other comprehensive income are immaterial). Our share of their revenues and expenses are translated using average rates for the year. Other transaction gains and losses resulting from exchange rate changes on transactions denominated in a currency other than the local currency are included in earnings as incurred.

Derivative Financial Instruments – Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133), requires all derivatives to be recorded on the balance sheet at fair value, and requires changes in the fair value of the derivatives to be recorded in net income or other comprehensive income. We adopted FAS 133 on January 1, 2001, as a one-time, noncash cumulative effect of accounting change. However, because of our minimal use of derivatives, the adoption of this standard did not have a significant effect on our financial position or results of operations.

We do not invest in derivatives for trading purposes. From time to time, as part of our risk-management strategy, we use derivative financial instruments, including interest rate swaps, to hedge exposures to interest rate risk on debt obligations, and foreign currency forward-exchange contracts to hedge exposures to changes in foreign currency rates for transactions related to foreign investments. Derivative contracts are entered into for hedging of firm commitments only. Interest rate swap settlements are recognized as adjustments to interest expense in the consolidated statements of income when paid or received. Foreign currency forward-exchange contracts are set up to coincide with firm commitments. Gains and losses are deferred until the underlying transaction being hedged occurs and then are recognized as part of that transaction (see Note 9).

NOTE 2. COMPLETION OF MERGERS

In October 1999, SBC and Ameritech completed the merger of an SBC subsidiary with Ameritech in a transaction in which each share of Ameritech common stock was exchanged for 1.316 shares of SBC common stock (equivalent to approximately 1,446 million shares). Ameritech became a wholly owned subsidiary effective with the merger, and the transaction has been accounted for as a pooling of interests and a tax-free reorganization. Financial statements for prior periods have been restated to include the accounts of Ameritech. Transaction costs related to the

merger were $77 ($48 net of tax). Of this total, $25 ($16 net of tax) was included in expenses in 1999.

Post-Merger Initiatives

Upon completion of the merger, we reviewed operations throughout the merged company. Based on these merger integration reviews, we made certain strategic decisions, integrated certain operations and consolidated some administrative and support functions resulting in one-time charges. The following table summarizes the charges recorded in 1999 for the merger-related reviews and decisions:

One-time charges	Pre-tax	After-tax
Reorganization	$ 582	$ 379
Impairments/asset valuation	690	472
Wireless conversion	220	143
Regulatory and legal	164	102
Merger approval	31	19
Other items and estimates of other obligations	79	342
Total one-time charges	$1,766	$1,457

One-time charges incurred in the third and fourth quarter of 1999 totaled $1,766 ($1,457 net of tax). These charges included various regulatory and legal issues, merger approval and other related costs of $274 ($174 net of tax). In addition, these charges included costs related to strategic decisions reached by the review teams of $1,492 ($1,283 net of tax) in 1999. At December 31, 2001 and 2000, anticipated remaining cash expenditures related to the accruals for the Ameritech merger decisions totaled $14 and $147. Remaining accruals for anticipated cash expenditures for decisions related to the 1998 pooling of interests with Southern New England Telecommunications Corp. (SNET) and decisions related to the 1997 pooling of interests with Pacific Telesis Group (PAC) were $0 at December 31, 2001 and approximately $11 at December 31, 2000.

Reorganization – We centralized several key functions that will support the wireline operations including network planning, strategic marketing and procurement. We also consolidated a number of corporatewide support activities, including research and development, information technology, financial transaction processing and real estate management. These initiatives resulted in the creation of some jobs and the elimination and realignment of others, with many of the affected employees changing job responsibilities and in some cases assuming positions in other locations.

We recognized net charges of approximately $582 ($379 net of tax) during the fourth quarter of 1999 in connection with these initiatives. The charges were comprised mainly of postemployment benefits, primarily related to severance, and costs associated with closing duplicate operations, primarily contract cancellations. Other charges, arising out of the mergers related to relocation, retraining and other effects of consolidating certain operations, are being recognized in the periods those charges are incurred. The fourth-quarter 1999 charge is net of $45 ($29 net of tax) of reversals of accruals made in connection with the SNET and PAC mergers that were related to plans now superseded by the subsequent reorganization plan.

Impairments/Asset Valuation – As a result of our merger integration plans and strategic review of domestic operations and organizational alignments, we reviewed the carrying values of the long-lived assets in the third and fourth quarter of 1999. These reviews included estimating remaining useful lives and cash flows and identifying assets to be abandoned. Where this review indicated impairment, fair market values, including, in some cases, discounted cash flows as an estimate of fair value related to those assets, were analyzed to determine the amount of the impairment. As a result of these reviews, we wrote off certain assets and recognized impairments to the value of other assets with a combined charge of $690 ($472 net of tax) in the third and fourth quarter of 1999.

The 1999 adjustments include an impairment of $300 ($224 net of tax) related to SecurityLink. This impairment adjustment, taken as a reduction in goodwill of $300, reflected a reduction of the investment to fair market value based upon the value of comparable businesses. In connection with this adjustment, we shortened the estimated life of the remaining goodwill on the security business from 40 to 15 years. In January 2001, we sold SecurityLink. In connection with the sale, we took an additional charge of $614 ($454 net of tax) in 2000 (see Note 3).

Also in 1999, we performed a review of the allowance for doubtful accounts at the Ameritech subsidiaries and recognized a charge of $212 ($135 net of tax). This charge resulted from adjusting Ameritech's estimation methods to the method we use. Other 1999 adjustments consisted primarily of valuation adjustments on certain analog switching equipment at Ameritech and certain cost investments.

Wireless Conversion – In December 1999, Ameritech notified its wireless customers that the current wireless network platform (Code Division Multiple Access or CDMA) would be converted to our network platform (Time Division Multiple Access or TDMA). As part of the conversion, we sold the CDMA network assets and leased them back over the conversion period. A charge of $220 ($143 net of tax) was recognized in the fourth quarter of 1999 to recognize the loss on the sale and leaseback, and to replace the customers' CDMA handsets.

Other Items and Estimates of Other Obligations – We performed reviews of Ameritech's accounting operations and applied consistent accounting techniques between the merging companies. As a result, we recognized charges in 1999 related to the impact of several regulatory and legal rulings of $164 ($102 net of tax). Also in 1999, we incurred a charge of $31 ($19 net of tax) for Ameritech merger approval costs. In 1999 charges for deferred taxes on Ameritech's international investments of $289, net charges related to the routine deferral of certain costs and revenues by Ameritech of $62 ($40 net of tax), and other miscellaneous items of $17 ($13 net of tax) were recognized.

NOTE 3. ACQUISITIONS, DISPOSITIONS, AND VALUATION AND OTHER ADJUSTMENTS

Acquisitions – In November 2001, we acquired the shares of Prodigy Communications Corporation (Prodigy) that we did not already own through a cash tender offer followed by a merger of a subsidiary into Prodigy. We paid approximately

$470 and assumed debt of $105. This transaction resulted in approximately $589 in goodwill, which was not amortized in 2001. The majority of the shares we bought in the cash tender offer were from persons or entities affiliated with Teléfonos de México, S.A. de C.V. (Telmex), of which we own approximately 8.1%. In the fourth quarter of 2000, in connection with a change to our agreements with Prodigy, we recognized a charge of approximately $143 ($89 net of tax). Approximately $110 of the charge was recorded in equity in net income of affiliates reflecting previously unrecognized equity losses from our investment in Prodigy.

In August 2000, we acquired wireless properties in Washington and Texas from GTE Corporation for approximately $1,349. These properties were included in the contribution to Cingular (see Note 7).

In March 2000, we acquired Sterling, a provider of electronic business integration solutions, in an all-cash tender offer valued at approximately $3,576. The assets acquired include certain intangible assets such as developed technology, trade name, assembled work force, customer relationships and goodwill, which were assigned amortization lives of between 3 and 20 years. We expensed the acquired in-process research and development of approximately $132 in March 2000. In accordance with FAS 142, we have determined that the fair value of our investment in Sterling is less than the carrying value at January 1, 2002. Although we have not yet completed the impairment testing, we expect the impairment to goodwill to be between $1,500 and $1,900, which we will record as a cumulative effect of accounting change in the first quarter of 2002.

In July 1999, we acquired wireless properties in Pennsylvania, Delaware, New Jersey and Illinois from Comcast Corporation for approximately $677 in cash and $1,400 in assumed debt. These properties were included in the contribution to Cingular (see Note 7).

In June 1999, we acquired 20% of Bell Canada, a subsidiary of BCE Inc., a publicly traded Canadian communications company, for approximately $3,447.

These acquisitions were accounted for under the purchase method of accounting. The purchase prices in excess of the underlying fair value of identifiable net assets acquired were assigned amortization lives not to exceed 40 years. However, beginning in 2002, this goodwill amount will not be amortized and goodwill will be tested annually for impairment (see Note 1). Results of operations of the properties acquired have been included in the consolidated financial statements from their respective dates of acquisition.

Dispositions – In November 2001, we sold the assets of Ameritech New Media, a cable television operation, for approximately $205, resulting in a pre-tax loss of $61. In the first quarter of 2001, in anticipation of the disposal of these cable operations and in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," we evaluated these operations for impairment. We estimated that the future undiscounted cash flows of these operations were insufficient to recover their related carrying values. The impairment was measured by comparing the book value to fair value of the assets as indicated by prevailing market prices. The resulting adjustment of approximately $316 ($205 net of tax) to reduce the book value of these assets, primarily writing down property, plant and equipment, was recorded in the first quarter of 2001 as a charge to operating expenses.

In January 2001, we sold SecurityLink, our electronic security services operations, for approximately $479. As a result of the pending sale, as well as a general decline in the market value of companies in the security industry, we reviewed the carrying value of our investment in SecurityLink at December 31, 2000. This review included estimating remaining useful lives and cash flows. As this review indicated impairment, fair market values, including in some cases discounted cash flows as an estimate of fair value related to those assets, were analyzed to determine the amount of the impairment. Those fair market values also were compared to market values of comparable publicly traded companies. As a result of this review, we recognized impairments to the carrying value of SecurityLink of approximately $614 ($454 net of tax) in the fourth quarter of 2000. Approximately $430 of that charge was a write-off of goodwill.

Due to our wireless property contribution to Cingular in October 2000, we were required to sell our overlapping properties, which included selected wireless properties in Louisiana and Indiana. This resulted in a pre-tax gain of $357 (see Note 7).

In August 2000, we sold our interest and TDC A/S (TDC) (formerly known as TeleDanmark A/S), an equity investee, also sold its interest in Netcom GSM, a wireless telecommunications provider in Norway, which resulted in a direct and indirect pre-tax gain of approximately $546. In August 2000, we also sold our interest in MATÁV, a Hungarian telecommunications company, to Deutsche Telekom, our partner in the investment, for approximately $2,199, resulting in a pre-tax gain of approximately $1,153.

In October 1999, we completed the required disposition, as a condition of the merger with Ameritech, of 20 Midwestern cellular properties consisting of the competing cellular licenses in several markets, including, but not limited to, Chicago, Illinois, and St. Louis, Missouri. We recognized an extraordinary gain from these sales of approximately $1,379, or $0.40 per share.

Valuation Adjustments – In January 2002, we purchased from América Móvil S.A. de C.V. (América Móvil) its approximately 50% of Cellular Communications of Puerto Rico (CCPR) for cash and a note redeemable for our investment in Telecom Américas Ltd. (Telecom Américas). This represents a forward sale of our interest in Telecom Américas. In connection with this transaction, we reviewed the values at which we would carry CCPR and our interest in Telecom Américas and recognized a charge of $390 ($262 net of tax) for the reduction of our direct and indirect book values to the value indicated by the transaction. The charges were recorded in both other income (expense) – net ($341) and equity in net income of affiliates ($49).

We have cost investments in Williams Communications Group Inc. (Williams) and alternative providers of digital subscriber line (DSL) services accounted for under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115). We periodically review the investments to determine whether an investment's decline in value is other than

temporary. If so, the cost basis of the investment is written down to fair value, which is the new cost basis.

In the third quarter of 2001, we recognized an other than temporary decline of $162 ($97 net of tax) in the value of shares we received as payment of future rents on land and wireless towers and related equipment. We have determined that the other than temporary decline in the value of these marketable securities should reduce the overstatement of deferred revenue for these payments that were recorded when the marketable securities were originally received. Future rent revenues will also be reduced.

In the second quarter of 2001, we concluded that the continued depressed market values for certain of our investments, as well as difficulties experienced by many similar companies, indicated the decline in value of our investments was other than temporary. As a result of these reviews, we recognized a combined charge of $401 ($261 net of tax) in the second quarter of 2001 in other income (expense) – net primarily related to our investment in Williams.

In the fourth quarter of 2000, we concluded that the precipitous decline of the market values of the alternative providers of DSL, as well as difficulties experienced by many companies in that industry, indicated the decline in value of our investments was other than temporary. As a result of these reviews, we recognized a combined charge of $214 ($134 net of tax) in the fourth quarter of 2000 in other income (expense) – net.

Comprehensive Review of Operations – During the fourth quarter of 2001, we performed a comprehensive review of operations that resulted in decisions to reduce our work force, terminate certain real estate leases and shut down certain operations. The charges related to those decisions, which we recorded as expense in 2001 are as follows:

- ***Work force reduction charges*** Our review of staffing needs led to decisions to reduce our number of management and nonmanagement employees. We recorded a charge of approximately $377 ($244 net of tax), related to severance costs under our existing plans and an enhanced retirement benefit for certain nonmanagement employees (see Note 11).
- ***Lease termination charges*** As part of a review of real estate needs for our adjusted work force, all company-leased facilities were evaluated for probability of future usefulness. For each lease having no substantive future use or benefit to us, an accrual was made which represented either the buyout provisions of the lease, a negotiated lease termination or future required payments under the lease, net of anticipated sublease rentals. We recorded a charge of approximately $138 ($90 net of tax) in relation to these leases.
- ***Asset impairments and other charges*** A review of certain nonstrategic operations indicated the need, in some cases, for either impairment or shutdown. We recorded asset impairment and shutdown costs and other charges of approximately $104 ($91 net of tax) for operations including exiting operations at InQuent Technologies Inc., the parent company of Webhosting.com.

NOTE 4. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for income before extraordinary items and cumulative effect of accounting change for the years ended December 31, 2001, 2000 and 1999 are shown in the table below:

Year Ended December 31,	2001	2000	1999
Numerators			
Numerator for basic earnings per share:			
Income before extraordinary items and cumulative effect of accounting change	$7,260	$7,967	$6,573
Dilutive potential common shares:			
Other stock-based compensation	6	6	4
Numerator for diluted earnings per share	$7,266	$7,973	$6,577
Denominators			
Denominator for basic earnings per share:			
Weighted average number of common shares outstanding (000,000)	3,366	3,392	3,409
Dilutive potential common shares (000,000):			
Stock options	21	33	42
Other stock-based compensation	9	8	7
Denominator for diluted earnings per share	3,396	3,433	3,458
Basic earnings per share			
Income before extraordinary items and cumulative effect of accounting change	$ 2.16	$ 2.35	$ 1.93
Extraordinary items	(0.01)	—	0.40
Cumulative effect of accounting change	—	—	0.06
Net income	$ 2.15	$ 2.35	$ 2.39
Diluted earnings per share			
Income before extraordinary items and cumulative effect of accounting change	$ 2.14	$ 2.32	$ 1.90
Extraordinary items	(0.01)	—	0.40
Cumulative effect of accounting change	—	—	0.06
Net income	$ 2.13	$ 2.32	$ 2.36

NOTE 5. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We evaluate performance based on income before income taxes adjusted for normalizing (e.g., one-time) items that we describe below. For internal management reporting purposes, we exclude (i.e., normalize) these items from our results and analyze them separately. We have five reportable

segments that reflect the current management of our business: (1) wireline; (2) wireless; (3) directory; (4) international; and (5) other.

In the second quarter of 2001, we moved the results of the SBC Services unit from the other segment to the wireline segment because the SBC Services unit now primarily supports the wireline segment. We have restated all prior period information for this change, and this had no effect on our consolidated results.

The wireline segment provides landline telecommunications services, including local, network access, long distance services, messaging, Internet services, and sells customer premise and private business exchange equipment.

Prior to the fourth quarter of 2000, the wireless segment included our consolidated businesses that provided wireless telecommunications services and sold wireless equipment. In October 2000, we contributed substantially all of our wireless businesses to Cingular and began reporting results from Cingular's operations as equity in net income of affiliates in the Consolidated Financial Statements. However, for internal management reporting purposes, we analyze Cingular's results using proportional consolidation and therefore will discuss Cingular's results on that basis for segment reporting.

The directory segment includes all directory operations, including Yellow and White Pages advertising and electronic publishing. All investments with primarily international operations are included in the international segment. The other segment includes all corporate operations and Ameritech's paging, cable television and SecurityLink operations. SecurityLink was sold in January 2001, and we sold Ameritech New Media, Ameritech's cable television operations, in November 2001.

Normalized results for 2001 exclude the following items:

- Pension settlement gains of $1,097 ($688 net of tax) related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.
- Combined charges of $401 ($261 net of tax) primarily related to valuation adjustments of Williams as well as certain other cost investments accounted for under FAS 115. The charges resulted from an evaluation that the decline was other than temporary.
- Reduction of a valuation allowance of $120 ($78 net of tax) on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.
- Combined charges of $316 ($205 net of tax) related to impairment of our cable operations.
- A charge of $390 ($262 net of tax) indicated by a transaction pending as of December 31, 2001 to reduce the direct and indirect book value of our investment in Telecom Américas.
- A charge of $197 (with no tax effect) for costs related to TDC's decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.
- A charge of $197 ($128 net of tax) representing a proposed settlement agreement with the Illinois Commerce Commission (ICC) related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.
- Combined charges of $619 ($425 net of tax) associated with our comprehensive review of operations in the fourth quarter of 2001, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

Normalized results for 2000 exclude the following items:

- Gains of $1,886 ($1,248 net of tax) related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates, and from the contribution of our investment in ATL – Algar Telecom Leste S.A. (ATL), a Brazilian telecommunications company, to Telecom Américas.
- Gains of $238 ($155 net of tax) on the sale of Telmex L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the Debt Exchangeable for Common Stock (DECS).
- Pension settlement gains of $512 ($328 net of tax) associated with pension litigation, first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program net of enhanced pension and postretirement benefits associated with that program (see Note 12).
- Costs of $1,205 ($800 net of tax) associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.
- A charge of $132 (with no tax effect) related to in-process research and development from the March 2000 acquisition of Sterling (see Note 3).
- Combined charges of $971 ($677 net of tax) related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115, and the restructure of agreements with Prodigy, including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment (see Note 3).
- Gains of $357 ($99 net of tax) primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

Normalized results for 1999 exclude the following items:

- Charges totaling $1,766 ($1,457 net of tax) including recognition of impairment of long-lived assets, adjustments to the estimate of allowance for doubtful accounts, estimation of deferred taxes on international investments, wireless conversion costs and other items (see Note 2).
- Elimination of income of $197 ($119 net of tax) from the incremental impacts of overlapping wireless properties sold in October 1999 relating to the Ameritech merger.
- Pension settlement gains of $566 ($368 net of tax) associated with lump sum pension payments that exceeded the projected service and interest costs.
- Gains of $131 ($77 net of tax) recognized from the sale of property by an international equity affiliate.
- A reduction of $44 ($27 net of tax) related to a portion of a first-quarter 1998 charge to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores.

In the tables below, the Wireline, Wireless, Directory, International and Other columns represent the results of each such operating segment. The Elim. column reflects intercompany transactions that are eliminated upon consolidation and the elimination of 60% of our intercompany transactions with Cingular. The Cingular de-consolidation column removes the proportionally consolidated results of Cingular (reflected in the wireless segment) and includes these results in the equity in net income of affiliates line item.

Segment results, including a reconciliation to SBC consolidated results, for 2001, 2000 and 1999 are as follows:

At December 31, 2001 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular De-consolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$40,657	$ 8,647	$4,382	$ 152	$ 535	$ (72)	$54,301	$ (8,393)	$ —	$45,908
Intersegment revenues	30	—	86	33	54	(203)	—	—	—	—
Total operating revenues	40,687	8,647	4,468	185	589	(275)	54,301	(8,393)	—	45,908
Operations and support expenses	24,041	5,957	1,898	238	151	(275)	32,010	(5,714)	(353)	25,943
Depreciation and amortization expenses	8,381	1,232	36	3	207	—	9,859	(1,170)	388	9,077
Total operating expenses	32,422	7,189	1,934	241	358	(275)	41,869	(6,884)	35	35,020
Operating income	8,265	1,458	2,534	(56)	231	—	12,432	(1,509)	(35)	10,888
Interest expense	1,205	538	—	49	883	(917)	1,758	(159)	—	1,599
Interest income	29	25	4	(15)	1,248	(917)	374	308	—	682
Equity in net income of affiliates	—	(11)	—	800	14	—	803	1,038	(246)	1,595
Other income (expense) – net	2	8	5	384	15	—	414	(1)	(622)	(209)
Income before income taxes	7,091	942	2,543	1,064	625	—	12,265	(5)	(903)	11,357
Segment assets	70,879	14,231	2,764	9,454	57,257	(44,748)	N/A	(13,515)	N/A	96,322
Investment in equity method investees	120	1,314	21	8,196	3,441	—	N/A	(1,125)	N/A	11,967
Expenditures for additions to long-lived assets	11,032	40	24	—	93	—	N/A	—	N/A	11,189

At December 31, 2000 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular De-consolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$39,707	$ 7,941	$4,251	$ 320	$ 1,014	$ (22)	$53,211	$ (1,814)	$ (23)	$51,374
Intersegment revenues	184	1	89	8	86	(368)	—	—	—	—
Total operating revenues	39,891	7,942	4,340	328	1,100	(390)	53,211	(1,814)	(23)	51,374
Operations and support expenses	23,472	5,348	2,008	458	571	(390)	31,467	(1,339)	755	30,883
Depreciation and amortization expenses	7,867	1,083	32	17	352	—	9,351	(253)	650	9,748
Total operating expenses	31,339	6,431	2,040	475	923	(390)	40,818	(1,592)	1,405	40,631
Operating income	8,552	1,511	2,300	(147)	177	—	12,393	(222)	(1,428)	10,743
Interest expense	1,298	424	4	174	895	(1,157)	1,638	(46)	—	1,592
Interest income	37	1	55	17	1,234	(1,157)	187	92	—	279
Equity in net income of affiliates	(12)	12	—	862	(1)	—	861	72	(36)	897
Other income (expense) – net	47	(121)	10	372	90	—	398	14	2,149	2,561
Income before income taxes	7,326	979	2,361	930	605	—	12,201	2	685	12,888
Segment assets	65,948	14,478	2,808	12,282	57,567	(42,230)	N/A	(12,202)	N/A	98,651
Investment in equity method investees	(5)	232	20	9,394	2,777	—	N/A	(40)	N/A	12,378
Expenditures for additions to long-lived assets	12,093	856	35	—	140	—	N/A	—	N/A	13,124

At December 31, 1999 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular Deconsolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$37,050	$ 6,624	$4,045	$ 242	$ 1,041	$ —	$49,002	$ —	$529	$49,531
Intersegment revenues	322	1	81	13	97	(514)	—	—	—	—
Total operating revenues	37,372	6,625	4,126	255	1,138	(514)	49,002	—	529	49,531
Operations and support expenses	21,422	4,464	2,081	249	639	(514)	28,341	—	1,039	29,380
Depreciation and amortization expenses	6,828	918	33	17	342	—	8,138	—	415	8,553
Total operating expenses	28,250	5,382	2,114	266	981	(514)	36,479	—	1,454	37,933
Operating income	9,122	1,243	2,012	(11)	157	—	12,523	—	(925)	11,598
Interest expense	1,188	226	9	235	701	(941)	1,418	—	12	1,430
Interest income	55	24	6	23	960	(941)	127	—	—	127
Equity in net income of affiliates	(2)	42	—	739	2	—	781	—	131	912
Other income (expense) – net	61	(200)	2	186	(381)	—	(332)	—	(22)	(354)
Income before income taxes	8,048	883	2,011	702	37	—	11,681	—	(828)	10,853
Segment assets	53,763	11,559	2,422	12,613	44,699	(41,841)	N/A	—	N/A	83,215
Investment in equity method investees	31	216	48	10,372	(19)	—	N/A	—	N/A	10,648
Expenditures for additions to long-lived assets	8,781	988	52	1	482	—	N/A	—	N/A	10,304

Geographic Information

Our investments outside of the United States are primarily accounted for under the equity method of accounting, and accordingly, we do not include in our operating revenues and expenses, the revenues and expenses of our individual investees. Therefore, less than 1% of total operating revenues for all years presented are from outside the United States.

Long-lived assets consist primarily of net property, plant and equipment; net goodwill; and the book value of our equity investments, and are shown in the table below:

December 31,	2001	2000
United States	**$57,174**	$53,885
Canada	**3,429**	3,593
Denmark	**1,959**	3,024
Belgium	**876**	861
Mexico	**725**	738
France	**478**	406
South Africa	**415**	596
Other foreign countries	**314**	189
Total	**$65,370**	$63,292

NOTE 6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized as follows at December 31:

	Lives (years)	2001	2000
Land	—	**$ 601**	$ 592
Buildings	35-45	**10,645**	9,864
Central office equipment	3-10	**52,164**	47,094
Cable, wiring and conduit	10-50	**49,008**	47,143
Other equipment	5-15	**10,277**	10,529
Software	3	**2,044**	1,438
Under construction	—	**2,785**	3,093
		127,524	119,753
Accumulated depreciation and amortization		**77,697**	72,558
Property, plant and equipment – net		**$ 49,827**	$47,195

Our depreciation expense was $8,596, $8,480 and $8,175 for 2001, 2000 and 1999.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases for 2001, 2000 and 1999 were $799, $755 and $707. At December 31, 2001, the future minimum rental payments under noncancelable operating leases for the years 2002 through 2006 were $361, $306, $301, $215 and $161 with $574 due thereafter. Capital leases are not significant.

NOTE 7. EQUITY INVESTMENTS

Investments in equity affiliates are accounted for under the equity method of accounting. Our equity investments include Cingular and various international investments.

The following table is a reconciliation of our investments in equity affiliates:

	2001	2000	1999
Beginning of year	**$12,378**	$10,648	$7,412
Additional investments	**184**	783	3,702
Cingular contributions	**506**	2,688	—
Equity in net income	**1,595**	897	912
Dividends received	**(840)**	(376)	(445)
Currency translation adjustments	**(528)**	(849)	(707)
Dispositions and other adjustments	**(1,328)**	(1,413)	(226)
End of year	**$11,967**	$12,378	$10,648

The currency translation adjustment for 2001 primarily reflects the effect of exchange rate fluctuations on our investments in Bell Canada, Telkom S.A. Limited (Telkom), Telmex and América Móvil. Dispositions and other adjustments for 2001 reflect the return of capital in Cingular and the combination of diAx A.G. (diAx) with TDC.

The currency translation adjustment for 2000 primarily reflects the effect of exchange rate fluctuations on our investments in TDC, Telmex, Telkom and Bell Canada. Dispositions and other adjustments for 2000 reflect the sale of Telmex L shares, the sale of our investment in MATÁV and the contribution of ATL to Telecom Américas.

The currency translation adjustment for 1999 primarily reflects the effect of exchange rate fluctuations on our investments in TDC and Belgacom S.A. (Belgacom). Dispositions and other adjustments for 1999 reflect the sale of portions of Telmex L shares and the sale of our investment in Chile.

Undistributed earnings from equity affiliates were $2,858 and $2,140 at December 31, 2001 and 2000, including $1,109 and $80 from Cingular.

Wireless

We account for our 60% economic interest in Cingular under the equity method of accounting because we share control equally with our 40% partner. Cingular serves approximately 21.6 million customers, is the second-largest wireless operator in the United States and has approximately 219 million potential customers in 41 states, the District of Columbia, Puerto Rico and the United States Virgin Islands.

The following table presents summarized financial information for Cingular at December 31, or for the period then ended:

	2001 (12 months)	2000 (3 months)
Income Statement		
Operating revenues	**$14,108**	$ 3,060
Operating income	**2,551**	381
Net income	**1,692**	127
Balance Sheet		
Current assets	**$ 2,820**	$ 2,343
Noncurrent assets	**19,706**	15,575
Current liabilities	**3,261**	3,467
Noncurrent liabilities	**13,235**	12,000

Prior to the fourth quarter of 2000, our wireline operations recorded network access revenue from interconnection agreements with our wireless properties. This revenue was eliminated in the consolidation process. For operations contributed to Cingular, this network access revenue is no longer eliminated, but does not have a material impact on our net income since the revenue is mostly offset when we record our share of equity income from Cingular. The incremental amount of network access revenue from Cingular, which was previously eliminated, was approximately $120 during 2001 and $37 for the fourth quarter of 2000.

Prior to the fourth quarter of 2000, our other segment recorded interest income on notes receivable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular, this interest income is no longer eliminated. However, this does not have a material impact on our net income because the interest income is mostly offset when we record our share of equity income in Cingular. The interest income from Cingular was approximately $555 in 2001 and $154 for the fourth quarter of 2000.

In the second quarter of 2001, we netted approximately $2,500 of payables to Cingular with our notes receivable from Cingular. In addition, based on our revised expectations of when Cingular will repay the amount owed, we reclassified the notes receivable from Cingular from current to noncurrent assets. At December 31, 2001, we had notes receivable from Cingular of $5,924 bearing interest at the rate of 7.5%.

In October 2001, Cingular announced it plans to begin upgrading its network to EDGE (Enhanced Data Rates for Global Evolution) third-generation wireless data technology. Cingular targets completion of the upgrade for early 2004 and approximates capital expenditures of 18 to 19 dollars per potential customer in the affected Cingular coverage area. We expect funding for this upgrade to be provided by Cingular.

International

Our investments in equity affiliates include a 20% interest in Bell Canada, the largest supplier of telecommunications services in Canada; an 8.1% interest in Telmex, Mexico's national telecommunications company; an 8.0% interest in América Móvil, a wireless provider in Mexico and Latin America that was spun off from Telmex in 2001; and a 41.6% interest in TDC, the national communications provider in Denmark.

In January 2001, TDC increased its investment in Sunrise, a Swiss landline and Internet operator; purchased a 70% stake in diAx, a Swiss mobile and landline operator; and consolidated its Swiss operations by subsequently merging diAx with Sunrise. As part of this transaction, TDC obtained our 40% interest in diAx, and we received 1,200 million Swiss francs (approximately $783) in cash and notes. Due to the nature of our investment in TDC, we accounted for the consideration received as a dividend from an equity investee.

Other international equity investments that we hold include a 17.5% interest in Belgacom, the national communications provider in Belgium; an 18% interest in Telkom, the state-owned telecommunications company of South Africa; and a 15% interest in Cegetel S.A., a joint venture providing a broad range of telecommunications offerings in France. TDC also holds a 16.5% interest in Belgacom.

The following table presents summarized financial information of our significant international investments accounted for using the equity method, taking into account all adjustments necessary to conform to GAAP but excluding our purchase adjustments, including goodwill, at December 31 or for the year then ended:

	2001	2000	1999
Income Statements			
Operating revenues	**$44,662**	$40,190	$32,776
Operating income	**11,598**	11,911	8,941
Net income	**5,838**	5,714	4,892
Balance Sheets			
Current assets	**$12,491**	$17,092	
Noncurrent assets	**47,395**	37,052	
Current liabilities	**17,495**	16,490	
Noncurrent liabilities	**25,539**	25,318	

At December 31, 2001, we had goodwill, net of accumulated amortization, of approximately $4,747 related to our international investments in equity affiliates. Equity in net income of affiliates in future periods will reflect our adoption of FAS 142 (see Note 1).

Based on the December 31, 2001, quoted market price, the aggregate market value of our investment in TDC was approximately $3,168. The fair value of our investment in Telmex, based on the equivalent value of Telmex L shares at December 31, 2001, was approximately $1,856. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2001, was approximately $1,032. Our weighted average share of operating revenues shown above was 17% in 2001 and 2000 and 19% in 1999.

NOTE 8. DEBT

Long-term debt of SBC and its subsidiaries, including interest rates and maturities, is summarized as follows at December 31:

		2001	2000
Notes and debentures			
1.84% – 5.98%	2001 – 2007[1]	**$ 5,800**	$ 2,831
6.03% – 7.85%	2001 – 2048[2]	**14,006**	14,584
8.85% – 10.50%	2001 – 2016	**240**	556
		20,046	17,971
Unamortized discount – net of premium		**(170)**	51
Total notes and debentures		**19,876**	18,022
Capitalized leases		**248**	84
Total long-term debt, including current maturities		**20,124**	18,106
Current maturities of long-term debt		**(2,991)**	(2,614)
Total long-term debt		**$17,133**	$15,492

[1]Includes $250 of 5.95% debentures maturing in 2038 with a put option by holder in 2005.
[2]Includes $125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006.

At December 31, 2001, the aggregate principal amounts of long-term debt and weighted average interest rate scheduled for repayment for the years 2002 through 2006 were $2,991 (4.1%), $1,330 (6.0%), $832 (6.6%), $1,112 (6.8%) and $2,840 (5.9%) with $11,189 (6.8%) due thereafter. As of December 31, 2001, we were in compliance with all covenants and conditions of instruments governing our debt. Substantially all of our outstanding long-term debt is unsecured.

Financing Activities

During 2001, approximately $3,334 in long-term notes matured. In addition to these maturities, we redeemed notes totaling approximately $1,320 and issued approximately $5,750 of new notes whose proceeds were used primarily to pay down short-term borrowings and for general corporate purposes.

In March 2001, we paid the principal amount of each of the DECS, as adjusted by the exchange rate specified in the DECS, in the form of cash, which we received from settlement of our note receivable with characteristics similar to the DECS.

In March 2001, we issued two, one-year notes for approximately $500 each, which carry variable interest rates. Each note's interest is calculated based on the London Interbank Offer Rate (LIBOR), one recalculating monthly at the LIBOR less 1 basis point and the other recalculating quarterly at the LIBOR less 2.5 basis points.

In March 2001, we also issued approximately $1,250 of 10-year, 6.25%, global notes and in April 2001, we issued approximately $2,000 of five-year, 5.75%, global notes. The March and April 2001 global notes are redeemable at any time, in whole or in part, and under certain circumstances, at a premium.

In June 2001, we issued approximately $500 of 7.00% notes due 2041. We may redeem the notes, in whole or in part, at any time on or after June 13, 2006.

In June 2001, we also privately sold $1,000 of 20-year annual Puttable Reset Securities. The notes will bear interest at 4.25% until June 2002, at which time an investment bank has an annual option to require us to remarket or redeem the notes. If the option is exercised, the investment bank will reset the interest rate and remarket the notes for another 12-month term. If the bank does not exercise its option on that reset date, we will be required to redeem the notes at par. The notes are classified as short-term debt.

In July and August 2001, we redeemed approximately $615 of multiple bonds with maturities up to 40 years and interest rates ranging from 5.8% to 8.5%.

In October and November 2001, we redeemed approximately $665 of multiple bonds with maturities up to 40 years and interest rates ranging from 4.4% to 6.9%.

In February 2002, we issued approximately $1,000 of 10-year, 5.875%, global notes. The notes will pay interest semiannually, beginning in August 2002, and are redeemable at any time, in whole or in part, and under certain circumstances, at a premium.

Debt maturing within one year consists of the following at December 31:

	2001	2000
Commercial paper	$6,039	$ 6,437
Current maturities of long-term debt	2,991	2,614
Other short-term debt	3	1,419
Total	$9,033	$10,470

The weighted average interest rate on commercial paper debt at December 31, 2001 and 2000 was 2.07% and 6.51%. We have lines of credit with several banks totaling $3,700, all of which may be used to support commercial paper borrowings. We had no borrowings outstanding under these lines of credit as of December 31, 2001 or 2000.

NOTE 9. FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of our long-term debt, including current maturities and other financial instruments, are summarized as follows at December 31:

	2001		2000	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	$19,876	$20,315	$18,022	$17,592
TOPrS	—	—	1,000	990
Preferred stock of subsidiaries	350	350	820	820

The fair values of our notes and debentures were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates. The fair value of the Trust Originated Preferred Securities (TOPrS) was estimated based on quoted market prices. The carrying amounts of preferred stock of subsidiaries and commercial paper debt approximate fair values. Our short-term investments and customer deposits are recorded at amortized cost and the carrying amounts approximate fair values. Our notes receivable from Cingular are recorded at face value and the carrying amounts approximate fair values.

TOPrS Redemption – Pacific Telesis Financing I and II (the Trusts) were formed in 1996 for the exclusive purpose of issuing preferred and common securities representing undivided beneficial interests in the Trusts and investing the proceeds from the sales of TOPrS in unsecured subordinated debt securities of PAC. Under certain circumstances, dividends on TOPrS could be deferred for up to a period of five years.

In February 2001, we redeemed prior to maturity approximately $500 of the TOPrS with an interest rate of 7.56%, and in June 2001, we redeemed the remaining $500 of the TOPrS with an interest rate of 8.50%. The TOPrS had an original maturity of 30 years and were included on the balance sheet as corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. Due to this early redemption, we recognized an extraordinary loss of $18, net of taxes of $10, during 2001.

Preferred Stock Redemptions – In April 1998, a subsidiary issued, through private placements, 3,250 shares in multiple series of stated rate auction preferred stock (STRAPS). Net proceeds from these issuances totaled $322. Dividends are cumulative from the date of issuance and accrue at varying rates, which are adjusted periodically through separate auctions on each series. In November and December of 2001, we redeemed the STRAPS at par.

In June 2001, we redeemed $60 of variable rate Series B Preferred Stock of a subsidiary that was not subject to mandatory redemption. In August 2001, we redeemed $85 of 7.04% Series A Preferred Stock of a subsidiary that was subject to mandatory redemption in 2001.

Preferred Stock Issuances by Subsidiaries – In June 1997 and December 1999, a subsidiary issued $250 and $100 of preferred stock in private placements. The holders of the preferred stock may require SBC's subsidiary to redeem the shares after May 20, 2004. Holders receive quarterly dividends based on a rolling three-month LIBOR. The dividend rate for the December 31, 2001, payment was 3.37%.

The preferred stock of subsidiaries discussed above is included in other noncurrent liabilities on the consolidated balance sheets.

Derivatives – We use interest rate swaps to manage interest rate risk. Related gains and losses are reflected in net income when the underlying transaction being hedged occurs. The notional amounts, carrying amounts and estimated fair values of our derivative financial instruments are summarized as follows at December 31:

	Notional Amount	Carrying Amount	Fair Value
2001			
Interest rate swaps	$ 580	$0	$5
2000			
Interest rate swaps	$1,020	$0	$4

NOTE 10. INCOME TAXES

Significant components of our deferred tax liabilities and assets are as follows at December 31:

	2001	2000
Depreciation and amortization	$ 6,749	$ 7,683
Equity in foreign affiliates	586	789
Deferred directory expenses	498	533
Other	3,777	1,794
Deferred tax liabilities	11,610	10,799
Employee benefits	1,619	2,069
Currency translation adjustments	871	698
Allowance for uncollectibles	286	205
Unamortized investment tax credits	106	122
Other	1,329	2,052
Deferred tax assets	4,211	5,146
Deferred tax assets valuation allowance	140	156
Net deferred tax liabilities	$ 7,539	$ 5,809

The decrease in the valuation allowance is the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets. The valuation allowance is maintained in deferred tax assets for certain unused federal and state loss carryforwards.

The components of income tax expense are as follows:

	2001	2000	1999
Federal:			
Current	$1,803	$3,249	$2,883
Deferred – net	1,712	1,051	814
Amortization of investment tax credits	(44)	(71)	(85)
	3,471	4,229	3,612
State and local:			
Current	206	575	421
Deferred – net	405	113	247
Foreign	15	4	—
	626	692	668
Total	$4,097	$4,921	$4,280

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes, extraordinary items and cumulative effect of accounting change is as follows:

	2001	2000	1999
Taxes computed at federal statutory rate	$3,975	$4,511	$3,798
Increases (decreases) in income taxes resulting from:			
Amortization of investment tax credits over the life of the plant that gave rise to the credits	(28)	(46)	(55)
State and local income taxes – net of federal income tax benefit	407	450	440
Contributions of appreciated investments	(208)	—	(12)
Other – net	(49)	6	109
Total	$4,097	$4,921	$4,280

NOTE 11. PENSION AND POSTRETIREMENT BENEFITS

Pensions – Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. Management employees participate in either cash balance or defined lump sum pension plans with a new minimum based upon a stated percentage of employees' adjusted career income adopted in 2001. The pension benefit formula for most nonmanagement employees is based on a flat dollar amount per year according to job classification. Most employees can elect to receive their pension benefits in either a lump sum payment or annuity.

Our objective in funding the plans, in combination with the standards of the Employee Retirement Income Security Act of 1974 (as amended), is to accumulate funds sufficient to meet the plans' benefit obligations to employees upon their retirement. Contributions to the plans are made to a trust for the benefit of plan participants. Plan assets consist primarily of stocks, U.S. government and domestic corporate bonds, index funds and real estate.

Effective with the Ameritech merger, we performed a midyear valuation affecting the net pension benefit for all pension plans in 1999. Additionally, per our joint venture agreement with BellSouth, our employees that were previously leased to Cingular became Cingular employees on or before December 31, 2001, and the pension assets and liabilities related to those former employees were transferred to Cingular. The amounts that follow reflect the impacts and assumptions of the midyear valuation and the transfer of employees to Cingular.

The following table presents the change in the pension plan projected benefit obligation for the years ended December 31:

	2001	2000
Benefit obligation at beginning of year	$25,577	$25,685
Service cost – benefits earned during the period	550	525
Interest cost on projected benefit obligation	1,847	1,927
Amendments	317	425
Actuarial loss	1,512	940
Special termination benefits	164	1,104
Transfer to Cingular	(167)	—
Benefits paid	(4,740)	(5,029)
Benefit obligation at end of year	$25,060	$25,577

The following table presents the change in pension plan assets for the years ended December 31 and the pension plans' funded status at December 31:

	2001	2000
Fair value of plan assets at beginning of year	$40,814	$ 45,958
Actual return on plan assets	(2,798)	95
Transfer to Cingular	(290)	—
Benefits paid	(5,011)	(5,239)
Fair value of plan assets at end of year[1]	$32,715	$ 40,814
Funded status	$ 7,655	$ 15,237
Unrecognized prior service cost	1,946	1,963
Unrecognized net gain	(1,852)	(11,395)
Unamortized transition asset	(412)	(683)
Prepaid pension cost[2]	$ 7,337	$ 5,122

[1]Plan assets include SBC common stock of $14 at December 31, 2001, and $18 at December 31, 2000.
[2]Represents net amount recognized in our consolidated balance sheets. Accrued pension liability was $0 at December 31, 2001 and 2000.

Net pension benefit is composed of the following:

	2001	2000	1999
Service cost – benefits earned during the period	$ 550	$ 525	$ 584
Interest cost on projected benefit obligation	1,847	1,927	1,831
Expected return on plan assets	(3,515)	(3,149)	(2,951)
Amortization of prior service cost	81	43	(35)
Recognized actuarial gain	(413)	(491)	(273)
Net pension benefit	$(1,450)	$(1,145)	$ (844)

Significant weighted-average assumptions used in developing pension information include:

	2001	2000	1999
Discount rate for determining projected benefit obligation	7.50%	7.75%	7.75%
Long-term rate of return on plan assets	9.50%	8.50%	8.50%
Composite rate of compensation increase	4.25%	4.25%	4.25%

The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to previously rendered employee service. It is measured based on assumptions concerning future interest rates and employee compensation levels. At December 31, 2001, we determined our 7.5% discount rate based on a range of factors including the rates of return on high-quality, fixed-income investments available at the time of measurement. During 2001, we reduced our discount rate by 0.25%, resulting in an increase in our pension plan benefit obligation of approximately $471 at December 31, 2001. For each of the three years ended 2001, our actual 10-year return on investments exceeded 10%, including the effect of the negative returns in 2001; this, along with future expectations, was the rationale behind the change in our expected long-term rate of return on plan assets from 8.5% to 9.5% in 2001. A 0.25% change in the expected long-term rate of return causes a change of approximately $90 in net pension benefit. Should actual experience differ from the actuarial assumptions, the projected benefit obligation and net pension benefit will be affected.

During 2001, as part of our force-reduction program, an enhanced retirement program (ERB) was offered to eligible PTG nonmanagement employees. The ERB program offered eligible employees who voluntarily decided to terminate employment an enhanced pension benefit and increased eligibility for postretirement medical and dental benefits. Approximately 1,400 employees accepted this offer and terminated employment before the end of December 31, 2001. Enhanced pension benefits related to this program were recognized as an expense of $164 in 2001.

In October 2000, we implemented a voluntary enhanced pension and retirement program (EPR) to reduce the number of management employees. The program offered eligible management employees who decided to terminate employment an enhanced pension benefit and increased eligibility for postretirement medical and dental benefits. Approximately 7,000 of the employees who accepted this offer terminated employment before December 31, 2000; however, under the program, approximately 2,400 employees were retained for up to one year. Enhanced pension benefits related to this program were recognized as an expense of $1.1 billion in 2000. We recognized $896 in net settlement and curtailment gains in the fourth quarter of 2000 and $940 in settlement gains in 2001 primarily associated with the EPR program. In addition to the net pension benefit and EPR amounts, we also recognized $423 in net settlement gains in 2001, $1.2 billion in 2000 and $566 in 1999.

We anticipate that additional lump sum payments will be made in 2002 in connection with the force reductions resulting from the comprehensive review of operations we conducted in the fourth quarter of 2001 (see Note 3). These payments may require the recognition of additional settlement gains in 2002.

In December 2001 and 2000, under the provisions of Section 420 of the Internal Revenue Code, we transferred $286 and $220 in pension assets to a health care benefit account for the reimbursement of certain retiree health care benefits paid by us.

Supplemental Retirement Plans – We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. These plans include supplemental defined pension benefits as well as compensation deferral plans, some of which include a corresponding match by us based on a percentage of the compensation deferral. Expenses related to these plans were $166, $195 and $149 in 2001, 2000 and 1999. Liabilities of $1,479 and $1,408 related to these plans have been included in other noncurrent liabilities in our consolidated balance sheets at December 31, 2001 and 2000.

Postretirement Benefits – We provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. We maintain Voluntary Employee Beneficiary Association trusts to fund postretirement benefits. Assets consist principally of stocks and U.S. government and corporate bonds.

The following table sets forth the change in the accumulated postretirement benefit obligation (APBO) for the years ended December 31:

	2001	2000
Benefit obligation at beginning of year	**$17,802**	$15,511
Service cost – benefits earned during the period	**256**	245
Interest cost on APBO	**1,316**	1,201
Amendments	**(605)**	(134)
Actuarial loss	**2,395**	1,776
Special termination benefits	**9**	79
Transfer to Cingular	**(36)**	—
Benefits paid	**(997)**	(876)
Benefit obligation at end of year	**$20,140**	$17,802

The following table sets forth the change in plan assets for the years ended December 31 and the plans' funded status at December 31:

	2001	2000
Fair value of plan assets at beginning of year	**$ 7,220**	$ 7,871
Actual return on plan assets	**(641)**	(401)
Employer contribution	**—**	42
Benefits paid	**(304)**	(292)
Fair value of plan assets at end of year[1]	**$6,275**	$7,220
Funded status	**$(13,865)**	$(10,582)
Unrecognized prior service cost (benefit)	**(28)**	680
Unrecognized net loss	**3,962**	203
Accrued postretirement benefit obligation	**$ (9,931)**	$ (9,699)

[1]Plan assets include SBC common stock of $13 at December 31, 2001, and $1 at December 31, 2000.

Postretirement benefit cost is composed of the following:

	2001	2000	1999
Service cost – benefits earned during the period	**$ 256**	$ 245	$ 260
Interest cost on APBO	**1,316**	1,201	1,050
Expected return on assets	**(665)**	(549)	(504)
Amortization of prior service cost	**94**	147	157
Recognized actuarial (gain) loss	**13**	(33)	(13)
Postretirement benefit cost	**$1,014**	$1,011	$ 950

The fair value of plan assets restricted to the payment of life insurance benefits was $968 and $1,114 at December 31, 2001 and 2000. At December 31, 2001 and 2000, the accrued life insurance benefits included in the APBO were $614 and $593.

In addition to the postretirement benefit cost reported in the table above, we recognized $107 in net curtailment losses in 2000 associated with EPR. Enhanced benefits related to the EPR program were recognized as an expense of $71 in 2000. Enhanced benefits related to the ERB program were recognized as an expense of $9 in 2001.

The assumed medical cost trend rate in 2002 is 8.0% for retirees 64 and under and 9.0% for retirees 65 and over, decreasing to 5.0% in 2007, prior to adjustment for cost-sharing provisions of the medical and dental plans for certain retired employees. The assumed dental cost trend rate in 2002 is 5.0%. A one percentage-point change in the assumed health care cost trend rate would have the following effects:

	One Percentage-Point Increase	One Percentage-Point Decrease
Effect on total of service and interest cost components	$ 214	$ 172
Effect on APBO	2,308	1,900

Significant assumptions for the discount rate, long-term rate of return on plan assets and composite rate of compensation increase used in developing the APBO and related postretirement benefit costs were the same as those used in developing the pension information. The reduction of our discount rate by 0.25% during 2001 resulted in an increase in our postretirement benefit obligation of approximately $599 at December 31, 2001. A 0.25% change in the expected long-term rate of return causes a change of approximately $18 in postretirement benefit cost. Should actual experience differ from the actuarial assumptions, the APBO and postretirement benefit cost will be affected. Due to the Ameritech merger, a midyear valuation also was performed for all postretirement benefit plans in 1999. The amounts above reflect the impacts and assumptions of the midyear valuation and the 2001 transfer of employees to Cingular.

NOTE 12. EMPLOYEE STOCK OWNERSHIP PLANS

We maintain contributory savings plans that cover substantially all employees. Under the savings plans, we match a stated percentage of eligible employee contributions, subject to a specified ceiling.

As a result of past mergers, we had six leveraged ESOPs as part of our existing savings plans. Five of the ESOPs were funded with notes issued by the savings plans to various lenders, the proceeds of which were used to purchase shares of SBC's common stock in the open market. The original principal amounts were paid off in 2000 with our contributions to the savings plans, dividends paid on SBC shares and interest earned on funds held by the ESOPs. We extended the terms of certain ESOPs through previous internal refinancing of the debt, resulting in unallocated shares remaining in one of those ESOPs at December 31, 2001 and two at December 31, 2000.

One ESOP purchased PAC treasury shares in exchange for a promissory note from the plan to PAC. All PAC shares were exchanged for SBC shares effective with the merger April 1, 1997. The provisions of the ESOP were unaffected by this exchange. This promissory note from the plan to PAC was paid off in 2001 with our contributions to the savings plans, dividends paid on SBC shares and interest earned on funds held by the ESOPs.

Our match of employee contributions to the savings plans is fulfilled with shares of stock allocated from the ESOPs and with purchases of SBC's stock in the open market. Shares held by the ESOPs are released for allocation to the accounts of employees as employer-matching contributions are earned. Benefit cost is based on a combination of the contributions to the savings plans and the cost of shares allocated to participating employees' accounts. Both benefit cost and interest expense on the notes are reduced by dividends on SBC's shares held by the ESOPs and interest earned on the ESOPs' funds.

Information related to the ESOPs and the savings plans is summarized below:

	2001	2000	1999
Benefit expense – net of dividends and interest income	**$185**	$134	$ 90
Interest expense – net of dividends and interest income	**—**	5	10
Total expense	**$185**	$139	$100
Company contributions for ESOPs	**$177**	$ 47	$104
Dividends and interest income for debt service	**$ 58**	$ 93	$ 75

SBC shares held by the ESOPs are summarized as follows at December 31 (in millions):

	2001	2000
Unallocated	**4**	8
Allocated to participants	**76**	103
Total	**80**	111

NOTE 13. STOCK-BASED COMPENSATION

Under our various plans, senior and other management and nonmanagement employees and nonemployee directors have received stock options, performance stock units, and other nonvested stock units. Stock options issued through December 31, 2001, carry exercise prices equal to the market price of the stock at the date of grant and have maximum terms ranging from five to ten years. Beginning in 1994 and ending in 1999, certain Ameritech employees were awarded grants of nonqualified stock options with dividend equivalents. Depending upon the grant, vesting of stock options may occur up to four years from the date of grant. Performance stock units are granted to key employees based upon the common stock price at the date of grant and are awarded in the form of common stock and cash at the end of a two- or three-year period, subject to the achievement of certain performance goals. Nonvested stock units are valued at the market price of the stock at the date of grant and vest over a three- to five-year period. As of December 31, 2001, we were authorized to issue up to 133 million shares of stock (in addition to shares that may be issued upon exercise of outstanding options or upon vesting of performance stock units or other nonvested stock units) to officers, employees and directors pursuant to these various plans.

We measure compensation cost for these plans using the intrinsic value-based method of accounting as allowed in Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123). Accordingly, no compensation cost for our stock option plans has been recognized. Had compensation cost for stock option plans been recognized using the fair value-based method of accounting at the date of grant for awards in 2001, 2000 and 1999 as defined by FAS 123, our net income would have been $7,008, $7,800 and $7,969 (i.e., lower by $234, $167 and $190), and basic net income per share would have been $2.08, $2.30 and $2.34. The compensation cost that has been charged against income for our other stock-based compensation plans totaled $0, $19 and $42 for 2001, 2000 and 1999. These amounts include $(33), $(23) and $2 in 2001, 2000 and 1999 for the mark-to-market effect on dividend equivalents.

For purposes of these pro forma disclosures, the estimated fair value of the options granted is amortized to expense over the options' vesting period. The fair value for these options was estimated at the date of grant, using a Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999: risk-free interest rate of 4.51%, 6.67% and 5.31%; dividend yield of 2.37%, 2.19% and 1.65%; expected volatility factor of 24%, 16% and 15%; and expected option life of 4.0, 4.6 and 4.5 years.

Information related to options is summarized below (shares in millions):

	Number	Weighted-Average Exercise Price
Outstanding at January 1, 1999	146	26.26
Granted	26	48.70
Exercised	(19)	23.13
Forfeited/Expired	(4)	39.06
Outstanding at December 31, 1999 (116 exercisable at weighted-average price of $26.91)	149	30.24
Granted	51	39.62
Exercised	(30)	24.22
Forfeited/Expired	(14)	41.05
Outstanding at December 31, 2000 (101 exercisable at weighted-average price of $29.22)	156	33.53
Granted	76	43.41
Exercised	(13)	24.41
Forfeited/Expired	(12)	43.09
Outstanding at December 31, 2001 (109 exercisable at weighted-average price of $32.36)	**207**	**$37.21**

Information related to options outstanding at December 31, 2001:

Exercise Price Range	$10.90-$17.39	$17.40-$29.99	$30.00-$35.49	$35.50-$59.00
Number of options (in millions):				
Outstanding	6	51	7	143
Exercisable	6	51	7	45
Weighted-average exercise price:				
Outstanding	$15.48	$24.13	$34.17	$43.02
Exercisable	$15.48	$24.13	$34.17	$43.95
Weighted-average remaining contractual life	2.54 years	4.43 years	6.30 years	8.47 years

The weighted-average, grant-date fair value of each option granted during 2001, 2000 and 1999 was $8.37, $8.31 and $9.31.

As of December 31, additional shares available under stock options with dividend equivalents were approximately 1 million in 2001 and 2000 and 2 million in 1999.

NOTE 14. SHAREOWNERS' EQUITY

Share Repurchase – From time to time, we repurchase shares of common stock for distribution through our employee benefit plans or in connection with certain acquisitions. In November 2001, the Board of Directors authorized the repurchase of up to 100 million shares of SBC common stock. This is in addition to the authorization to repurchase 100 million shares in January 2000. As of January 31, 2002, we have repurchased a total of approximately 99 million shares of our common stock of the 200 million authorized to be repurchased.

We have entered into a series of put options on SBC stock with institutional counterparties. The put options are exercisable only at maturity and expire in February, May and December 2002. We have a maximum potential obligation to purchase 9,000,000 shares of our common stock at a weighted average exercise price of $37.45. Three million of the put options expired on February 15, 2002, with the remaining options having a weighted average exercise price of $39.14. We have the right to settle the put options by physical settlement of the options or by net share settlement using shares of the SBC common stock. We received cash of $38 in 2001 and $65 in 2000 from these transactions, which was credited to shareowners' equity.

NOTE 15. SUBSIDIARY FINANCIAL INFORMATION

We have fully and unconditionally guaranteed certain outstanding capital securities of Pacific Bell Telephone Company (PacBell) and Southwestern Bell Telephone Company (SWBell), each of which is a wholly owned subsidiary of SBC. These securities are reflected on our consolidated balance sheet. In accordance with SEC rules, we are providing the following condensed consolidating financial information.

The Parent column presents investments in all subsidiaries under the equity method of accounting. PacBell and SWBell are listed separately because each has securities that we have guaranteed that would otherwise require SEC periodic reporting. All other wholly owned subsidiaries that do not have securities guaranteed by us that would require separate reporting are presented in the Other column. The consolidating adjustments column (Adjs.) eliminates the intercompany balances and transactions between our subsidiaries.

Condensed Consolidating Statements of Income

For the Twelve Months Ended December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$10,842	$11,802	$24,766	$(1,502)	$45,908
Total operating expenses	(141)	7,391	8,722	20,550	(1,502)	35,020
Operating Income	141	3,451	3,080	4,216	—	10,888
Interest expense	528	365	362	928	(584)	1,599
Equity in net income of affiliates	6,696	—	—	1,593	(6,694)	1,595
Royalty income (expense)	471	(414)	(471)	414	—	—
Other income (expense) – net	423	6	1	630	(587)	473
Income Before Income Taxes	7,203	2,678	2,248	5,925	(6,697)	11,357
Income taxes	(39)	1,088	830	2,218	—	4,097
Income Before Extraordinary Items	7,242	1,590	1,418	3,707	(6,697)	7,260
Extraordinary Items	—	—	—	(18)	—	(18)
Net Income	$7,242	$ 1,590	$ 1,418	$ 3,689	$(6,697)	$ 7,242

Condensed Consolidating Statements of Income

For the Twelve Months Ended December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$10,356	$11,580	$30,778	$(1,340)	$51,374
Total operating expenses	(199)	7,437	8,636	26,097	(1,340)	40,631
Operating Income	199	2,919	2,944	4,681	—	10,743
Interest expense	504	391	383	1,379	(1,065)	1,592
Equity in net income of affiliates	7,417	—	—	961	(7,481)	897
Royalty income (expense)	460	(407)	(460)	407	—	—
Other income (expense) – net	728	2	10	3,104	(1,004)	2,840
Income Before Income Taxes	8,300	2,123	2,111	7,774	(7,420)	12,888
Income taxes	333	847	778	2,963	—	4,921
Net Income	$7,967	$ 1,276	$ 1,333	$ 4,811	$(7,420)	$ 7,967

Condensed Consolidating Statements of Income

For the Twelve Months Ended December 31, 1999

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$9,718	$11,173	$29,567	$ (927)	$49,531
Total operating expenses	(228)	7,459	8,358	23,271	(927)	37,933
Operating Income	228	2,259	2,815	6,296	—	11,598
Interest expense	206	388	384	1,393	(941)	1,430
Equity in net income of affiliates	8,137	—	—	937	(8,162)	912
Other income (expense) – net	113	42	6	528	(916)	(227)
Income Before Income Taxes	8,272	1,913	2,437	6,368	(8,137)	10,853
Income taxes	106	752	896	2,526	—	4,280
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	8,166	1,161	1,541	3,842	(8,137)	6,573
Extraordinary Items	—	—	—	1,379	—	1,379
Cumulative Effect of Accounting Change	(7)	(1,010)	(274)	1,498	—	207
Net Income	$8,159	$ 151	$ 1,267	$ 6,719	$(8,137)	$ 8,159

Condensed Consolidating Balance Sheets
December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Cash and cash equivalents	$ 445	$ 4	$ 99	$ 155	$ —	$ 703
Accounts receivable – net	4,238	2,223	1,919	13,535	(12,539)	9,376
Other current assets	304	381	838	978	—	2,501
Total current assets	4,987	2,608	2,856	14,668	(12,539)	12,580
Property, plant and equipment – net	118	13,522	15,588	20,599	—	49,827
Goodwill – net	—	—	—	3,577	—	3,577
Investments in equity affiliates	35,226	—	—	14,907	(38,166)	11,967
Other assets	8,140	2,382	428	11,140	(3,719)	18,371
Total Assets	$48,471	$18,512	$18,872	$64,891	$(54,424)	$96,322
Debt maturing within one year	$ 8,094	$ 2,594	$ 3,914	$ 2,654	$ (8,223)	$ 9,033
Other current liabilities	690	3,598	3,629	11,314	(4,316)	14,915
Total current liabilities	8,784	6,192	7,543	13,968	(12,539)	23,948
Long-term debt	4,137	3,673	2,868	10,125	(3,670)	17,133
Postemployment benefit obligation	57	2,860	2,996	3,926	—	9,839
Other noncurrent liabilities	3,002	1,816	1,369	6,773	(49)	12,911
Total shareowners' equity	32,491	3,971	4,096	30,099	(38,166)	32,491
Total Liabilities and Shareowners' Equity	$48,471	$18,512	$18,872	$64,891	$(54,424)	$96,322

Condensed Consolidating Balance Sheets
December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Cash and cash equivalents	$ 436	$ 9	$ 52	$ 146	$ —	$ 643
Accounts receivable – net	9,503	2,219	2,111	10,439	(14,128)	10,144
Other current assets	631	474	697	1,059	—	2,861
Total current assets	10,570	2,702	2,860	11,644	(14,128)	13,648
Property, plant and equipment – net	138	13,028	14,984	19,045	—	47,195
Goodwill – net	—	—	—	3,719	—	3,719
Investments in equity affiliates	30,072	—	—	17,058	(34,752)	12,378
Other assets	3,750	2,061	272	20,478	(4,850)	21,711
Total Assets	$44,530	$17,791	$18,116	$71,944	$(53,730)	$98,651
Debt maturing within one year	$ 8,918	$ 1,776	$ 2,648	$ 4,607	$ (7,479)	$10,470
Other current liabilities	2,527	3,795	4,112	16,102	(6,649)	19,887
Total current liabilities	11,445	5,571	6,760	20,709	(14,128)	30,357
Long-term debt	568	4,293	3,976	11,505	(4,850)	15,492
Postemployment benefit obligation	83	2,817	2,993	3,874	—	9,767
Other noncurrent liabilities	1,971	1,535	1,314	6,752	—	11,572
Corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts	—	—	—	1,000	—	1,000
Total shareowners' equity	30,463	3,575	3,073	28,104	(34,752)	30,463
Total Liabilities and Shareowners' Equity	$44,530	$17,791	$18,116	$71,944	$(53,730)	$98,651

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 1,150	$ 3,395	$ 3,285	$12,880	$(5,905)	$14,805
Net cash from investing activities	1,328	(2,397)	(2,996)	(5,416)	1,094	(8,387)
Net cash from financing activities	(2,469)	(1,003)	(242)	(7,455)	4,811	(6,358)
Net Increase (Decrease) in Cash	$ 9	$ (5)	$ 47	$ 9	$ —	$ 60

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 3,853	$ 3,197	$ 4,152	$ 5,311	$(2,447)	$ 14,066
Net cash from investing activities	(4,154)	(2,679)	(3,630)	(3,873)	166	(14,170)
Net cash from financing activities	637	(521)	(519)	(1,626)	2,281	252
Net Increase (Decrease) in Cash	$ 336	$ (3)	$ 3	$ (188)	$ —	$ 148

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 1999

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 2,434	$ 3,233	$ 4,393	$ 9,772	$(3,158)	$ 16,674
Net cash from investing activities	(364)	(2,437)	(2,882)	(4,708)	(282)	(10,673)
Net cash from financing activities	(2,284)	(799)	(1,522)	(4,940)	3,440	(6,105)
Net Increase (Decrease) in Cash	$ (214)	$ (3)	$ (11)	$ 124	$ —	$ (104)

NOTE 16. ADDITIONAL FINANCIAL INFORMATION

	December 31,	
Balance Sheets	**2001**	2000
Accounts payable and accrued liabilities:		
Accounts payable	**$ 3,959**	$ 5,018
Accounts payable – Cingular	**—**	2,514
Advance billing and customer deposits	**1,317**	1,322
Compensated future absences	**1,017**	837
Accrued interest	**486**	440
Accrued payroll	**669**	986
Other	**4,011**	4,315
Total	**$11,459**	$15,432

Statements of Income	**2001**	2000	1999
Advertising expense	**$ 354**	$ 774	$ 812
Interest expense incurred	**$1,718**	$1,693	$1,511
Capitalized interest	**(119)**	(101)	(81)
Total interest expense	**$1,599**	$1,592	$1,430

Statements of Cash Flows	**2001**	2000	1999
Cash paid during the year for:			
Interest	**$1,546**	$1,681	$1,516
Income taxes, net of refunds	**2,696**	3,120	2,638

No customer accounted for more than 10% of consolidated revenues in 2001, 2000 or 1999.

NOTE 17. CONTINGENT LIABILITIES

In addition to issues specifically discussed elsewhere, we are party to numerous lawsuits, regulatory proceedings and other matters arising in the ordinary course of business. In our opinion, although the outcomes of these proceedings are uncertain, they should not have a material adverse effect on the company's financial position, results of operations or cash flows.

NOTE 18. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share	Diluted Earnings Per Share	Stock Price High	Stock Price Low	Stock Price Close
2001								
First	**$11,190**	**$ 2,659**	**$1,854**	**$0.55**	**$0.54**	**$53.06**	**$39.50**	**$44.63**
Second	**11,477**	**3,077**	**2,071**	**0.62**	**0.61**	**45.68**	**38.20**	**40.06**
Third	**11,338**	**2,822**	**2,072**	**0.62**	**0.61**	**47.50**	**39.74**	**47.12**
Fourth	**11,903**	**2,330**	**1,245**	**0.37**	**0.37**	**47.25**	**36.50**	**39.17**
Annual	**$45,908**	**$10,888**	**$7,242**	**2.15**	**2.13**			
2000								
First	$12,553	$ 3,076	$1,822	$0.54	$0.53	$49.00	$34.81	$42.13
Second	13,191	2,998	1,851	0.54	0.54	50.00	40.44	43.25
Third	13,422	2,846	2,999	0.89	0.88	50.19	38.44	49.88
Fourth	12,208	1,823	1,295	0.38	0.38	59.00	41.75	47.75
Annual	$51,374	$10,743	$7,967	2.35	2.32			

We reclassified all four quarters of 2000 to conform with the current year's presentation. The first and second quarters of 2001 include extraordinary losses of $10 and $8 for a total of $18, or $0.01 per share, related to the early redemption of $1,000 of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. There were also normalizing (e.g., one-time) items which are included in the information above but are excluded from the information that management uses to evaluate the performance of each segment of the business (see Note 5).

The quarterly impact of the year 2001 normalizing items was as follows:

- Pension settlement gains of $526 ($329 net of tax) in the first quarter, $315 ($189 net of tax) in the second quarter, $123 ($72 net of tax) in the third quarter and $133 ($98 net of tax) in the fourth quarter related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.
- Combined charges of $401 ($261 net of tax) in the second quarter primarily related to valuation adjustments of Williams as well as certain other cost investments accounted for under FAS 115. The charges resulted from an evaluation that the decline was other than temporary.
- Reduction of a valuation allowance of $120 ($78 net of tax) in the second quarter on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.
- Combined charges of $316 ($205 net of tax) in the first quarter related to impairment of our cable operations.
- A charge of $390 ($262 net of tax) indicated by a transaction pending as of December 31, 2001 to reduce the direct and indirect book value of our investment in Telecom Américas.
- A charge of $197 (with no tax effect) in the fourth quarter for costs related to TDC's decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.
- A charge of $197 ($128 net of tax) in the fourth quarter representing a proposed settlement agreement with the ICC related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.
- Combined charges of $619 ($425 net of tax) in the fourth quarter associated with our comprehensive review of operations, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

The quarterly impact of the year 2000 normalizing items was as follows:

- Gains of $1,699 ($1,125 net of tax) in the third quarter related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates and $187 ($123 net of tax) in the fourth quarter from the contribution of our investment in ATL to Telecom Américas.
- Gains of $238 ($155 net of tax) in the third quarter on the sale of Telmex L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the DECS.
- Pension settlement gains of $250 ($161 net of tax) in the first quarter, $124 ($80 net of tax) in the second quarter, $29 ($19 net of tax) in the third quarter and $109 ($68 net of tax) in the fourth quarter associated with pension litigation; first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program net of enhanced pension and postretirement benefits associated with that program (see Note 12).
- Costs of $141 ($117 net of tax) in the first quarter, $239 ($153 net of tax) in the second quarter, $400 ($258 net of tax) in the third quarter and $425 ($272 net of tax) in the fourth quarter associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.
- A charge of $132 (with no tax effect) in the first quarter related to in-process research and development from the March 2000 acquisition of Sterling.
- Combined charges of $971 ($677 net of tax) related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115 and the restructure of agreements with Prodigy, including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment.
- Gains of $357 ($99 net of tax) in the fourth quarter primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

REPORT OF MANAGEMENT

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management, as is all other information included in the Annual Report, unless otherwise indicated.

The financial statements of SBC Communications Inc. (SBC) have been audited by Ernst & Young LLP, independent auditors. Management has made available to Ernst & Young LLP all of SBC's financial records and related data, as well as the minutes of shareowners' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate.

Management has established and maintains a system of internal accounting controls that provides reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition and the prevention and detection of fraudulent financial reporting. The concept of reasonable assurance recognizes that the costs of an internal accounting controls system should not exceed, in management's judgment, the benefits to be derived.

Management also seeks to ensure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communication programs aimed at ensuring that its policies, standards and managerial authorities are understood throughout the organization. Management continually monitors the system of internal accounting controls for compliance. SBC maintains an internal auditing program that independently assesses the effectiveness of the internal accounting controls and recommends improvements thereto.

The Audit Committee of the Board of Directors, which consists of nine directors who are not employees, meets periodically with management, the internal auditors and the independent auditors to review the manner in which they are performing their respective responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have access to the Audit Committee at any time.

Edward E. Whitacre Jr.

Edward E. Whitacre Jr.
Chairman of the Board and
Chief Executive Officer

Randall Stephenson

Randall Stephenson
Senior Executive Vice President and
Chief Financial Officer

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareowners
SBC Communications Inc.

We have audited the accompanying consolidated balance sheets of SBC Communications Inc. (the Company) as of December 31, 2001 and 2000, and the related consolidated statements of income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SBC Communications Inc. at December 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

San Antonio, Texas
February 8, 2002

Edward E. Whitacre Jr., 60 (2,4,5)

Chairman of the Board and Chief Executive Officer
SBC Communications Inc.
San Antonio, Texas
SBC Director since October 1986
Background: Telecommunications

Gilbert F. Amelio, Ph.D., 59 (3,5)

Chairman and Chief Executive Officer
Beneventure Capital
Irvine, California
Senior Partner
Sienna Ventures, Sausalito, California
SBC Director since February 2001
Advisory Director 1997-2001
PTG Director 1995-1997
Background: Technology, electronics engineering

Clarence C. Barksdale, 69 (1,3)

Retired Chairman of the Board and Chief Executive Officer
Centerre Bancorporation
St. Louis, Missouri
SBC Director since October 1983
SWBT Director 1982-1983
Background: Banking

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MAPCO Inc.
Tulsa, Oklahoma
SBC Director since November 1990
Background: Diversified energy

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Anheuser-Busch Companies, Inc.
St. Louis, Missouri
SBC Director since October 1983
SWBT Director 1980-1983
Background: Brewing, family entertainment, transportation, manufacturer of aluminum beverage containers

The Honorable William P. Clark, 70 (2,3)

Senior Counsel
Clark, Cali and Negranti, Attorneys at Law
Paso Robles, California
SBC Director since April 1997
PTG Director 1985-1997
Background: Law, ranching

Martin K. Eby Jr., 67 (1,5)

Chairman of the Board and Chief Executive Officer
The Eby Corporation
Wichita, Kansas
SBC Director since June 1992
Background: General building construction

Herman E. Gallegos, 71 (1,3)

Independent Management Consultant
Brisbane, California
SBC Director since April 1997
PTG Director 1983-1997
Background: Management consulting

Jess T. Hay, 71 (1,6)

Chairman
HCB Enterprises Inc
Chairman
Texas Foundation for Higher Education, Dallas, Texas
SBC Director since April 1986
Background: Financial services

James A. Henderson, 67 (1,5)

Retired Chairman and Chief Executive Officer
Cummins Inc.
Columbus, Indiana
SBC Director since October 1999
AIT Director 1983-1999
Background: Manufacturing

Admiral Bobby R. Inman, 70 (5,6)

United States Navy, Retired
Austin, Texas
SBC Director since March 1985
Background: Private investment, education

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Chairman of the Board
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St. Louis, Missouri
SBC Director since October 1983
SWBT Director 1974-1983
Background: Electrical manufacturing

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Chair of the Council for the Advancement of Women
Advisor to the Firm
Deloitte & Touche LLP
Professor, J.L. Kellogg Graduate School of Management
Northwestern University
Chicago, Illinois
SBC Director since October 1999
AIT Director 1993-1999
Background: Consulting, former Congresswoman and Secretary of Labor

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Retired Chairman and Chief Executive Officer
BANK ONE CORPORATION
Columbus, Ohio
SBC Director since October 1999
AIT Director 1991-1999
Background: Banking

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San Francisco, California
SBC Director since April 1997
PTG Director 1986-1997
Background: Education, administration

Toni Rembe, Esq., 65 (2,3)

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Pillsbury Winthrop LLP
San Francisco, California
SBC Director since January 1998
Advisory Director 1997-1998
PTG Director 1991-1997
Background: Law

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Alpine Partners
Chairman and Chief Executive Officer (Retired)
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Danville, California
SBC Director since April 1997
PTG Director 1984-1997
Background: Diversified retail

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President and Chief Executive Officer
Girls Incorporated
New York, New York
SBC Director since October 1998
SNET Director 1997-1998
Background: Marketing

Ing. Carlos Slim Helú, 62 (3,5)

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Carso Global Telecom, S.A. de C.V.
Chairman of the Board
Teléfonos de México, S.A. de C.V.
Chairman of the Board
América Móvil, S.A. de C.V.
Mexico City, Mexico
SBC Director since September 1993
Background: Telecommunications, consumer goods, automobile parts, construction, retailing

Dr. Laura D'Andrea Tyson, 54 (1,5)

Dean
London Business School
London, England
SBC Director since October 1999
AIT Director 1997-1999
Background: Economics, education

Patricia P. Upton, 63 (3)

President and Chief Executive Officer
Aromatique, Inc.
Heber Springs, Arkansas
SBC Director since June 1993
Background: Manufacturing and marketing of decorative home fragrances

Committees of the Board:

(1) Audit
(2) Corporate Development
(3) Corporate Public Policy and Environmental Affairs
(4) Executive
(5) Finance/Pension
(6) Human Resources

EXECUTIVES OF SBC AND ITS SUBSIDIARIES

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Chairman & CEO
SBC Communications Inc.

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Group President
SBC Communications Inc.

James W. Callaway, 55
Group President
SBC Communications Inc.

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SBC Communications Inc.

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Senior Executive Vice President
& General Counsel
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Human Resources
SBC Communications Inc.

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Senior Executive Vice President-
Corporate Development
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Corporate Communications
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SBC Communications Inc.

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Senior Executive Vice President and CFO
SBC Communications Inc.

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Consumer Markets

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Telkom S. Africa

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Network Services

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Chief Marketing Officer

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Compliance Relief

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SBC Directory Operations

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Business Communications Services

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Network Planning and Engineering, ASI

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& Secretary-SBC Ameritech

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and Engineering

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Product Management Officer

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James Smith, 52
President-SBC Ameritech Ohio

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Business Communications Services

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San Francisco, Bay Area

Van H. Taylor, 53
President-SBC Southwestern Bell
Network Services

W. Fred Taylor, 56
Vice President-Operations,
ASI Central/Southeast and North/Northeast

Randy J. Tomlin, 42
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Gail Torreano, 51
President-SBC Ameritech Michigan

J. Michael Turner, 52
President-DataComm, Global and
Internet Services

Michael J. Viola, 47
Vice President-Treasurer

Joe W. Walkoviak, 54
Senior Executive Vice President-SBC

D. Wayne Watts, 48
Vice President and
Assistant General Counsel

Lora K. Watts, 45
President-SBC Pacific Bell

Stephen G. Welch, 58
President-Procurement and
Corporate Real Estate

Rayford Wilkins Jr., 50
President and CEO-
SBC Pacific Bell/Nevada Bell

Angiolina M. Wiskocil, 49
Vice President-SBC/Yahoo!
Strategic Alliance

Toll-Free Shareowner Hotline
Call us at 1-800-351-7221 between 8 a.m. and 7 p.m. Central Time Monday through Friday. TDD 1-888-403-9700
For help with:

- Account inquiries
- Requests for assistance, including stock transfers
- Information on The DirectSERVICE™ Investment Program for Shareholders of SBC Communications Inc. (sponsored and administered by EquiServe Trust Company, N.A.)

Written Requests
Please mail all account inquiries and other requests for assistance regarding your stock ownership to:

SBC Communications Inc.
c/o EquiServe Trust Company, N.A.
P. O. Box 2508
Jersey City, New Jersey 07303-2508

Please mail requests for transactions involving stock transfers or account changes to:

SBC Communications Inc.
c/o EquiServe Trust Company, N.A.
P. O. Box 2589
Jersey City, New Jersey 07303-2589

You also may reach the Transfer Agent for SBC, at their e-mail address:
sbc@equiserve.com

The DirectSERVICE™ Investment Program for Shareowners of SBC Communications Inc. (sponsored and administered by EquiServe Trust Company, N.A.)

The DirectSERVICE Investment Program for shareowners of SBC Communications Inc. is sponsored and administered by EquiServe Trust Company, N.A.. The Program allows current shareowners to reinvest dividends, purchase additional SBC stock or enroll in an Individual Retirement Account.

For more information, call 1-800-351-7221.

Stock Trading Information
SBC is listed on the New York, Chicago and Pacific stock exchanges as well as The Swiss Exchange. SBC is traded on the London Stock Exchange through the SEAQ International Markets facility.

Ticker symbol (NYSE): SBC

Newspaper stock listing: SBC or SBC Comm

Information on the Internet
Information about SBC is available on the Internet. Visit our home page on the World Wide Web: *http://www.sbc.com*

Annual Meeting
The annual meeting of shareowners will be held at 9:00 a.m. Friday, April 26, 2002, at:

Alzafar Shrine Temple
901 North Loop 1604 West
San Antonio, Texas 78216

Independent Auditor
Ernst & Young LLP
1900 Frost Bank Tower
100 W. Houston
San Antonio, Texas 78205

Requests for 10-K
The SBC Form 10-K, filed with the Securities and Exchange Commission, is available in paper form by request and also is available on our home page on the World Wide Web:
http://www.sbc.com

Investor Relations
Securities analysts and other members of the professional financial community may call the Investor Relations Hotline:
210-351-3327

General Information – Corporate Offices
SBC Communications Inc.
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San Antonio, Texas 78299-2933
210-821-4105

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VERIFICATION

I am an attorney for Vycera Communications, Inc.; said applicant is absent from Washington, D.C., where I have my office, and I make this verification for said Vycera Communications, Inc. for that reason; the statements in the foregoing Response to Application by Pacific Bell Telephone Company for Arbitration with Vycera Communications, Inc. are true of my own knowledge, except as to matters which are therein stated on information or belief, and as to those matters I believe them to be true. I declare under penalty of perjury that the foregoing is true and correct.

Executed on October 4, 2002 at Washington, D.C.

Rogena Harris
Attorney for Vycera Communications, Inc.

CERTIFICATE OF SERVICE

I, Carolyn Shaw, hereby certify that the following is true and correct: I am a citizen of the United States, State of Maryland, am over eighteen years of age, and am not a party to the within cause. My business address is Swidler Berlin Shereff Friedman, LLP, 3000 K Street, Suite 300, Washington D.C. 20007. I hereby certify that on this 4th day of October, 2002, a complete copy of the foregoing RESPONSE TO APPLICATION BY PACIFIC BELL TELEPHONE COMPANY FOR ARBITRATION WITH VYCERA COMMUNICATIONS, INC. was served by first class mail to the attached service list.

Carolyn Shaw

Carolyn Shaw

Executed this 4th day of October, 2002.

R. 93-04-003/I.93-04-002/R.95-040043/I.95-04-044
271/ARBITRATION
SERVICE LIST

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Exhibit 5

SBC Communications Inc.'s Annual Report for 2001, dated February 8, 2002

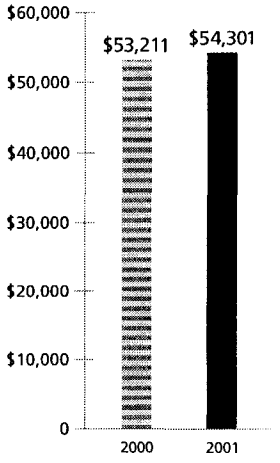
SBC Communications Inc.

ANNUAL REPORT
2001

OPERATING REVENUES

Dollars in millions

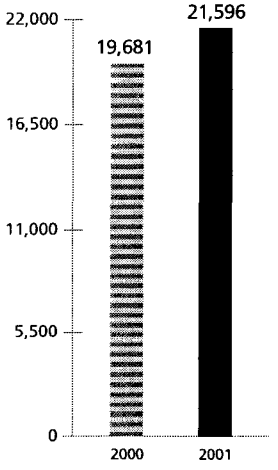
Excluding one-time items (see page 5). 2001 and the fourth quarter of 2000 reflect 60 percent proportional consolidation of Cingular Wireless' actual revenues.



WIRELESS SUBSCRIBERS

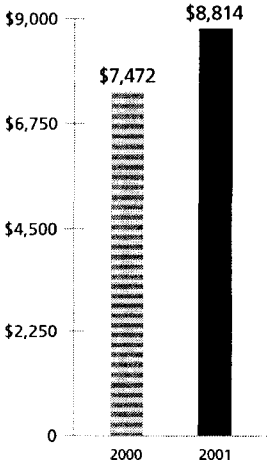
In thousands

Total customers of Cingular Wireless



DATA REVENUES

Dollars in millions



DEAR FELLOW INVESTOR:

The year 2001 challenged our nation and our industry. Our country's economic woes were magnified by September's terrorist attacks, creating uncertainty and concern throughout the communities we serve. However, these challenging times brought out the best in SBC, as our team of more than 190,000 employees reacted swiftly to a fast-changing, difficult environment and took the decisive actions needed to best serve our customers and shareowners.

I never am completely satisfied with our results, but given the circumstances, I am proud of our performance in 2001. We remained committed to our long-term strategy of building a company with the size, skills and financial power to excel in good times and remain solid during tough times. Simply put, SBC has the strongest balance sheet, cash flows and credit ratings in our industry, and we are well-positioned for future growth, particularly when the economy turns around.

LOOKING BACK AT 2001

The weak U.S. economy was only one factor that made last year difficult. We operated in a difficult and uncertain regulatory environment that hampered our data/broadband and long-distance businesses, and our operations saw the impact of additional competition at the local level.

Despite these factors and the generally unfavorable conditions throughout the telecom sector, SBC's scale, advanced network, customer service, product mix and financial health enabled your employee team to turn in a solid financial performance last year:

- Net income of $8.0 billion, before one-time items, up 2.7 percent
- $14.8 billion in operating cash flow, an increase of 5.3 percent
- $8.8 billion in total data revenues, up 18.0 percent
- $3.5 billion in dividend payments in a year where many companies cut the amount of earnings distributed to shareowners

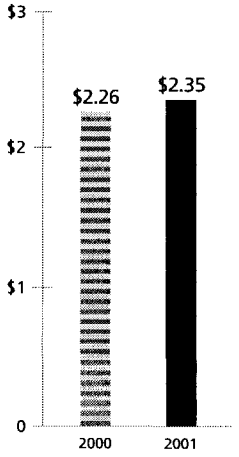
In the fourth quarter, the SBC Board of Directors approved a share-repurchase program that authorizes SBC to buy back up to 100 million shares of its common stock; this follows a repurchase program approved in 2000 under which SBC bought back more than 97 million shares.

Our focus throughout the year centered on:

- **Continued commitment to our growth drivers.** Through acquisitions and strategic partnerships over the past several years, we have assembled the right assets to create a growth platform that will serve the company well into the future. The three legs of our growth platform — data/broadband, long distance and wireless communications — performed well last year. These areas offer the greatest opportunities for SBC to grow by leveraging our advanced networks against a large customer base.
- **Disciplined expense management.** We sought to offset the impact of a difficult economy by focusing on what we could control, namely capital spending and operating costs. We slowed capital expenditures when economic and regulatory issues created too much uncertainty as to whether capital invested in expanding broadband would generate the kinds of returns our shareowners expect. Also, we took advantage of SBC's size and scope to cut costs. While many cost-cutting decisions were fairly simple ones, we were forced to make the most difficult decision of all — eliminating several thousand jobs in the second half of the year. I'm proud to report that all of this was accomplished during a year in which SBC registered its best residential customer service performance in company history.
- **Making the right long-term decisions.** We believe in staying focused on core business segments that have the greatest potential for SBC to generate acceptable returns for our shareowners. That is why last year we sold noncore assets such as Ameritech's security-monitoring and cable television businesses. We also divested certain international investments such as our stakes in diAx (Switzerland) and TransAsia Telecommunications (Taiwan).

DILUTED EARNINGS PER SHARE

Before extraordinary items and one-time items (see page 5)



LONG-TERM STRATEGY SERVES SBC WELL

The passage of the Telecommunications Act of 1996 unleashed changes that still reverberate through the industry. At the time, we anticipated that access lines would become even more valuable, that data would surpass voice as the predominant service, that wireless would become even more important to every consumer's daily life, and that many customers would prefer the option of choosing one carrier for all of their services.

We prepared for that day by acquiring access lines through groundbreaking mergers, by investing billions into new data networks, by working hard to get into long distance, and through creative partnerships, such as with Cingular and Yahoo!, to expand our set of products and services.

That strategy has served SBC well. Although SBC is still very much a work in progress, we have positioned the company for the environment we foresaw years ago. Even more important, we positioned the company for the environment that few predicted.

SBC's scale, scope, financial health, market position, diversification and employee talent are exactly the strengths we depended on to see us through 2001.

GROWTH DRIVERS DELIVER

SBC is strongly positioned to compete in our markets in the three key areas of data/broadband, long distance and wireless.

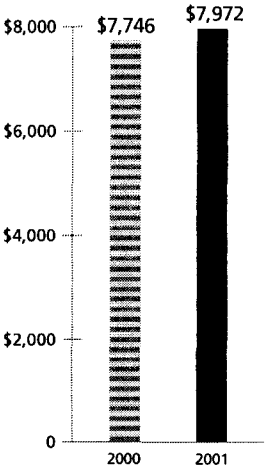
- **Data.** Clearly, economic and regulatory conditions negatively affected our data business during 2001, but we remain very optimistic about future data revenue growth. We are also positioned well for broadband growth, as we can provide DSL Internet services to about 25 million customer locations, up 37 percent from the year before. As we add additional data products and, importantly, gain long-distance freedom in additional states, we'll be able to attract more large-business customers. While data revenue growth slowed in 2001, the business still added an incremental $1.3 billion in revenue compared with 2000. Our November 2001 acquisition of Prodigy Communications and strategic alliance with Yahoo! have further strengthened SBC's data capabilities.

- **Long Distance.** Opportunities are equally clear with our second growth driver. Our long-distance business, while growing slower than expected due to continued delays in the regulatory approval process, showed solid results in 2001, including a total of $2.9 billion in revenues. In fact, our entry into the market in four new states made SBC the first former regional Bell company to provide long-distance service in each of its original states. Last year we gained approval to provide long-distance services to customers in Arkansas, Kansas, Missouri and Oklahoma. We ended 2001 with 4.9 million long-distance customers in six states. The potential revenues are significant once we can offer long distance in our seven other states, including California — the nation's biggest long-distance market. Because we have network, sales and billing platforms already in place for local telephone service, adding long distance is a very attractive business opportunity for us. Additionally, research shows that a significant proportion of consumers want to buy local and long-distance service from the same company. In fact, 60 percent of our long-distance customers buy the service bundled with local service. We think SBC is perfectly positioned to be a company that consumers and businesses can look to for both local and long-distance service.
- **Wireless.** Our wireless joint venture, Cingular Wireless, continues to grow as it now serves an area with a population of 219 million people, has 21.6 million subscribers, has 27,000 retail sales outlets, and has a well-recognized, nationwide brand less than two years after being launched. In 2001, Cingular generated $14.3 billion in total revenue, which was a 12.8 percent increase over the previous year on a pro forma basis. Also, Cingular improved its profitability and took several strategic steps to expand into new markets. The biggest move was an agreement with VoiceStream Wireless Corp., which gives Cingular access to the lucrative New York market while investing a nominal amount of capital because Cingular will share VoiceStream's network just as they will share Cingular's in California and Nevada. Cingular also is expanding into new markets such as Salt Lake City, and we continue to consolidate assets and centralized functions from the previous SBC Wireless and BellSouth Wireless operations, generating even more cost savings. Finally, Cingular is at the forefront of the high-speed wireless data explosion, and in 2001 became the first wireless provider to offer customers high-speed data services that are 10 times faster than current technologies used by other U.S. companies.

EARNINGS

Dollars in millions

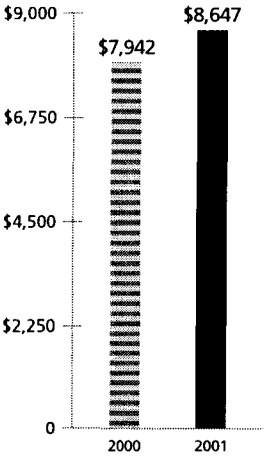
Before extraordinary items and one-time items (see page 5)



WIRELESS OPERATING REVENUES

Dollars in millions

2001 and the fourth quarter of 2000 reflect 60 percent proportional consolidation of Cingular Wireless' actual revenues.



REGULATORY OUTLOOK

As I have mentioned, we worked through a challenging regulatory environment in 2001, yet we made good progress by becoming the first company to gain long-distance approval in an entire region. We are optimistic that the regulatory process will move forward at a pace that would allow us to begin providing long-distance service in California and Nevada by midyear 2002. Also, we continue to make solid progress with our efforts to win regulatory approval to provide long distance in the former Ameritech region.

We view 2002 as an opportunity for a fresh start on the broadband regulatory front. FCC Chairman Michael K. Powell has made several encouraging statements about the need to minimally regulate broadband for the benefit of consumers, which of course is a viewpoint shared by SBC. Regulatory parity between SBC and cable companies such as AT&T Comcast and AOL Time Warner will give consumers real competition and real benefits in the broadband services market. We're hopeful that parity will be achieved in 2002 through Congress or the FCC.

Additionally, we have retooled portions of our management structure that most frequently and directly interact with regulators. One such change was bringing in one of the nation's most respected public affairs and business leaders, former U.S. Commerce Secretary William M. Daley, as president of SBC. His career takes on the intersection of policy and business like no other.

We have worked hard to position SBC to capitalize on the opportunities that can result from a more pro-consumer, pro-investment regulatory environment. Under the right conditions, we believe that there is significant potential for growth in long-distance and data services, and we will pursue those opportunities in ways that make sense for our customers and create value for our shareowners.

AMERITECH UPDATE

Since my letter to you in last year's annual report, we have dramatically improved the quality of service we are providing to our Ameritech customers. In the vast majority of cases, we are restoring service in less than 24 hours and installing new access lines within five business days. We invested nearly $2.9 billion in technology infrastructure improvements in the Ameritech region during 2001 and have expanded the data services offered to customers in the five-state region.

WHAT YOU SHOULD EXPECT FROM SBC

We have been very consistent about our view of 2002, which is that the economic effects of last year likely will linger through 2002, making it difficult for us to generate meaningful growth. While some economists believe the U.S. economy could begin recovering in 2002, we remain cautious and do not plan to alter our strategy of tight expense control and reduced capital expenditures. Also, in 2002 we will continue to face strong competition in our local and long-distance markets.

We remain committed to managing SBC with the long-term goal of growth and a short-term goal of maintaining maximum financial strength and flexibility until the economic shocks of 2001 fade away. You should expect your company to stay intensely focused on expense control, maintaining profit margins and free cash flow, rigorous financial discipline in operational decisions, spending our capital in the right places, and continued commitment to our growth drivers — data/broadband, long distance and wireless.

I am very proud of the way our company and our country faced the challenges of the past year, and I am equally confident in SBC's long-term potential for growth, business leadership and generating value for you, our shareowners.

Sincerely,

Edward E. Whitacre Jr.

Edward E. Whitacre Jr.
Chairman and Chief Executive Officer
February 8, 2002

SELECTED FINANCIAL AND OPERATING DATA

Dollars in millions except per share amounts

At December 31 or for the year ended:	2001	2000	1999	1998	1997
Financial Data[1]					
Operating revenues	**$45,908**	$51,374	$49,531	$46,241	$43,126
Operating expenses	**$35,020**	$40,631	$37,933	$35,018	$35,524
Operating income	**$10,888**	$10,743	$11,598	$11,223	$ 7,602
Interest expense	**$ 1,599**	$ 1,592	$ 1,430	$ 1,605	$ 1,550
Equity in net income of affiliates	**$ 1,595**	$ 897	$ 912	$ 613	$ 437
Other income (expense) – net	**$ (209)**	$ 2,561	$ (354)	$ 1,702	$ (93)
Income taxes	**$ 4,097**	$ 4,921	$ 4,280	$ 4,380	$ 2,451
Income before extraordinary items and cumulative effect of accounting change	**$ 7,260**	$ 7,967	$ 6,573	$ 7,735	$ 4,087
Net income[2]	**$ 7,242**	$ 7,967	$ 8,159	$ 7,690	$ 4,087
Earnings per common share: Income before extraordinary items and cumulative effect of accounting change	**$ 2.16**	$ 2.35	$ 1.93	$ 2.27	$ 1.21
Net income[2]	**$ 2.15**	$ 2.35	$ 2.39	$ 2.26	$ 1.21
Earnings per common share – assuming dilution: Income before extraordinary items and cumulative effect of accounting change	**$ 2.14**	$ 2.32	$ 1.90	$ 2.24	$ 1.20
Net income[2]	**$ 2.13**	$ 2.32	$ 2.36	$ 2.23	$ 1.20
Total assets	**$96,322**	$98,651	$83,215	$74,966	$69,917
Long-term debt	**$17,133**	$15,492	$17,475	$17,170	$17,787
Construction and capital expenditures	**$11,189**	$13,124	$10,304	$ 8,882	$ 8,856
Free cash flow[3]	**$ 3,616**	$ 942	$ 6,370	$ 4,108	$ 2,721
Dividends declared per common share[4]	**$ 1.025**	$ 1.015	$ 0.975	$ 0.935	$ 0.895
Book value per common share	**$ 9.69**	$ 9.00	$ 7.87	$ 6.69	$ 5.26
Ratio of earnings to fixed charges	**6.14**	6.95	6.52	6.79	4.10
Debt ratio	**44.6%**	45.2%	42.9%	47.3%	54.9%
Weighted average common shares outstanding (000,000)	**3,366**	3,392	3,409	3,406	3,391
Weighted average common shares outstanding with dilution (000,000)	**3,396**	3,433	3,458	3,450	3,420
End of period common shares outstanding (000,000)	**3,354**	3,386	3,395	3,406	3,398
Operating Data					
Network access lines in service (000)	**59,532**	61,250	60,697	58,980	56,707
Access minutes of use (000,000)	**283,164**	281,581	264,010	247,597	228,300
Wireless customers (000) – Cingular/SBC[5]	**21,596**	19,681	11,151	8,686	7,556
Number of employees	**193,420**	220,090	204,530	200,380	202,440

[1]Amounts in the above table have been prepared in accordance with accounting principles generally accepted in the United States. Certain one-time items are included in the results for each year presented but are excluded when management evaluates our results of operations. See Results of Operations for a summary of the 2001, 2000 and 1999 one-time items. In 1998, results include the incremental operating impacts attributable to the operations of the overlapping Ameritech Corporation (Ameritech) wireless properties sold in 1999, charges related to strategic initiatives resulting from the merger integration process with Southern New England Telecommunications Corp. (SNET) and charges to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores. Additionally, we recognized a gain on the sale of Telecom Corporation of New Zealand Limited shares; gains from the sale of certain noncore businesses, principally the required disposition of our investment in MTN, a cellular company in South Africa; and gains from the sale of certain telephone and directory assets. Excluding these items, SBC Communications Inc. (SBC) reported an adjusted income before extraordinary item and cumulative effect of accounting change of $6,611, or $1.92 diluted earnings per share, and an adjusted net income of $6,566, or $1.90 diluted earning per share in 1998. In 1997, results include the incremental operating impacts attributable to the operations of the overlapping Ameritech wireless properties sold in 1999, charges resulting from the merger integration process with Pacific Telesis Group (PAC), and charges related to a work force restructuring at Belgacom S.A. Additionally, we recognized gains from the sale of our interests in Bell Communications Research, Inc. and from settlement gains at PAC associated with lump sum pension payments for 1996 retirements. Excluding these items, SBC reported an adjusted net income of $5,836, or $1.71 diluted earnings per share in 1997.

[2]Amounts include the following extraordinary items and cumulative effect of accounting change: 2001, loss related to the early extinguishment of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts; 1999, gain on the sale of overlapping cellular properties and change in directory accounting at Ameritech; 1998, early retirement of debt and change in directory accounting at SNET.

[3]Free cash flow is net cash provided by operating activities less construction and capital expenditures.

[4]Dividends declared by SBC's Board of Directors; these amounts do not include dividends declared and paid by Ameritech, SNET and PAC prior to their respective mergers.

[5]All periods exclude customers from the overlapping Ameritech wireless properties sold in 1999. Beginning in 2000, the number presented is the total customers served by Cingular Wireless, in which we own a 60% equity interest.

Throughout this document, SBC Communications Inc. is referred to as "we" or "SBC". We are a holding company whose subsidiaries and affiliates operate in the communications services industry. Our subsidiaries and affiliates provide wireline and wireless telecommunications services and equipment and directory advertising services both domestically and worldwide.

You should read this discussion in conjunction with the consolidated financial statements and the accompanying notes. A reference to a Note in this section refers to the accompanying Notes to the Consolidated Financial Statements.

RESULTS OF OPERATIONS

Overview

Reported financial results are summarized as follows:

				Percent Change	
	2001	2000	1999	2001 vs. 2000	2000 vs. 1999
Operating revenues	**$45,908**	$51,374	$49,531	**(10.6)%**	3.7%
Operating expenses	**35,020**	40,631	37,933	**(13.8)**	7.1
Operating income	**10,888**	10,743	11,598	**1.3**	(7.4)
Income before extraordinary items and cumulative effect of accounting change	**7,260**	7,967	6,573	**(8.9)**	21.2
Extraordinary items	**(18)**	—	1,379	—	—
Cumulative effect of accounting change	—	—	207	—	—
Net income	**7,242**	7,967	8,159	**(9.1)**	(2.4)
Diluted earnings per share	**2.13**	2.32	2.36	**(8.2)**	(1.7)

In 2001, we incurred an extraordinary loss related to the early redemption of $1,000 of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. In 1999, we recognized an extraordinary gain on the sale of overlapping cellular properties relating to the Ameritech Corporation (Ameritech) merger (see Note 3), and a cumulative effect of accounting change related to accounting for directory revenues and expenses (see Note 1).

Our reported operating revenues, expenses and income were lower in 2001 and in the fourth quarter of 2000 primarily due to the contribution of our wireless properties to Cingular Wireless (Cingular). This contribution resulted in a change in the way we account for Cingular's revenues and expenses from operating results to equity in net income of affiliates. In addition, sales of nonstrategic assets in 2001, including our Ameritech security monitoring and cable operations, lowered revenues but also decreased expenses by a greater amount, thereby increasing 2001 operating income. Also included in income before extraordinary items and cumulative effect of accounting change were certain one-time items that were incurred in 2001, 2000 and 1999. For internal management reporting purposes, we exclude (i.e., normalize) the one-time items from our results and analyze them separately.

The net effect of excluding the normalizing items was to increase net income by $712 in 2001, decrease net income by $221 in 2000 and increase net income by $866 in 1999. In addition to the normalizing items, for internal management purposes, we include the 60% proportional consolidation of Cingular in our 2001 and fourth quarter of 2000 normalized results (see the columns labeled "Cingular" in the tables below). The proportional consolidation of Cingular changes our normalized revenues, expenses, operating income and nonoperating items, but does not change our net income. The following tables reconcile our reported results to our normalized results and list the normalizing items for 2001, 2000 and 1999. Following the tables are explanations of the normalizing items.

2001

		Normalizing Items									
	Reported	A	B	C	D	E	F	G	H	Cingular	Normalized
Operating revenues	$45,908	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ —	$ 8,393	$54,301
Operating expenses	35,020	1,097	—	—	(316)	—	—	(197)	(619)	6,884	41,869
Operating income	10,888	(1,097)	—	—	316	—	—	197	619	1,509	12,432
Interest expense	1,599	—	—	—	—	—	—	—	—	159	1,758
Interest income	682	—	—	—	—	—	—	—	—	(308)	374
Equity in net income of affiliates	1,595	—	—	—	—	49	197	—	—	(1,038)	803
Other income (expense) – net	(209)	—	401	(120)	—	341	—	—	—	1	414
Income before income taxes	11,357	(1,097)	401	(120)	316	390	197	197	619	5	12,265
Income taxes	4,097	(409)	140	(42)	111	128	—	69	194	5	4,293
Income before extraordinary items and cumulative effect of accounting change	$ 7,260	$ (688)	$261	$ (78)	$ 205	$262	$197	$ 128	$ 425	$ —	$ 7,972

2000		Normalizing Items								
	Reported	I	J	K	L	M	N	O	Cingular	Normalized
Operating revenues	$51,374	$ —	$ —	$ —	$ —	$ —	$ 23	$ —	$1,814	$53,211
Operating expenses	40,631	—	—	506	(1,183)	(132)	(596)	—	1,592	40,818
Operating income	10,743	—	—	(506)	1,183	132	619	—	222	12,393
Interest expense	1,592	—	—	—	—	—	—	—	46	1,638
Interest income	279	—	—	—	—	—	—	—	(92)	187
Equity in net income of affiliates	897	(68)	—	(6)	—	—	110	—	(72)	861
Other income (expense) – net	2,561	(1,818)	(238)	—	22	—	242	(357)	(14)	398
Income before income taxes	12,888	(1,886)	(238)	(512)	1,205	132	971	(357)	(2)	12,201
Income taxes	4,921	(638)	(83)	(184)	405	—	294	(258)	(2)	4,455
Income before extraordinary items and cumulative effect of accounting change	$ 7,967	$(1,248)	$(155)	$(328)	$ 800	$ 132	$ 677	$ (99)	$ —	$ 7,746

1999		Normalizing Items					
	Reported	P	Q	R	S	T	Normalized
Operating revenues	$49,531	$ 176	$(705)	$ —	$ —	$ —	$49,002
Operating expenses	37,933	(1,591)	(473)	566	—	44	36,479
Operating income	11,598	1,767	(232)	(566)	—	(44)	12,523
Interest expense	1,430	(1)	(11)	—	—	—	1,418
Interest income	127	—	—	—	—	—	127
Equity in net income of affiliates	912	—	—	—	(131)	—	781
Other income (expense) – net	(354)	(2)	24	—	—	—	(332)
Income before income taxes	10,853	1,766	(197)	(566)	(131)	(44)	11,681
Income taxes	4,280	309	(78)	(198)	(54)	(17)	4,242
Income before extraordinary items and cumulative effect of accounting change	$ 6,573	$ 1,457	$(119)	$(368)	$ (77)	$(27)	$ 7,439

Normalizing items for 2001:

A. Pension settlement gains related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.

B. Combined charges primarily related to valuation adjustments of Williams Communications Group Inc. as well as certain other cost investments accounted for under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115). The charges resulted from an evaluation that the decline was other than temporary (see Note 3).

C. Reduction of a valuation allowance on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.

D. Combined charges related to impairment of our cable operations.

E. A charge indicated by a transaction pending as of December 31, 2001, to reduce the direct and indirect book value of our investment in Telecom Américas.

F. A charge for costs related to TDC A/S's (TDC) (formerly known as Tele Danmark A/S) decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.

G. A charge representing a proposed settlement agreement with the Illinois Commerce Commission (ICC) related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.

H. Combined charges associated with our comprehensive review of operations in the fourth quarter of 2001, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

Normalizing items for 2000:

I. Gains related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates, and from the contribution of our investment in ATL – Algar Telecom Leste S.A. (ATL), a Brazilian telecommunications company, to Telecom Américas.

J. Gains on the sale of Teléfonos de Mexico, S.A. de C.V. (Telmex) L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the Debt Exchangeable for Common Stock (DECS).

K. Pension settlement gains associated with pension litigation, first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program

net of enhanced pension and postretirement benefits associated with that program (see Note 12).

L. Costs associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.

M. A charge related to in-process research and development from the March 2000 acquisition of Sterling Commerce, Inc. (Sterling) (see Note 3).

N. Combined charges related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115, and the restructure of agreements with Prodigy Communications Corporation (Prodigy), including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment (see Note 3).

O. Gains primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

Normalizing items for 1999:

P. Charges including recognition of impairment of long-lived assets, adjustments to the estimate of allowance for doubtful accounts, estimation of deferred taxes on international investments, wireless conversion costs and other items (see Note 2).

Q. Elimination of income from the incremental impacts of overlapping wireless properties sold in October 1999 relating to the Ameritech merger.

R. Pension settlement gains associated with lump sum pension payments that exceeded the projected service and interest costs.

S. Gains recognized from the sale of property by an international equity affiliate.

T. A reduction related to a portion of a first-quarter 1998 charge to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores.

Normalized financial results are summarized as follows:

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating revenues	**$54,301**	$53,211	$49,002	**2.0%**	8.6%
Operating expenses	**41,869**	40,818	36,479	**2.6**	11.9
Operating income	**12,432**	12,393	12,523	**0.3**	(1.0)
Income before extraordinary items and cumulative effect of accounting change	**7,972**	7,746	7,439	**2.9**	4.1
Diluted earnings per share, before extraordinary items and cumulative effect of accounting change	**2.35**	2.26	2.15	**4.0**	5.1

Normalized operating revenues increased in 2001 and 2000 primarily due to growth in demand for data communications, wireless, interLATA (Local Access and Transport Area) long distance and directory services. In 2001, the revenue increase was partially offset by declines in our core telephone operations, including the impact of our decision to de-emphasize low-margin equipment. Sales of nonstrategic assets, including our Ameritech security monitoring and cable operations, also partially offset the revenue increases in 2001. The slowing revenue growth rate reflects the ongoing impact of a weak United States (U.S.) economy, challenging federal and state regulatory environments and increased competition. We expect that these factors will continue to dampen business and consumer demand, and our revenue in 2002.

Normalized operating expenses increased in 2001 and 2000 primarily due to the higher level of investments made for new products and services, including Digital Subscriber Line (DSL) and interLATA long distance, and to restore the quality of service in the Ameritech region. Expenses also increased in 2001 due to an increase in our provision for uncollectible accounts for companies that went out of business and customers with a higher credit risk due to the adverse U.S. economic environment. Partially offsetting the expense increases in 2001 were cost savings from employee reductions, the scale-back of our national expansion initiative, and favorable expense comparisons to 2000 now that we are beyond the first year of our initial launch of DSL.

Growth of our diluted earnings per share, before extraordinary items and cumulative effect of accounting change, in 2001 was greater than our operating income growth primarily due to a decreasing effective tax rate and a decline in our weighted average common shares outstanding from our purchases of approximately 47 million shares of our common stock. In 2000 our diluted earnings per share increased while our operating income declined primarily due to reduced mark-to-market expense on the DECS securities and increased gains on sales of multiple smaller investments as compared to 1999. The current U.S. economy, combined with a challenging regulatory and competitive environment, will continue to put significant pressure on our results in 2002.

Segment Results

Our segments are strategic business units that offer different products and services and are managed accordingly. We evaluate performance based on income before income taxes adjusted for the normalizing (e.g., one-time) items that we describe in the "Overview" section. We have five reportable segments that reflect the current management of our business: (1) wireline; (2) wireless; (3) directory; (4) international; and (5) other.

In the second quarter of 2001, we moved the results of the SBC Services unit from the other segment to the wireline segment because the SBC Services unit now primarily supports the wireline segment. We have restated all prior

period information for this change, and this had no effect on our consolidated results.

The ***wireline segment***, which accounted for approximately 75% of our total normalized operating revenues in 2001, provides landline telecommunications services, including local, network access and long distance services, messaging and Internet services and sells customer premise and private business exchange equipment.

Prior to the fourth quarter of 2000, the ***wireless segment***, which accounted for approximately 16% of our total normalized operating revenues in 2001, included our consolidated businesses that provided wireless telecommunications services and sold wireless equipment. In October 2000, we contributed substantially all of our wireless businesses to Cingular and began reporting results from Cingular's operations as equity in net income of affiliates in the Consolidated Financial Statements. However, for internal management purposes, we analyze Cingular's results using proportional consolidation and therefore will discuss Cingular's results on that basis for segment reporting. Cingular offers both wireless voice and data communications services across most of the U.S., providing cellular and PCS services.

The ***directory segment***, which accounted for approximately 8% of our total normalized operating revenues in 2001, includes all directory operations, including Yellow and White Pages advertising and electronic publishing. All investments with primarily international operations are included in the ***international segment***. The ***other segment*** includes all corporate operations and Ameritech's paging, cable television and SecurityLink operations. SecurityLink was sold in January 2001, and we sold Ameritech New Media, Ameritech's cable television operations, in November 2001.

Wireline

Normalized Results

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating revenues					
Local service	**$22,735**	$22,057	$19,526	**3.1%**	13.0%
Network access	**10,459**	10,491	10,184	**(0.3)**	3.0
Long distance service	**2,914**	2,930	3,348	**(0.5)**	(12.5)
Other	**4,579**	4,413	4,314	**3.8**	2.3
Total Operating Revenues	**40,687**	39,891	37,372	**2.0**	6.7
Operating expenses					
Operations and support	**24,041**	23,472	21,422	**2.4**	9.6
Depreciation and amortization	**8,381**	7,867	6,828	**6.5**	15.2
Total Operating Expenses	**32,422**	31,339	28,250	**3.5**	10.9
Operating Income	**8,265**	8,552	9,122	**(3.4)**	(6.2)
Interest Expense	**1,205**	1,298	1,188	**(7.2)**	9.3
Other Income (Expense) – Net	**31**	72	114	**(56.9)**	(36.8)
Income Before Income Taxes	**$ 7,091**	$ 7,326	$ 8,048	**(3.2)%**	(9.0)%

The results of our wireline segment during 2001 reflect the impacts of the weak U.S. economy, regulatory uncertainty and increasing competition. The decline in revenue growth during 2001 was partially offset by a slowing trend in expense growth, primarily from reductions in work force and other employee-related costs. In 2002 we expect a continued slowdown in the revenue growth rate as we continue to face regulatory challenges and strong competition in our local and long distance markets. In response to our declining revenue trend, we will continue to control expenses where possible.

Local service revenues increased $678, or 3.1%, in 2001 and $2,531, or 13.0%, in 2000. Access line revenue steadily declined during 2001 as a result of a slowing U.S. economy, increased competition, and technology substitution from wireless and high-speed access service. The access line revenue decrease was approximately $634 in 2001. Access lines served at the end of 2001 decreased by 2.8% compared to 2000. And, although total access lines in service at the end of 2000 increased by approximately 1%, this was a declining trend when compared to the increase of 3% during 1999. Partially offsetting the access line revenue decrease, the continued rollout of DSL increased local service revenues in 2001 by approximately $319, and our DSL customers increased to approximately 1,333,000 as compared to 767,000 at the end of 2000. Certain other data-related revenues including data equipment sales and network integration services increased in 2001. However, these data revenues declined sequentially during the second half of the year primarily due to our decision to de-emphasize low-margin equipment as a component in data solutions. Wholesale revenues, which include unbundled network elements and resale services, increased approximately $352 during 2001. Revenues from vertical services such as Caller ID, voice mail and other enhanced services and vertical service packages increased by approximately $127 during

2001; however, the sequential quarterly growth rate has been declining to flat since the first quarter.

During 2000, excluding the operations of Sterling, acquired in March 2000, local service revenue increased approximately 10.9% over the prior year. Approximately $619 of that increase was attributable to increased demand from business customers for network integration and Internet services. Demand for DSL and dial-up Internet services in the residential market increased local service revenues by approximately $164 in 2000. Increased demand for wholesale services accounted for approximately $389 of the increase in 2000. Additionally, directory assistance revenues increased approximately $75 in 2000, primarily due to price increases in California, Illinois and Texas, while vertical services revenues increased by approximately 10% to more than $3.7 billion in 2000, up from more than $3.3 billion in 1999.

During 2001, Illinois legislation caused an increase in revenues of approximately $139, and as discussed below, this legislation increased operations and support expenses and decreased interest expense resulting in a net increase of $68 in pre-tax income. During 2000, local service revenues increased as a result of regulatory actions that decreased one or more other types of operating revenues. The introduction of extended area service plans and the September 1999 Texas Universal Service Fund (TUSF) rate rebalancing collectively increased local service revenues in 2000 by approximately $140. However, these regulatory actions had only a nominal effect on overall revenue during 2000 because they decreased intrastate network access revenues by approximately $95 and decreased long distance revenues by approximately $22. The Texas Public Utility Commission stated that the TUSF was intended, among other things, to help support the provision of basic local telephone service to high-cost rural areas.

Network access revenues decreased $32, or 0.3%, in 2001 and increased $307, or 3.0%, in 2000. The decrease in 2001 was primarily due to decreases in switched access revenue related to decreased demand, the continuing impact of the July 2000 implementation of the Coalition for Affordable Local and Long Distance Service (CALLS) proposal, and state regulatory access rate reductions in Texas. These rate reductions were partially offset by continued demand for our high-capacity data transport services.

The increase in 2000 was due primarily to demand for special access and switched data transport services, as well as higher network usage by alternative providers of intraLATA toll services. The increase in 2000 was partially offset by a decrease of $293 due to the impact of CALLS. Also offsetting the 2000 increase were the effects of the TUSF described in local service above of $95 as well as other state regulatory rate reductions of $183.

Long distance service revenues decreased $16, or 0.5%, in 2001 and $418, or 12.5%, in 2000. During 2001, long distance service revenues decreased approximately $197 due to competitive losses resulting from intraLATA dialing parity and $146 attributable to competitive pricing actions in the Ameritech region. These losses were partially offset by an increase of approximately $322 resulting from our 2001 entry into the Arkansas, Kansas, Missouri and Oklahoma interLATA long distance markets in addition to our previous entry into the Texas and Connecticut markets. Competition will continue to affect our intraLATA markets as we seek interLATA long distance approval in the remainder of our 13-state area.

In 2000, competitive losses of approximately $329, primarily resulting from dialing parity implementation, decreased long distance service revenues. Regulatory actions related to the continued introduction of extended area service plans, as discussed in local service, decreased revenues approximately $22. These decreases were partially offset by approximately $64 from the entry into the Texas long distance market for interLATA and interstate services and $31 due to price increases in Illinois, Indiana, Michigan and Ohio.

Other operating revenues increased $166, or 3.8%, in 2001 and $99, or 2.3%, in 2000. Price increases added revenue of approximately $112 in 2001. Continued declines in the payphone business decreased other operating revenues by approximately $52 in 2001 and $124 in 2000. Sales of nonregulated products and services increased in 2001, but at a slower rate than in 2000 due to a decline in demand related to the weakness of the U.S. economy.

Operations and support expenses increased $569, or 2.4%, in 2001 and $2,050, or 9.6%, in 2000. Our provision for uncollectible accounts increased approximately $540 in 2001 for companies that went out of business and customers with a higher credit risk due to the adverse U.S. economic environment. Costs to restore the quality of service in the Ameritech region increased approximately $260 in 2001. The Illinois legislation discussed above in local service caused a one-time increase in expenses of approximately $84 in 2001, which includes a reversal of approximately $26 in the fourth quarter of 2001 of expenses we no longer expect to incur. Costs associated with our continued rollout of DSL increased approximately $120 in 2001 compared to an increase of $930 in 2000, primarily due to growth in subscribers and favorable expense comparisons to 2000 now that we are beyond the first year of our initial launch of DSL. Costs associated with data equipment sales, network integration and e-commerce services increased approximately $70 in 2001, significantly lower than the increase of $850 in 2000, primarily due to our decision to de-emphasize low-margin equipment, and acquisitions in 2000. Costs associated with our national expansion initiative decreased approximately $90 in 2001, reflecting the initiative's scale-back, compared to an increase of $300 in 2000. InterLATA long distance service expenses increased by approximately $320 in 2001 compared to $260 in 2000 primarily reflecting our entry into four new states. The acquisition of Prodigy (see Note 3) late in 2001 increased expenses approximately $50.

Costs associated with reciprocal compensation decreased approximately $185 in 2001 and $175 in 2000 as we signed new contracts with lower rates and favorable settlement agreements with carriers, partially offset by growth in minutes of use on our network. Expenses decreased approximately $635 in 2001 due to work force reductions, early retirements, lower personnel benefit costs, reduced outsourcing and advertising costs, and gains from certain employee postretirement plans. This compared to employee-related expense increases of approximately $130 in 2000 to meet demand for our new products and services. In addition,

2001 included a reduction in taxes of approximately $92, primarily related to settlements and lower property tax appraisals.

We expect our personnel benefits costs to increase in 2002 due primarily to reduced investment portfolio returns, higher medical claim costs and lower interest rates. We expect that the Prodigy acquisition and increased personnel benefits costs will add between $650 and $850 to operations and support expenses in 2002.

Depreciation and amortization expenses increased $514, or 6.5%, in 2001 and $1,039, or 15.2%, in 2000. The majority of the increase in 2001 was related to higher plant levels from the build-out of our broadband network and launch of new products and services, including DSL and Internet data centers. Approximately $308 of the 2000 increase was related to higher plant levels. Our acquisition of Sterling in 2000 increased expenses approximately $100 and $263 in 2001 and 2000. Amortization of capitalized software also increased approximately $148 in 2001 and $198 in 2000.

Amortization expense of goodwill was approximately $161 in 2001. Goodwill will no longer be amortized in 2002 when we adopt new accounting standards (see Note 1).

Wireless

Normalized Results

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating revenues					
Subscriber revenue	**$7,307**	$6,480	$5,308	**12.8%**	22.1%
Other	**1,340**	1,462	1,317	**(8.3)**	11.0
Total Operating Revenues	**8,647**	7,942	6,625	**8.9**	19.9
Operating expenses					
Operations and support	**5,957**	5,348	4,464	**11.4**	19.8
Depreciation and amortization	**1,232**	1,083	918	**13.8**	18.0
Total Operating Expenses	**7,189**	6,431	5,382	**11.8**	19.5
Operating Income	**1,458**	1,511	1,243	**(3.5)**	21.6
Interest Expense	**538**	424	226	**26.9**	87.6
Equity in Net Income of Affiliates	**(11)**	12	42	**—**	(71.4)
Other Income (Expense) – Net	**33**	(120)	(176)	**—**	31.8
Income Before Income Taxes	**$ 942**	$ 979	$ 883	**(3.8)%**	10.9%

We account for our 60% economic interest in Cingular under the equity method of accounting. However, we use proportional consolidation in order to evaluate the results of Cingular for internal management purposes. In the table above, Cingular's proportional results are included in 2001 and the fourth quarter of 2000 along with the residual wireless properties we hold that have not been contributed. The first nine months of 2000 and all of 1999 include the historical results of our comparable wireless operations.

During 2001, at the expense of customer additions, Cingular focused on policies that had the effect of shifting subscribers from analog plans to digital plans which typically have higher margins. Cingular's expenses increased due to marketing of its new brand after beginning operations in the fourth quarter 2000. Partially offsetting the increased brand costs were synergies and economies of scale created by the formation of Cingular.

Subscriber revenues increased $827, or 12.8%, in 2001 and $1,172, or 22.1%, in 2000. The 2001 increase was primarily related to growth in customer base accompanied by existing customers shifting to higher monthly rate plans, increased minutes of use and the sale of higher access rate plans to new customers. During 2001, Cingular focused on policies that had the effect of shifting subscribers from analog plans to digital plans. For 2002, as Cingular's digital network and rate plan offerings continue to expand, they expect continued erosion in their analog customer base. Cingular's net customer additions during 2001 were approximately 1,987,000, excluding approximately 72,000 customers sold to minority partners. At December 31, 2001, Cingular had approximately 21,596,000 customers.

The 2000 increase in subscriber revenues resulted from the 1999 acquisitions of Comcast Cellular Corporation (Comcast) and Cellular Communication of Puerto Rico, Inc. (CCPR), with the remaining increase due to net customer additions.

Other revenues decreased $122, or 8.3%, in 2001 and increased $145, or 11.0%, in 2000. The 2001 decrease was due to a decline in roaming revenues from other carriers, reflecting the continued build-out of competitors' networks, which resulted in fewer minutes on Cingular's network and lower negotiated rates with other carriers. Equipment revenues also declined due to a lower customer growth rate in 2001. The 2000 increase was primarily due to higher equipment sales resulting from a higher customer growth rate in 2000.

Operations and support expenses increased $609, or 11.4%, in 2001 and $884, or 19.8%, in 2000. The 2001 increase was primarily due to increased minutes of use on the network, increased long distance expenses as more plans include free long distance, and the Cingular national branding campaign that was completed in 2001. These increases were partially offset by new long distance rates with BellSouth Corporation (BellSouth) and SBC Long Distance that became effective June 2001, and administrative cost savings gained through the formation of Cingular. The 2000 increase reflects increased minutes of use on the system due to the growth in number of customers served during 2000.

Depreciation and amortization expenses increased by $149, or 13.8%, in 2001 and $165, or 18.0%, in 2000 primarily related to higher plant levels. The 2000 increase was partially offset by a decrease of approximately $35 resulting from a purchase price allocation true-up adjustment related to the 1999 acquisitions of Comcast and CCPR.

Our 60% share of Cingular's amortization expense on goodwill and wireless licenses was approximately $182 in 2001. Goodwill and wireless licenses will no longer be amortized in 2002 upon adoption of new accounting standards (see Note 1).

Directory

Normalized Results

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating Revenues	**$4,468**	$4,340	$4,126	**2.9%**	5.2%
Operating expenses					
Operations and support	**1,898**	2,008	2,081	**(5.5)**	(3.5)
Depreciation and amortization	**36**	32	33	**12.5**	(3.0)
Total Operating Expenses	**1,934**	2,040	2,114	**(5.2)**	(3.5)
Operating Income	**2,534**	2,300	2,012	**10.2**	14.3
Other Income (Expense) – Net	**9**	61	(1)	**(85.2)**	—
Income Before Income Taxes	**$2,543**	$2,361	$2,011	**7.7%**	17.4%

Our directory results in 2001 and 2000 included increased demand for directory advertising services and decreased expenses from merger initiatives and cost-containment efforts. However, the growth rate has slowed due to increased competition, increased bad debt expenses and a weak U.S. economy.

Operating revenues increased $128, or 2.9%, in 2001 and $214, or 5.2%, in 2000. A change in the timing of directory publications contributed approximately $79 in 2001 and $33 in 2000 to the increase in revenues. The remaining increases in 2001 and 2000 related to increased demand for directory advertising services. The 2001 growth rate was lower than the growth rate for 2000, reflecting the impacts of a weaker U.S. economy and increased competition.

Operations and support expenses decreased $110, or 5.5%, in 2001 and $73, or 3.5%, in 2000. The decreased expenses in 2001 were due primarily to lower compensation-related expenses, as a result of merger initiatives, a 2000 pension and retirement program, and cost-containment efforts. Offsetting these decreases was an increase in bad debt expense for companies that went out of business or are a higher credit risk due to the weak U.S. economy. The decreased expenses in 2000 were primarily related to cost savings from the merger integration process with Ameritech.

International

Normalized Results

				Percent Change	
	2001	2000	1999	**2001 vs. 2000**	2000 vs. 1999
Operating Revenues	**$ 185**	$ 328	$255	**(43.6)%**	28.6%
Operating Expenses	**241**	475	266	**(49.3)**	78.6
Operating Income (Loss)	**(56)**	(147)	(11)	**61.9**	—
Interest Expense	**49**	174	235	**(71.8)**	(26.0)
Equity in Net Income of Affiliates	**800**	862	739	**(7.2)**	16.6
Other Income (Expense) – Net	**369**	389	209	**(5.1)**	86.1
Income Before Income Taxes	**$1,064**	$ 930	$702	**14.4%**	32.5%

Our international results for 2001 reflect our prior sale of various international investments through decreased interest expense, and lower operating expenses due to the first-quarter 2001 completion of the depreciation of certain property, plant and equipment. These savings were offset by reduced operating results at our international affiliates and lower management fee revenues. We expect our international affiliates will continue to feel the impact of a weak global economy and increasing competition.

Operating revenues decreased $143, or 43.6%, in 2001 and increased $73, or 28.6%, in 2000. Revenues declined approximately $87 due to lower volume-related long distance revenues and the September 2001 disposition of Ameritech Global Gateway Services (AGGS). Directory advertising revenues declined approximately $41 due to the December 2000 sale of our German directory investment, Wer Liefert Was (WLW), and the remaining decrease was due to lower management fee revenues. We expect future operating revenues to decrease as a result of the 2001 sale of AGGS. The 2000 increase was primarily due to higher volume-related long distance revenues.

Operating expenses decreased $234, or 49.3%, in 2001 and increased $209, or 78.6%, in 2000. The 2001 decrease was primarily due to AGGS, through both lower long distance activity and the September 2001 disposition, and our December 2000 sale of WLW. Additionally, depreciation expense declined due to certain property, plant and equipment being fully depreciated during the first quarter of 2001. We expect future operating expenses to decrease as a result of the 2001 sale of AGGS. The 2000 increase was largely due to the costs associated with the higher long distance volumes during 2000 and to an increase in corporate support charges.

Equity in net income of affiliates decreased $62, or 7.2%, in 2001 and increased $123, or 16.6%, in 2000. The 2001 decrease includes a decrease of approximately $295 from Belgacom S.A. (Belgacom) and TDC, primarily related to decreased earnings from their foreign affiliates and the inclusion in 2000 results of the gain on the sale of Telenordia. Offsetting this 2001 decrease was a gain of approximately $64 related to Belgacom's fourth-quarter 2001 sale of a portion of its Netherlands wireless operations to an unaffiliated special purpose entity (SPE). Although Belgacom guaranteed approximately $237 of the SPE's debt, the SPE has the right to put the investment to a subsidiary of Deutsche Telekom A.G. at a price that is greater than the amount guaranteed. The third-quarter 2000 sale of our investment in MATÁV reduced earnings approximately $65 in 2001 as compared to 2000. Lower income from South American wireless companies held by América Móvil S.A. de C.V., certain true-up adjustments in 2000 at Telmex and our smaller ownership percentage at these affiliates resulted in a decrease of approximately $26. Offsetting these decreases were increases of approximately $92 resulting from wireless subscriber growth, higher average revenue per customer and Cegetel S.A.'s (Cegetel) second-quarter 2001 sale of AOL France. Bell Canada's first-quarter 2001 gain on their disposition of an Internet service provider subsidiary and improved operating results contributed approximately $74 to the increase in 2001. Also offsetting the decrease was the elimination of losses, on a comparative basis, of approximately $139 resulting from the first-quarter 2001 disposition of diAx A.G. (diAx), a Swiss mobile landline operator, and the exchange of our equity investment in ATL for a cost investment in Telecom Américas.

The 2000 increase includes increased equity in net income, including our share of certain disposition gains, of approximately $219 from investments in Telmex, TDC, and Belgacom. A full 12 months of operations from Bell Canada in 2000 resulted in approximately $48 higher equity income than the seven months of operations in 1999. Our investment in Cegetel produced positive equity income for the first time in 2000 leading to an increase of approximately $17 over prior year equity losses. Offsetting these increases were reductions to equity in net income of approximately $35 as a result of the sale of our investment in the Aurec companies in Israel and MATÁV, a Hungarian telecommunications company. Our investment in diAx contributed approximately $32 in increased losses in equity income due to increased operating losses, as well as severance accruals and other one-time adjustments. Our investment in Telkom SA Limited (Telkom) had approximately $20 in lower equity income from the prior year due mainly to one-time adjustments. Additionally, our investment in ATL had equity losses of approximately $80.

Our earnings from foreign affiliates will continue to be sensitive to exchange-rate changes in the value of the respective local currencies. Our foreign investments are recorded under accounting principles generally accepted in the United States (GAAP), which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries, such as inflation adjustments.

Amortization expense of embedded goodwill on our international equity investments was approximately $134 in 2001. In addition, we estimate our international holdings had between $45 and $65 of their own goodwill amortization expense in 2001. Goodwill will no longer be amortized when our international investees adopt new U.S. accounting standards (see Note 1).

Other

Normalized Results

	2001	2000	1999	Percent Change 2001 vs. 2000	Percent Change 2000 vs. 1999
Operating Revenues	**$ 589**	$1,100	$1,138	**(46.5)%**	(3.3)%
Operating Expenses	**358**	923	981	**(61.2)**	(5.9)
Operating Income	**231**	177	157	**30.5**	12.7
Interest Expense	**883**	895	701	**(1.3)**	27.7
Other Income (Expense) – Net	**1,277**	1,323	581	**(3.5)**	—
Income Before Income Taxes	**$ 625**	$ 605	$ 37	**3.3%**	—%

Our other segment results in 2001 reflect the sales of nonstrategic assets, including our Ameritech security monitoring and cable operations.

Operating revenues decreased $511, or 46.5%, in 2001 and $38, or 3.3%, for 2000. The decrease in 2001 is primarily due to the January 2001 sale of SecurityLink. In November 2001, we sold Ameritech New Media, Ameritech's cable television operations that reported $151 in revenues during 2001. We expect 2002 revenues to decline as a result of this disposition activity. The remaining revenues in this segment are primarily the result of corporate operations.

Operating expenses decreased $565, or 61.2%, in 2001 and $58, or 5.9%, in 2000. The decreases in 2001 and 2000 relate to the sale of nonstrategic assets and their associated expenses. The 2001 decrease is primarily due to the sale of SecurityLink. Ameritech New Media, whose sale is mentioned above, reported operating expenses of approximately $160 in 2001. We expect 2002 expenses to decline as a result of these sales.

Consolidated Results

The following discussion is based on consolidated results as reported under GAAP. It does not include the impacts of the normalizing items.

Interest expense increased $7, or 0.4%, in 2001 and increased $162, or 11.3%, in 2000. The 2001 increase was primarily due to interest accrued on payables to Cingular. Prior to the fourth quarter of 2000, our other segment recorded interest expense on notes payable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular this interest expense is no longer eliminated. However, this does not have a material impact on our net income because the interest expense is mostly offset when we record our share of equity income in Cingular. In the second quarter of 2001 we completed a net debt settlement agreement with Cingular and are no longer incurring this expense (see Note 7). Also contributing to the increase was debt issued to redeem the Trust Originated Preferred Securities (TOPrS), the interest on which was reported as other income (expense) – net, and higher commercial paper borrowings. Offsetting these increases were lower composite rates and the reversal of an accrual of approximately $23 related to items resolved by the June 2001 Illinois legislation discussed in local service. The 2000 increase was primarily due to higher composite rates and increased debt levels.

Interest income increased $403 in 2001 and $152 in 2000. The increases were primarily due to the income accrued from Cingular. Prior to the fourth quarter of 2000, our other segment recorded interest income on notes receivable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular, this interest income is no longer eliminated. However, this does not have a material impact on our net income because the interest income is mostly offset when we record our share of equity income in Cingular.

Other income (expense) – net includes items that we normalized as previously described in the "Overview" section. These normalizing items totaled $623, $2,163 and $22 in 2001, 2000 and 1999. In addition to those items, results for 2001 included gains on the sale of investments of approximately $476, consisting of the sale of our investment in TransAsia Telecommunications, Smith Security, Amdocs Limited (Amdocs) shares and other investments. These gains were partially offset by a loss of approximately $61 on the sale of Ameritech New Media. Additional offsets came from dividends paid on preferred securities issued by Ameritech subsidiaries of approximately $33 and minority interest of $16. The amount of our 2001 minority interest expense significantly declined from 2000 due to the contribution of most of our wireless properties to Cingular in the fourth quarter of 2000. Included in 2001 are net gains of approximately $23 recognized for mark-to-market adjustments on shares of Amdocs, one of our equity investees, which were granted to executives as deferred compensation. An offsetting deferred compensation expense was recorded in operations and support expense. Additionally, in 2001, we recognized an expense of approximately $581 related to an endowment of Amdocs shares to the SBC Foundation and income of approximately $575 from the related mark-to-market adjustment on the Amdocs shares, for a net expense of $6. Also included in 2001 is approximately $32, which represents consideration for modifications to our agreement with SpectraSite Communications Inc. (SpectraSite).

Results for 2000 include gains of approximately $87 that were recognized for mark-to-market adjustments on shares of Amdocs used for deferred compensation. An offsetting deferred compensation expense was recorded in operations and support expense. Results for 2000 also include gains of approximately $295 on the sales of our interests in WLW, the Aurec companies in Israel and certain cost investments. Additionally, we sold our remaining Telmex L shares not related to the DECS for a gain, which was partially offset by appreciation in the market value of Telmex L shares underlying the DECS, for a net gain of approximately $117. These gains were partially offset by lower income from our wireless minority interest and dividends paid on preferred securities issued by Ameritech subsidiaries of approximately $208.

Results for 1999 include a gain from the sale of Amdocs shares of approximately $92 and gains of $63 representing dividends and mark-to-market adjustments on Amdocs shares used for contributions to the SBC Foundation and deferred compensation. Results for 1999 also include a gain of approximately $59 on the sale of our investment in Chile and a gain of $81 on the sales of certain discontinued plant and other investments. These gains were offset by increased expenses related to higher appreciation in the market value of Telmex L shares underlying the DECS than in the comparable periods of 1998, net of gains recognized from the sale of certain Telmex L shares, of approximately $296, and dividends paid on preferred securities issued by Ameritech subsidiaries, losses on forward exchange contracts and other nonoperating items of $76. In addition, higher wireless minority interest resulted in approximately $287 of expense.

Income taxes for 2001, 2000 and 1999 reflect the tax effect of the normalizing items previously described in the "Overview" section. Excluding these items, income taxes in 2001 were lower than 2000 primarily due to contributions to the SBC Foundation in the first quarter of 2001. Income taxes in 2000 were higher than 1999 primarily due to higher income before income taxes. The decrease in the effective tax rate for 2001 was primarily due to contributions to the SBC Foundation in the first quarter of 2001. With the adoption of new accounting standards (see Note 1) in 2002, nondeductible amortization expense will decline, and therefore, we expect to see a decline in our effective tax rate for 2002.

Extraordinary items in 2001 included an extraordinary loss of $18, net of taxes of $10, related to the early redemption of $1,000 of the TOPrS (see Note 9). Results in 1999 included an extraordinary gain of $1,379, net of taxes of $960, on the sale of overlapping wireless properties in October 1999 due to the Ameritech merger (see Note 3).

Cumulative effect of accounting change includes a change in the method of recognizing directory publishing revenues and related expenses at Ameritech, effective January 1, 1999 (see Note 1). The cumulative after-tax effect of applying the new method to prior years was recognized as of January 1, 1999, as a one-time, noncash gain applicable to continuing operations of $207, or $0.06 per share, net of deferred taxes of $125.

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

Overview

Despite passage of the Telecommunications Act of 1996 (Telecom Act), the U.S. telecommunications industry, including DSL and other advanced services, continues, in many respects, to operate as a heavily regulated industry. The expected transition from an industry overseen by multiple regulatory bodies to a market-driven industry monitored by state and federal agencies has been slow. Our wireline subsidiaries remain subject to regulation by state regulatory commissions for intrastate services and by the FCC for interstate services. This continuing difficult and uncertain regulatory environment combined with the recent downturn in the U.S. economy presents challenges for our business.

Expected Growth Areas

We expect the wireline segment to remain the most significant portion of our business and have also discussed trends affecting this segment (see "Wireline" under "Segment Results" above). Over the next few years we expect an increasing percentage of our business to come from two areas within the wireline segment – data/broadband and long distance – and our wireless segment.

Data/Broadband In October 1999, we announced plans to upgrade our network to make broadband services available to approximately 80% of our U.S. wireline customers over the four years through 2003 (Project Pronto). Due to the weakening U.S. economy and uncertain regulatory environment noted above, in October 2001 we announced a scale-back in our broadband deployment plans. At December 31, 2001, we had approximately 1.3 million DSL subscribers, and more than half, or 25 million, of our wireline customer locations were DSL-capable. Additionally, we have spent approximately $3.2 billion as of December 31, 2001, for fiber, electronics and other technology for Project Pronto. The build-out will include transferring certain portions of our existing copper network to a new fiber network. Over the deployment period, marketing costs will be incurred depending on the rate of customer sign-ups and installations.

Long Distance We offer landline interLATA long distance services to customers in selected areas outside our wireline subsidiaries' operating areas. Further, we offer interLATA long distance services to customers in Texas, Kansas, Oklahoma, Arkansas, Missouri and Connecticut. The FCC approved our application to provide interLATA long distance service for calls originating in Kansas and Oklahoma effective March 7, 2001, and in Arkansas and Missouri on November 16, 2001. We officially launched service under the SBC Southwestern Bell brand in those states on the effective approval dates or shortly thereafter, offering domestic residential and business long distance services as well as international calling plans. We continue to seek long distance approval in our other in-region states

and have filed applications with state commissions in California, Illinois, Michigan, Nevada and Ohio. See "State Regulation" below for the status of our state applications.

In October 2001, the FCC completed its re-examination of certain information contained in our previously approved Kansas and Oklahoma long distance applications and found that we did not intentionally provide false information. However, the FCC proposed that we pay approximately $3 for alleged collateral violations related to those applications. This FCC ruling is still pending and has no effect on our ability to continue to offer long distance service in either state.

Wireless In October 2000, Cingular began operations as the second-largest wireless provider in the U.S. (see Note 7). Cingular's top priorities for 2002 include geographic expansion, including expansion into New York City through an infrastructure-sharing agreement with VoiceStream Wireless Corporation (VoiceStream), further rollout of wireless data services, overlaying GSM voice and GPRS high-speed data technology over its existing networks and integration of operations to strengthen its competitive position and realize cost synergies. The fastest-growing area of the wireless business is data. Although data revenues are not currently a significant portion of Cingular's total revenues, Cingular plans to accelerate the development of this business. In late 2001, Cingular launched GPRS in Seattle, Las Vegas, eastern Tennessee, coastal Georgia and the Carolinas and plans to launch GPRS in California by mid-2002. In January 2002, Cingular announced the formation of a joint venture with AT&T Wireless Services Inc. (AT&T Wireless) that is expected to allow Cingular to extend its GSM/GPRS network coverage along interstate highways in the upper Midwestern and Western sections of the U.S. Cingular expects the new networks to be operational by the first quarter of 2003. Additionally, Cingular has announced it will begin upgrading its network to third-generation (3G) wireless data technology by introducing Enhanced Data Rates for Global Evolution (EDGE). EDGE technology is Cingular's choice for a 3G wireless communications standard that will allow customers to access the Internet from their wireless devices at higher speeds than in the past. This upgrade is expected to be completed by early 2004. During 2002, Cingular expects to spend approximately $4.5 billion for ongoing capital expenditures and to begin overlaying its existing network with GSM voice and GPRS/EDGE data technology.

REGULATORY ENVIRONMENT

Wireline

Federal Regulation Under the Telecom Act, before being permitted to offer landline interLATA long distance service in any state within the 12-state region encompassed by the regulated operating areas of Southwestern Bell Telephone Company (SWBell), Pacific Bell Telephone Company (PacBell), Ameritech and Nevada Bell (these areas with the addition of Southern New England Telecommunications Corp.'s (SNET) area are referred to as our 13-state area), we are required to apply for and obtain state-specific approval from the FCC. The FCC's approval, which involves consultation with the U.S. Department of Justice and the appropriate state commission, requires favorable determinations that our wireline subsidiaries have entered into interconnection agreement(s) that satisfy a 14-point "competitive checklist" or, alternatively, the subsidiaries have a statement of terms and conditions effective in that state under which they offer the "competitive checklist" items. The FCC also must make favorable public interest and structural separation determinations in connection with each application. See "State Regulation" below for the status of our state applications.

Interconnection – Collocation Under the Telecom Act, regional Bell operating companies were required to allow competitors to put equipment in their offices "necessary" for connecting to the local network. In March 1999, the FCC issued rules allowing competitors to install any equipment that is "used" or "useful" for interconnection, even if some equipment has other functions. In August 2001, the FCC issued its order in response to a March 2000 appellate court reversal and remand of the FCC's March 1999 interconnection rules. In its August 2001 order, the FCC required that incumbent local exchange companies, such as our wireline subsidiaries, allow competitors to collocate only equipment that has the primary purpose of interconnecting or accessing local lines. The order also required incumbents to allow competitors to cross-connect with other collocated carriers. In August 2001, we, along with BellSouth, filed a petition for review of this order with the United States Court of Appeals for the District of Columbia (D.C. Court of Appeals) on the grounds that the order exceeds the FCC's jurisdiction and authority. The effect of any future decision on our results of operations and financial position cannot be determined at this time; however, if the August 2001 FCC order stands as written, we do not expect it to have a material effect on our financial position or results of operations.

Interconnection – Pricing In July 2000, the Eighth Circuit Court of Appeals (8th Circuit) struck down FCC rules governing the rates incumbent local exchange carriers, such as our wireline subsidiaries, charge competitors for interconnection and for leasing portions of the incumbents' telephone networks. The decision rejected FCC pricing rules that required incumbents to charge competitors rates based

on hypothetical costs and held that prices should instead be based on actual (but not necessarily historical) costs incurred by carriers to provide interconnection or access to unbundled network elements. In addition, the decision rejected FCC rules governing the amount incumbents must discount services purchased by competitors for resale to end users, holding that the discount should be based on actual, not hypothetical, avoided costs of the incumbents. The 8th Circuit remanded the pricing issues back to the FCC. The 8th Circuit also reaffirmed its prior conclusion that incumbents cannot be required to create new combinations of unbundled network elements for competitors, nor to provide competitors better quality interconnection or access to unbundled network elements than the incumbents provide to themselves. In October 2001, the United States Supreme Court (Supreme Court) heard an appeal of certain portions of the 8th Circuit's ruling, including its invalidation of the FCC's pricing rules and its rule governing new combinations of network elements. A Supreme Court decision is expected during the first half of 2002. Until the Supreme Court issues its decision on the appeal issues, the FCC rules continue in effect. The effect of the future Supreme Court decision, which may include remand of this issue back to the FCC, on our financial position or results of operations cannot currently be determined.

Unbundled Network Elements/Line Sharing In November 1999, the FCC ordered that incumbent local exchange carriers must continue leasing certain parts of their telephone network to competitors at a discount, as well as revised rules that expand the definitions of certain unbundled network elements (UNE). However, the order limited discounted access to switches serving customers with four or more lines under certain conditions. In addition, the FCC declined to regulate mandatory leasing of high-speed Internet and data equipment. In a separate order, the FCC ordered incumbents to share telephone lines with DSL competitors (DSL line sharing order).

Several parties petitioned the FCC for reconsideration of various aspects of the UNE and DSL line sharing orders. In addition, other parties appealed the UNE and DSL line sharing orders to the D.C. Court of Appeals. Several parties also requested that the FCC require our wireline subsidiaries and other incumbents to provide and support line sharing on a UNE platform as well as make DSL a UNE product.

In December 2001, the FCC began evaluating its unbundling rules, seeking to fashion a more targeted approach to unbundling. The FCC plans to consider whether existing UNEs should be changed and whether transition plans are appropriate prior to a change in existing UNE obligations. After considering data, the FCC is expected to issue a series of decisions on unbundling obligations beginning in mid-2002. The effect of this review on our results of operations and financial position cannot be determined at this time; however, we do not expect it to be materially adverse.

National Performance Measures In November 2001, the FCC released notices of proposed rulemaking (NPRMs) regarding the creation of national performance measures and standards for evaluating incumbent local exchange carriers, such as our wireline subsidiaries, performance in the provisioning of UNEs and interstate special access services to competitive local carriers. The FCC offered for comment performance measures and standards that apply to special access services and to facilities that the competitive carriers acquire from incumbents for use in entering the local services market. The FCC has stated it will also consider the imposition of enforcement measures in the event any adopted standards are not met. The effects of these NPRMs on our results of operations and financial position cannot be determined at this time.

Advanced Services In December 2001, the FCC began examining the appropriate rules for the provision of domestic broadband services by incumbent local carriers or their affiliates. This examination was triggered in part by our petition requesting that the FCC classify our separate affiliates offering DSL and other advanced services as nondominant providers and thus relieve us from dominant-carrier regulation of these services. In its review, the FCC plans to consider broadband services offered over cable, satellite and wireless platforms in addition to traditional wireline offerings. The effect of this review on our results of operations and financial position cannot be determined at this time.

Reciprocal Compensation is billed to our wireline subsidiaries by competitors for the termination of certain local exchange traffic to competitors' customers. In February 1999, the FCC declared that Internet traffic is not local traffic, but instead is primarily interstate, subject to interstate jurisdiction. However, the FCC found that existing federal law did not address to what extent, if any, compensation should be paid to competitors that deliver Internet traffic to Internet service providers and initiated a proceeding to establish such rules. In March 2000, the D.C. Court of Appeals vacated the FCC's February 1999 holding that Internet traffic is interstate and remanded the holding to the FCC for a more reasoned explanation of that conclusion. In April 2001, the FCC issued an order and further notice of proposed rulemaking (FNPRM) addressing that remand. In its FNPRM, the FCC launched a broad examination of all forms of inter-carrier compensation as well as proposed to eliminate all reciprocal compensation when the transitional mechanism expires.

Additionally, in its April 2001 order, the FCC ruled that calls to Internet service providers are interstate access and not subject to reciprocal compensation. However, instead of immediately eliminating all compensation, the FCC established a transitional compensation mechanism for exchange of this traffic. Under this mechanism, the per-minute-of-use fee was capped at 0.15 cents during the first six months following the order and declines to 0.07 cents after two years. In addition, the FCC capped the growth of Internet minutes for which carriers may seek compensation. The FCC transition plan is optional for incumbent local exchange carriers and in order to opt into the plan, incumbents must offer to exchange local and wireless traffic at the same compensation rate as Internet traffic. To date, none of our wireline subsidiaries have opted into the transition plan.

Appeals of reciprocal compensation decisions currently are pending before the Supreme Court, the United States Court of Appeals for the Sixth Circuit (6th Circuit) and U.S.

District Courts in Texas, Indiana, Ohio, Wisconsin and California. We have fully accrued expenses for amounts sought by competitors for the termination of Internet traffic to Internet service providers.

Pricing Flexibility In March 2001, the FCC granted our request to (1) offer volume and term discounts under contract for some access services in certain markets and (2) remove special access and dedicated transport services from price cap regulation in certain additional market areas. The market areas covered by this decision include Chicago, Los Angeles and Dallas. We expect this decision to have an immaterial favorable effect on our results of operations and financial position.

Coalition for Affordable Local and Long Distance Service (CALLS) In September 2001, the United States Court of Appeals for the Fifth Circuit (5th Circuit) ruled on appeal of the FCC's May 2000 CALLS order restructuring federal price cap regulation. Although the 5th Circuit upheld the CALLS order in most key respects, it reversed and remanded to the FCC two specific aspects of the order.

- The 5th Circuit held that the FCC failed to sufficiently justify an incremental $650 in universal service funding and remanded to the FCC for further explanation of the amount; and
- held that the FCC failed to show a rational basis for how it derived the 6.5% transitional mechanism, i.e., the productivity factor used to reduce access rates until a targeted average rate is achieved, and remanded to the FCC for an explanation of how the percentage was derived.

The current universal service fund amount and transitional mechanism will remain in effect pending FCC response. The effect of any future FCC order on our results of operations and financial position cannot be determined at this time.

Ameritech Merger In association with its approval of the October 1999 Ameritech merger, the FCC set specific performance and reporting requirements and enforcement provisions that mandate approximately $2.0 billion in potential payments through June 2004 if certain goals are not met. Associated with these conditions, we incurred approximately $94 and $355 in 2001 and 2000 in additional expenses, including payments for failing to meet certain performance measurements, specifically, the "Opening Local Markets to Competition" condition. At December 31, 2001, $1.9 billion in remaining potential payments could be triggered if the "Out-of-Region Competition" and "Opening Local Markets to Competition" conditions discussed below are not met. The following briefly summarizes all the major conditions:

- **Out-of-Region Competition** In accordance with this condition, we will offer local exchange services in 30 new markets across the country. We are required by the FCC to enter these 30 markets as a provider of local services to business and residential customers by April 2002. Failure to meet the FCC condition requirement could result in a payment of up to $40 for each market. Entrance into these new markets did not have a material effect on our results of operations or financial position.

  As of December 31, 2001 we had introduced service in 22 new markets (Boston, Fort Lauderdale, Miami, New York, Seattle, Atlanta, Denver, Minneapolis, Philadelphia, Phoenix, Baltimore, Bergen-Passaic, Middlesex, Nassau, Newark, Orlando, Salt Lake City, Tampa, Washington D.C., West Palm Beach, Louisville and Charlotte), and plan to enter at least eight more by April 2002. In March of 2001, we scaled back our service offerings in these areas in response to certain economic environment and regulatory factors, while still fulfilling our FCC merger condition requirements.
- **Opening Local Markets to Competition** We are required to file performance measurement data reflecting 20 different categories with the FCC and relevant state commissions on a monthly basis. These performance measurements address functions that the FCC believes may have a particularly direct effect on our local competitors and their customers, such as our response to competitors' requests for information and interconnection.
- **Improving Residential Service** We will offer residential customers a plan with no minimum monthly long distance fees for at least three years after entering the long distance business in that state. In addition, we offer a low-income Lifeline Universal Service plan to low-income residential customers in each state in our 13-state area.
- **Promoting Advanced Services** We established separate subsidiaries to provide advanced services, such as DSL, in order that the subsidiaries be exempt from a Telecom Act provision requiring them to make the services available for resale to competitors. These subsidiaries are required to use the same processes for the ordering and provisioning of our wireline services as competitors, pay an equivalent price for facilities and services and locate at least 10% of their DSL service facilities in low-income areas. See "Data/Broadband" under "Expected Growth Areas" above for further discussion of Project Pronto.

  In January 2001, the D.C. Court of Appeals struck down the FCC merger condition that granted our separate affiliates an exemption from the Telecom Act requirement to offer retail DSL transport and other retail advanced services for resale at a discount. Although the merger condition allows us to partially integrate the affiliates into our telephone companies under such circumstances, we are continuing to maintain the advanced services affiliates as separate companies. We believe this is in the best interest of our customers although we continue to evaluate our operations and customer needs. We do not expect, at this time, that this issue will have a material effect on our results of operations or financial position.

The effects of the FCC decisions on the above topics are dependent on many factors including, but not limited to, the ultimate resolution of the pending appeals; the number and nature of competitors requesting interconnection, unbundling or resale; and the results of the state regulatory commissions' review and handling of related matters within their jurisdictions. Accordingly, we are not able to assess the total potential impact of the FCC orders and proposed rulemakings.

State Regulation The following summarizes state regulation in the 13 states in which our wireline subsidiaries operated at December 31, 2001:

State	Alternative Regulation[1]	Number of Signed Wireline Interconnection Agreements[2]	Long Distance Application Status
Arkansas	Yes	122	Long distance service provided effective November 2001
California	Yes, review pending	237	Decision expected in 2002[3]
Connecticut	Yes	65	Long distance service provided
Illinois	Yes, pending state approval	139	Decision expected in 2002[3]
Indiana	Yes, through 12/2003	131	Filing planned in 2002[4]
Kansas	Yes	123	Long distance service provided effective March 2001
Michigan	Yes	95	Decision expected in 2002[3]
Missouri	Yes	126	Long distance service provided effective December 2001
Nevada	Yes	75	Decision expected in 2002[3]
Ohio	Yes, through 1/2003	133	Decision expected in 2002[3]
Oklahoma	Yes	105	Long distance service provided effective March 2001
Texas	Yes	342	Long distance service provided
Wisconsin	Yes	96	Filing planned in 2002[4]

Notes:

[1] Alternative regulation is other than rate of return regulation.

[2] Interconnection agreements are signed with competitors for the purpose of allowing them to exchange local calls with the incumbent telephone company and, at their option, to resell services and obtain unbundled network elements.

[3] Awaiting determination by state commissions on our compliance with the 14-point competitive checklist. FCC approval is required subsequent to state determination.

[4] Will require approval by the state commission and the FCC.

The following summarizes certain regulatory developments:

Illinois Merger Settlement In December 2001, we entered into an agreement to end the cost-sharing provision of the ICC Ameritech merger order. The annual cost-sharing provision required our Illinois wireline subsidiary to track and report merger-related costs and savings and share 50% of those savings with end-users and carriers. Under terms of the agreement, which is pending ICC approval, we will provide a one-time credit to end-users and carriers of approximately $197 during 2002 in exchange for elimination of any future sharing obligations as well as the requirement to track and report merger costs and savings. The credits were fully accrued at December 31, 2001.

Illinois Legislation The Illinois legislature passed a four-year law, effective June 30, 2001, imposing new requirements on Illinois telecommunications companies, including our Illinois wireline subsidiary. The law (1) requires all local telephone companies to provide wireless phones or cash payments to customers who wait more than five days to get local service repaired or installed, (2) increases the dollar amount the ICC is authorized to levy in fines against companies that violate ICC orders, (3) requires our subsidiary to offer fixed-rate service plans that will result in savings for the average residential customer and (4) requires our subsidiary to offer advanced broadband telecommunications services to at least 80% of its Illinois customers by 2005. Additionally, the law contains numerous provisions affecting competitive access to our wireline network, most notably a requirement that we offer for resale new combinations of unbundled network elements. This issue regarding new combinations is also pending before the Supreme Court and the Supreme Court's decision will likely affect implementation of these unbundling provisions.

Most of the provisions of this legislation will require the ICC to issue specific regulations, prior to implementation, in order to integrate the new legislation with existing alternative regulation laws. This legislation may require us to incur additional expenses to restructure our telecommunications network, which may or may not improve the efficiency of the network, and to improve installation and repair service quality. We are likely to experience a decrease in revenues due to the potentially lower total revenue from average customers generated under fixed-rate service plans as well as due to new rules regarding competitors' access to our network, including the impact of any required new combinations of unbundled network elements offered for resale. The extent of any decrease will depend, among other factors, on the monthly rates that the ICC ultimately authorizes for our service plans and the resulting number of access lines lost to competitors as well as on future ICC and Supreme Court rulings regarding competitive access. As we cannot predict how the ICC will implement the provisions

of this legislation, or the effect of the pending Supreme Court case, the legislation's effect on our future results of operations and financial position is not determinable at this time; however, it is not expected to be material. We are prepared to challenge various provisions of this law depending on ICC interpretation of those provisions.

This legislation increased pre-tax income approximately $68 in 2001, consisting of revenue increases due to the legislation resolving issues pending before the ICC partially offset by refunds and implementation expenses.

Michigan Legislation In July 2000, the Michigan legislature eliminated the monthly intrastate end-user common line (EUCL) charge and implemented price caps for certain telecommunications services. In July 2000, we eliminated the EUCL charge and filed suit in federal court challenging the constitutionality of the legislation. In September 2000, temporary stays of the price cap provision and the EUCL charge elimination were issued. In July 2001, the 6th Circuit ruled that we had demonstrated a substantial likelihood of ultimately showing that the price cap and the EUCL charge elimination were unconstitutional and stayed both provisions pending completion of the litigation. We reinstated the EUCL charge in October 2000, and increased prices for our basic local services in April 2001, both of which are subject to refund if the legislation is upheld. In July 2001, both the State of Michigan and MCI WorldCom, Inc. filed petitions for re-hearing of the 6th Circuit decision. In October 2001, the 6th Circuit decided to delay its decision on the petitions for rehearing until the Supreme Court rules on the 8th Circuit appeal discussed above in "Interconnection."

The law also authorized an expansion of local calling areas so that many short toll calls could be reclassified as local calls and 2001 revenues declined approximately $5 ($27 annualized) associated with the expansion of local calling areas.

California Proceedings In September 2001, the California Public Utilities Commission (CPUC) ruled that our California wireline subsidiary must pay approximately $26 for alleged overly aggressive and deceptive marketing practices related to packages of enhanced services such as Caller ID and call forwarding. We believe these allegations are unwarranted and could hinder our ability to inform consumers about the products and services we offer. The CPUC ruling also ordered us to reduce the commission we pay our customer service employees and prescribes acceptable marketing practices; however, in October 2001, the CPUC agreed to reconsider the provision relating to incentive compensation. We believe this decision is unlawful on a number of grounds and have filed legal challenges to the decision.

CPUC rules allow for an audit of a utility's books every three years. The audit of our California wireline subsidiary began in April 2000, and a report is expected during the first quarter of 2002. The CPUC will consider the results of the audit as it conducts its triennial review of our regulatory framework during 2002 and 2003. It is uncertain at this time what effect the report or changes to our regulatory framework might have on our future results of operations and financial position.

Ohio Service Quality Audit In January 2002, the Public Utilities Commission of Ohio (PUCO) issued a supplemental order adopting many of the recommendations made by an outside consultant that audited our Ohio wireline subsidiary's service quality and marketing practices. The audit covered the period from August 1999 through May 2001. The PUCO ordered us to improve service quality compliance, provide retroactive customer credits in accordance with the original order, and pay the State of Ohio approximately $9, with additional payments possible based on assessment of our past and future service quality compliance. The PUCO also ordered us to deploy advanced services in certain areas of Ohio and provide a temporary discount on certain wholesale services provided to competing carriers. We began providing the customer credits in October 2001. We do not expect the order to have a material effect on our results of operations or financial position.

COMPETITION

Competition continues to increase for telecommunications and information services. Recent changes in legislation and regulation have increased the opportunities for alternative communications service providers. Technological advances have expanded the types and uses of services and products available. As a result, we face increasing competition as well as new opportunities in significant portions of our business. The following discusses recent regulatory events affecting wireline competition.

Wireline

Our wireline subsidiaries expect increased competitive pressure in 2002 and beyond from multiple providers in various markets, including facilities-based local competitors, interexchange carriers and resellers. Substitution of wireless and Internet for traditional local service lines also continues to increase. At this time, we are unable to assess the effect of competition on the industry as a whole, or financially on us, but we expect both losses of market share in local service and gains resulting from new business initiatives, vertical services and new long distance service areas.

State legislative and regulatory developments over the last several years allow increased competition for local exchange services. Companies wishing to provide competitive local service have filed numerous applications with each of the state commissions throughout our 13-state area, and the commission of each state has been approving these applications since late 1995. Under the Telecom Act, companies seeking to interconnect to our wireline subsidiaries' networks and exchange local calls must enter into interconnection agreements with us. These agreements are then subject to approval by the appropriate state commission. We have reached over 1,700 wireline interconnection agreements with competitive local service providers, and most have been approved by the relevant state commission. In addition, other competitors are reselling our local exchange services, and as of December 31, 2001, we had approximately 1.2 million access lines (approximately 2.0% of our total access lines) supporting services of resale competitors throughout our 13-state area, primarily in Texas, California and Illinois.

The CPUC authorized facilities-based local services competition in California effective January 1996 and resale competition effective March 1996. In November 1998, the CPUC issued a decision authorizing our subsidiary to recover local competition implementation costs, and we recovered approximately $44 via a customer surcharge during 2001 and expect to recover approximately $44 in 2002.

The ICC approved Advantage Illinois in 1994, providing a framework for regulating our Illinois wireline subsidiary by capping prices for noncompetitive services. In this order, the ICC approved a price cap on the monthly line charge for residential customers and residential calling rates within local calling areas for an initial five-year period that ended in October 1999. In January 2000 the ICC initiated a review of Advantage Illinois with respect to its effectiveness and whether any modifications are necessary. We expect the ICC to complete this review in mid-2002. The price cap on residential rates will remain in effect until the review is completed.

The Indiana Court of Appeals reversed a portion of the 1997 Indiana Utility Regulatory Commission (IURC) order in October 1999, which had directed Ameritech to reduce rates for basic residential and business services and remanded the rate issue to the IURC. In March 2001, we and the IURC settled the outstanding issues under the 1997 order, including tightened service standards, thus extending alternative regulation in Indiana through December 2003. This agreement is not expected to have a material effect on our results of operations or financial position.

In Connecticut, the Connecticut Department of Public Utility Control (CDPUC) approved a five-year alternative regulation plan for SNET in 1996. In May 2001, the CDPUC issued a decision extending our alternative regulation plan indefinitely and the monitoring period until 2004. In its decision, the CDPUC rejected our request for authority to adjust local residential service rates annually based on the rate of inflation. Additionally, in March 2001, the CDPUC granted our request to close our Connecticut cable television business and we did so in June 2001.

Wireless

Cingular, our wireless joint venture with BellSouth, began operations in October 2000. Cingular serves approximately 21.6 million customers, is the second-largest wireless provider in the U.S., and has approximately 219 million potential customers in 41 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

Cingular targets further geographic expansion through possible spectrum exchanges and auctions. During 2001, Cingular agreed to share infrastructure with VoiceStream. VoiceStream is sharing infrastructure in New York City, St. Louis and Detroit, and Cingular is sharing infrastructure in Los Angeles and San Francisco. Additionally, in January 2002, Cingular announced the formation of a joint venture with AT&T Wireless. See "Wireless" under "Expected Growth Areas" above for further discussion.

Cingular also invested in Salmon PCS (Salmon), a participant in a December 2000/January 2001 FCC auction of wireless spectrum licenses, including licenses held by wireless companies that had previously filed for bankruptcy protection before completing payment. Salmon was the highest bidder on 79 licenses; 45 of those licenses were awarded to Salmon and 34 licenses remain subject to legal and regulatory challenges and possible legislative inquiry. It is unclear how a resolution of these proceedings will affect Cingular. To date, Cingular has provided Salmon equity of approximately $192 and secured loans of approximately $475, including interest. If all the licenses are awarded, it is estimated Cingular would be required to provide Salmon approximately $1.7 billion.

Cingular faces substantial competition in all aspects of its business as competition continues to increase in the wireless communications industry. Cingular competes for customers based principally on service offerings, price, call quality, coverage area and customer service. Cingular's competitors are principally large providers of cellular, PCS and other wireless communications services, but Cingular also competes with smaller companies, as well as dispatch mobile telephone companies, resellers and wireline service providers. Moreover, Cingular may experience significant competition from companies that provide similar services using other communications technologies and services. While some of these technologies and services are now operational, others are being developed or may be developed in the future. See discussion of EDGE technology in "Wireless" under "Expected Growth Areas" above.

Directory

Our directory subsidiaries face competition from over 100 publishers of printed directories in their operating areas. Direct and indirect competition also exists from other advertising media, including newspapers, radio, television and direct mail providers, as well as from directories offered over the Internet.

ACCOUNTING POLICIES AND STANDARDS

Significant Policies Because of the size of the financial statement elements they relate to, some of our accounting policies and estimates have a more significant impact on our financial statements than others:

- How we depreciate assets, including use of composite group depreciation and estimates of useful lives, are described in Notes 1 and 6. We assign useful lives based on periodic studies of actual asset lives. Changes in those lives with significant impact on the financial statements must be disclosed, but no such changes have occurred in the three years ended December 31, 2001.
- Our recording of revenue is described in Note 1, and the associated estimate of bad debts is based on analysis of history and future expectations. As discussed in Results of Operations, the impacts of companies that went out of business and customers with a higher credit risk due to the adverse U.S. economy were reflected in our results through a significant increase in both bad debt expense and allowance for uncollectible accounts in 2001.
- Our actuarial estimates of retiree benefit expense and the associated significant weighted-average assumptions are discussed in Note 11. The most significant of these is the return on assets assumption of 9.5% on nearly $40 billion of pension and other

post-retirement assets (for the year 2001). This assumption reflects our current view of long-term returns. The increase from 8.5% in 2000 reflects our actual long-term results exceeding previous assumptions; our assumption for 2002 is unchanged. For each of the three years ended 2001, our actual 10-year return on investments exceeded 10%, including the effect of the negative returns in 2001. Note 11 also discusses the effects of certain changes in assumptions related to medical trend rates to retiree health care costs. We did not reduce our medical trend rate as originally anticipated in response to actual claim results during 2001.

- Our estimates of income taxes and the significant items giving rise to the deferred assets and liabilities are shown in Note 10. These reflect our assessment of actual future taxes to be paid on items reflected in the financial statements, giving consideration to both timing and probability of these estimates. Actual income taxes could vary from these estimates due to future changes in income tax law or on results from final Internal Revenue Service review of our tax returns.
- Our use of estimates to accrue probable liabilities is noted in Note 1, and significant individual accruals are discussed within the affected area. Included in these items are those that are normalized as described in Note 5 and in the "Overview" section of our Results of Operations discussion.
- Our policy on valuation of intangible assets is described in Note 1. In addition, for cost investments, we evaluate whether mark-to-market declines are temporary and reflected in other comprehensive income, or other-than-temporary and recorded as an expense in the income statement; this evaluation is based on the length of time and the severity of decline in the investment's value. Significant asset and investment valuation adjustments we have made are discussed in Notes 2, 3 and 5.

New Accounting Standards On January 1, 2002, we were required to adopt Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. FAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. Adoption of FAS 142 means that we will stop amortizing goodwill. At least annually, we will test the remaining book value for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairments will be recorded in operating expenses.

For the fourth quarter of 2001, we reviewed the carrying values and lives of our intangible assets, including approximately $3,200 of goodwill, using the criteria of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (FAS 121), which was the current accounting rule for impairment of goodwill. Our review indicated that the estimated future undiscounted cash flows were sufficient to recover the related carrying values, so no impairment was recorded.

Under FAS 142, we will also stop amortizing goodwill recorded on our equity investments. However, we will continue to test this embedded goodwill for impairment under accounting rules for equity investments, which are based on comparisons between fair value and carrying value. In addition, we will adjust the equity in net income of affiliates line item to reflect the impact of adopting these new accounting standards on the operations of our equity investments.

Cingular has determined that the FCC wireless licenses they own have an indefinite useful life because cash flows are expected to continue, and historical practice has shown that Cingular has been able to renew the licenses at each expiration period. Under FAS 142, Cingular will not amortize these wireless licenses until Cingular determines that the licenses have a finite life. Cingular is currently performing the required impairment tests under FAS 142. Cingular held approximately $7,190 of wireless licenses as of December 31, 2001, and has determined that no impairment exists under FAS 121 as of that date.

Our existing and embedded goodwill amortization and our share of Cingular's license amortization was approximately $380 net of tax, or $0.11 per share in 2001. Amortization for these items will not occur in 2002, thus increasing our net income in 2002. Our international holdings are still reviewing the impact of FAS 141 and 142 on their own operations and these reviews will also impact us. Our current estimate of the impact on us of our international holdings ceasing amortization of goodwill is between $45 and $65 net of tax. This amount will also increase our net income in 2002.

During 2002, we will perform the first step of the required FAS 142 impairment tests as of January 1, 2002. This first step requires us to compare the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is one of our operating segments or a discrete component of that segment. If the current fair value is less than the carrying value, then we will perform the second step of the impairment test. This second step requires us to measure the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment.

We have determined that the fair value of our investment in Sterling is less than the carrying value, and are performing the second step of the impairment test. Although we have not yet completed the impairment testing, we expect the impairment to be between $1,500 and $1,900, before taxes. We plan to complete the impairment tests on our direct investments in the first quarter of 2002. We do not expect that all of our international holdings will have completed their own impairment tests by that time. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce our net income in 2002.

On January 1, 2001, we adopted Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," which requires all derivatives to be recorded on the balance sheet at fair value. Our adoption did not have a significant effect on our financial position or results of operations.

LIQUIDITY AND CAPITAL RESOURCES

We had $703 in cash and cash equivalents available at December 31, 2001. Commercial paper borrowings as of December 31, 2001 totaled $6,039. We have lines of credit with several banks totaling $3,700, all of which may be used to support commercial paper borrowings. We had no borrowings outstanding under these lines of credit as of December 31, 2001.

Cash from Operating Activities

During 2001, 2000 and 1999, our primary source of funds continued to be cash generated from operations, as shown in the consolidated statements of cash flows. Net cash provided by operating activities exceeded our construction and capital expenditures during 2001, 2000 and 1999; this excess is referred to as free cash flow, a supplemental measure of liquidity. We generated free cash flow of $3,616, $942 and $6,370 in 2001, 2000 and 1999.

During 2001, we received $495 in cash in addition to SpectraSite stock in exchange for leasing 2,665 communication towers to SpectraSite. In November 2001, we amended our agreement. We agreed to reduce the maximum number of towers to be leased from 3,900 to 3,600, and to extend the schedule for closing on towers until the first quarter of 2004. As consideration for those modifications, we received $35.

In the first quarter of 2001, we received approximately $783 related to the sale of our investment in diAx to TDC. Approximately $565 was recorded as a dividend, due to the nature of our investment in TDC, and was included in undistributed earnings from investments in equity affiliates.

Cash from Investing Activities

To provide high-quality communications services to our customers we must make significant investments in property, plant and equipment. The amount of capital investment is influenced by demand for services and products, continued growth and regulatory commitments.

Our capital expenditures totaled $11,189, $13,124 and $10,304 for 2001, 2000 and 1999. Capital expenditures in the wireline segment, which represented the majority of our total capital expenditures, decreased by 8.5% in 2001 compared to 2000, primarily due to the slowdown of the deployment of our national broadband network. The wireline segment capital expenditures increased by 37.8% in 2000 compared to 1999, primarily attributed to the expansion of our local exchange service into new markets, DSL, digital and broadband network upgrades and regulatory commitments.

In 2002, management expects total capital spending to be between $9,200 and $9,700. We expect these expenditures to relate primarily to our wireline subsidiaries' networks, our broadband initiative, DSL, and support systems for our long distance service.

We received $1,371 from Cingular in 2001 for payment on notes receivable. In 2001, our cash receipts from dispositions exceeded cash expended on acquisitions. In 2000 and 1999, cash expended on acquisitions exceeded receipts from dispositions (see Note 3).

Cash from Financing Activities

Dividends declared by the Board of Directors of SBC were $1.025 per share in 2001, $1.015 per share in 2000 and $0.975 per share in 1999. These per share amounts do not include dividends declared and paid by Ameritech prior to its 1999 merger. The total dividends paid by SBC and Ameritech were $3,448 in 2001, $3,443 in 2000 and $3,312 in 1999. SBC's dividend policy considers both the expectations and requirements of shareowners, internal requirements of SBC and long-term growth opportunities.

In November 2001, our Board of Directors authorized the repurchase of up to 100 million shares of SBC common stock. This is in addition to the January 2000 authorization to repurchase 100 million shares. In 2001, we spent $2,068 on these stock repurchases. As of January 31, 2002, we have repurchased a total of approximately 99 million shares of the 200 million that are authorized. We have also entered into a series of put options on SBC stock with institutional counterparties. We have a maximum potential obligation to purchase 9,000,000 shares of our common stock at a weighted average exercise price of $37.45 per share (see Note 14).

In February 2002, we issued approximately $1,000 of 10-year, 5.875%, global notes. We also issued $2,000 of five-year, 5.75%, global notes and $1,250 of 10-year, 6.25%, global notes in April and March, of 2001. In addition to these global notes, we issued two, variable interest rate, one-year notes, each for $500 in March 2001; $500 of 7.00% notes due 2041; and privately sold $1,000 of 20-year annual Puttable Reset Securities (PURS) in June 2001. For additional information on these debt issuances see Note 8.

During the third quarter of 2001, we redeemed approximately $665 of multiple bonds with maturities up to 40 years and interest rates ranging from 4.4% to 6.9%. We also redeemed approximately $615 of multiple bonds with maturities up to 40 years and interest rates ranging from 5.8% to 8.5% during the second quarter of 2001. In March 2001, we paid the principal amount of each of the DECS, as adjusted by the exchange rate specified in the DECS, in the form of cash that was received from the settlement of our note receivable with characteristics similar to the DECS. For additional information on these debt redemptions see Note 8.

During 2001, we redeemed prior to maturity the $1,000 of the TOPrS. The TOPrS had an original maturity of 30 years and were included on the balance sheet as corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts (see Note 9).

In May 2000, we issued $1,000 in notes through private placement. These notes matured in May 2001. In April 2000, we issued notes for $1,015 that also matured in May 2001.

In December 1999, we called approximately $31 of debt issued by our capital financing subsidiaries that was scheduled to mature in December 2004. The net income effect of retiring this debt did not materially impact our financial statements. During 1999, subsequent to the completion of the acquisitions of Comcast and CCPR, we retired $1,415 of Comcast's and CCPR's long-term debt with no effect on net income. In May 1999, we issued $750 of unsecured 6.25% Eurodollar notes, due May 2009, through our capital financing subsidiaries.

We expect to fund ongoing capital expenditures, the repurchase of stock and merger initiative expenses with cash provided by operations and incremental borrowings.

Other

Our total capital consists of debt (long-term debt and debt maturing within one year), TOPrS (in 2000), and shareowners' equity. Our capital structure does not include debt issued by our International equity investees or Cingular. Total capital increased $1,232 in 2001 and $8,850 in 2000. The 2001 increase was less than the 2000 increase because of lower net income, the redemption of the TOPrS and the repurchase of common shares through our stock repurchase programs. Our debt ratio was 44.6%, 45.2% and 42.9% at December 31, 2001, 2000 and 1999. The debt ratio is affected by the same factors that affect total capital.

Current accounting standards require us to disclose our material obligations and commitments to make future payments under contracts, such as debt and lease agreements, and under contingent commitments, such as debt guarantees. We occasionally enter into third-party debt guarantees, but they are not material. We disclose our contractual long-term debt repayment obligations in Note 8 and our operating lease payments in Note 6. In the ordinary course of business we routinely enter into commercial commitments for various aspects of our operations, such as plant additions and office supplies. However, we do not believe that the commitments will have a material effect on our financial condition, results of operations or cash flows.

MARKET RISK

We are exposed to market risks primarily from changes in interest rates and foreign currency exchange rates. In managing exposure to these fluctuations, we may engage in various hedging transactions that have been authorized according to documented policies and procedures. We do not use derivatives for trading purposes, to generate income or to engage in speculative activity. Our capital costs are directly linked to financial and business risks. We seek to manage the potential negative effects from market volatility and market risk. The majority of our financial instruments are medium- and long-term fixed rate notes and debentures. Fluctuations in market interest rates can lead to significant fluctuations in the fair value of these notes and debentures. It is our policy to manage our debt structure and foreign exchange exposure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. Where appropriate, we will take actions to limit the negative effect of interest and foreign exchange rates, liquidity and counterparty risks on shareowner value.

QUANTITATIVE INFORMATION ABOUT MARKET RISK

Interest Rate Sensitivity The principal amounts by expected maturity, average interest rate and fair value of our liabilities that are exposed to interest rate risk are described in Notes 8 and 9. Following are our interest rate derivatives subject to interest rate risk as of December 31, 2001. The interest rates illustrated in the interest rate swaps section of the table below refer to the average expected rates we would receive and the average expected rates we would pay based on the contracts. The notional amount is the principal amount of the debt subject to the interest rate swap contracts. The fair value represents the amount we would receive if we exited the contracts as of December 31, 2001.

	Maturity							
	2002	2003	2004	2005	2006	After 2006	Total	Fair Value 12/31/01
Interest Rate Derivatives								
Interest Rate Swaps:								
Receive Fixed/Pay Variable Notional Amount	—	—	—	—	$500	$75	$575	$ 5
Variable Rate Payable[1]	2.7%	4.8%	6.2%	6.7%	6.8%	6.2%		
Weighted Average Fixed Rate Receivable	5.7%	5.7%	5.7%	5.7%	5.7%	5.4%		
Receive Variable/Pay Fixed Notional Amount	$ 5	—	—	—	—	—	$ 5	—
Fixed Rate Payable	8.2%	—	—	—	—	—		
Weighted Average Variable Rate Receivable[2]	2.6%	—	—	—	—	—		
Lease Obligations								
Variable Rate Leases[3]	—	—	$81	—	—	—	$ 81	$81
Average Interest Rate[3]	3.8%	5.5%	6.1%	—	—	—		

[1]Interest payable based on Three Month London Interbank Offer Rate (LIBOR) plus or minus a spread.
[2]Interest receivable based on Three Month Commercial Paper Index published by Federal Reserve.
[3]Average interest rate as of December 31, 2001 based on current and implied forward rates for One Month LIBOR plus 30 basis points. The lease obligations require interest payments only until maturity.

The fair value of our interest rate swap contracts was $4 at December 31, 2000. In 2001, we entered into $500 in variable interest rate swap contracts. Of the $995 in variable rate contracts held at December 31, 2000, $920 were canceled during 2001 with no premium or penalty. We also held $25 in fixed interest rate swap contracts at December 31, 2000, of which $20 matured in 2001. In January 2002, we entered into $500 in variable interest rate swap contracts.

QUALITATIVE INFORMATION ABOUT MARKET RISK

Foreign Exchange Risk From time to time we make investments in businesses in foreign countries, are paid dividends, receive proceeds from sales or borrow funds in foreign currency. Before making an investment, or in anticipation of a foreign currency receipt, we often will enter into forward foreign exchange contracts. The contracts are used to provide currency at a fixed rate. Our policy is to measure the risk of adverse currency fluctuations by calculating the potential dollar losses resulting from changes in exchange rates that have a reasonable probability of occurring. We cover the exposure that results from changes that exceed acceptable amounts. We do not speculate in foreign exchange markets.

Interest Rate Risk We issue debt in fixed and floating rate instruments. Interest rate swaps are used for the purpose of controlling interest expense by managing the mix of fixed and floating rate debt. We do not seek to make a profit from changes in interest rates. We manage interest rate sensitivity by measuring potential increases in interest expense that would result from a probable change in interest rates. When the potential increase in interest expense exceeds an acceptable amount, we reduce risk through the issuance of fixed rate (in lieu of variable rate) instruments and purchasing derivatives.

CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties. We claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause our future results to differ materially from those expressed in the forward-looking statements:

- Adverse economic changes in the markets served by SBC or in countries in which SBC has significant investments.
- Changes in available technology and the effects of such changes including product substitutions and deployment costs.
- The final outcome of FCC proceedings, including rulemakings, and judicial review, if any, of such proceedings, including issues relating to jurisdiction.
- The final outcome of state regulatory proceedings in SBC's 13-state area, and judicial review, if any, of such proceedings, including proceedings relating to interconnection terms, access charges, universal service, unbundled network elements and resale rates, SBC's broadband initiative known as Project Pronto, service standards and reciprocal compensation.
- Enactment of additional state, federal and/or foreign regulatory laws and regulations pertaining to our subsidiaries and foreign investments.
- The timing of entry and the extent of competition in the local and intraLATA toll markets in SBC's 13-state area and our entry into the in-region long distance market.
- The impact of the Ameritech transaction, including performance with respect to regulatory requirements, and merger integration efforts.
- The timing, extent and cost of deployment of Project Pronto, its effect on the carrying value of the existing wireline network and the level of consumer demand for offered services.
- The impact of the wireless joint venture with BellSouth, known as Cingular, including marketing and product-development efforts, access to additional spectrum, technological advancements and financial capacity.

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially impact our future earnings.

CONSOLIDATED STATEMENTS OF INCOME

Dollars in millions except per share amounts

	2001	2000	1999
Operating Revenues			
Landline local service	**$22,754**	$22,029	$19,432
Wireless subscriber	**155**	4,945	5,851
Network access	**10,459**	10,422	10,094
Long distance service	**3,008**	3,133	3,447
Directory advertising	**4,518**	4,439	4,266
Other	**5,014**	6,406	6,441
Total operating revenues	**45,908**	51,374	49,531
Operating Expenses			
Operations and support	**25,943**	30,883	29,380
Depreciation and amortization	**9,077**	9,748	8,553
Total operating expenses	**35,020**	40,631	37,933
Operating Income	**10,888**	10,743	11,598
Other Income (Expense)			
Interest expense	**(1,599)**	(1,592)	(1,430)
Interest income	**682**	279	127
Equity in net income of affiliates	**1,595**	897	912
Other income (expense) – net	**(209)**	2,561	(354)
Total other income (expense)	**469**	2,145	(745)
Income Before Income Taxes	**11,357**	12,888	10,853
Income taxes	**4,097**	4,921	4,280
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**7,260**	7,967	6,573
Extraordinary items, net of tax	**(18)**	—	1,379
Cumulative effect of accounting change, net of tax	**—**	—	207
Net Income	**$ 7,242**	$ 7,967	$ 8,159
Earnings Per Common Share:			
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**$ 2.16**	$ 2.35	$ 1.93
Net Income	**$ 2.15**	$ 2.35	$ 2.39
Earnings Per Common Share-Assuming Dilution:			
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	**$ 2.14**	$ 2.32	$ 1.90
Net Income	**$ 2.13**	$ 2.32	$ 2.36

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

	December 31,	
	2001	2000
Assets		
Current Assets		
Cash and cash equivalents	$ 703	$ 643
Accounts receivable – net of allowances for uncollectibles of $1,254 and $1,016	9,376	10,144
Prepaid expenses	932	550
Deferred income taxes	713	671
Other current assets	856	1,640
Total current assets	12,580	13,648
Property, Plant and Equipment – Net	49,827	47,195
Goodwill – Net of Accumulated Amortization of $461 and $227	3,577	3,719
Investments in Equity Affiliates	11,967	12,378
Notes Receivable From Cingular Wireless	5,924	9,568
Other Assets	12,447	12,143
Total Assets	$96,322	$98,651
Liabilities and Shareowners' Equity		
Current Liabilities		
Debt maturing within one year	$9,033	$10,470
Accounts payable and accrued liabilities	11,459	15,432
Accrued taxes	2,598	3,592
Dividends payable	858	863
Total current liabilities	23,948	30,357
Long-Term Debt	17,133	15,492
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	8,578	6,806
Postemployment benefit obligation	9,839	9,767
Unamortized investment tax credits	274	318
Other noncurrent liabilities	4,059	4,448
Total deferred credits and other noncurrent liabilities	22,750	21,339
Corporation-Obligated Mandatorily Redeemable Preferred Securities Of Subsidiary Trusts#	—	1,000
Shareowners' Equity		
Preferred shares ($1 par value, 10,000,000 authorized: none issued)	—	—
Common shares ($1 par value, 7,000,000,000 authorized: issued 3,433,124,836 at December 31, 2001 and 2000)	3,433	3,433
Capital in excess of par value	11,992	12,125
Retained earnings	22,138	18,341
Guaranteed obligations of employee stock ownership plans (ESOP)	—	(21)
Deferred compensation – leveraged ESOP (LESOP)	—	(37)
Treasury shares (78,908,896 at December 31, 2001 and 46,416,071 at December 31, 2000, at cost)	(3,482)	(2,071)
Accumulated other comprehensive income	(1,590)	(1,307)
Total shareowners' equity	32,491	30,463
Total Liabilities and Shareowners' Equity	$96,322	$98,651

#The trusts contain assets of $1,030 in principal amount of the Subordinated Debentures of Pacific Telesis Group.

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents

	2001	2000	1999
Operating Activities			
Net income	**$ 7,242**	$ 7,967	$ 8,159
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	**9,077**	9,748	8,553
Undistributed earnings from investments in equity affiliates	**(755)**	(521)	(471)
Provision for uncollectible accounts	**1,384**	885	1,136
Amortization of investment tax credits	**(44)**	(71)	(85)
Deferred income tax expense	**2,117**	1,164	1,061
Gain on sales of investments	**(498)**	(2,902)	(335)
Extraordinary items, net of tax	**18**	—	(1,379)
Cumulative effect of accounting change, net of tax	—	—	(207)
Changes in operating assets and liabilities:			
Accounts receivable	**(672)**	(1,892)	(731)
Other current assets	**(61)**	(446)	335
Accounts payable and accrued liabilities	**(2,364)**	1,405	2,054
Other – net	**(639)**	(1,271)	(1,416)
Total adjustments	**7,563**	6,099	8,515
Net Cash Provided by Operating Activities	**14,805**	14,066	16,674
Investing Activities			
Construction and capital expenditures	**(11,189)**	(13,124)	(10,304)
Investments in affiliates	**1,482**	139	(45)
Purchase of short-term investments	—	(539)	(26)
Proceeds from short-term investments	**510**	—	31
Dispositions	**1,254**	4,476	4,867
Acquisitions	**(445)**	(5,121)	(5,198)
Other	**1**	(1)	2
Net Cash Used in Investing Activities	**(8,387)**	(14,170)	(10,673)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	**(1,424)**	5,169	(787)
Issuance of long-term debt	**5,723**	1,087	738
Repayment of long-term debt	**(4,025)**	(1,128)	(2,301)
Early extinguishment of debt and related call premiums	—	—	(31)
Early extinguishment of corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts	**(1,000)**	—	—
Issuance of common shares	—	—	313
Purchase of treasury shares	**(2,068)**	(2,255)	(1,169)
Issuance of treasury shares	**323**	732	318
Redemption of preferred shares of subsidiaries	**(470)**	—	—
Issuance of preferred shares of subsidiaries	—	—	103
Dividends paid	**(3,456)**	(3,418)	(3,287)
Other	**39**	65	(2)
Net Cash Provided by (Used in) Financing Activities	**(6,358)**	252	(6,105)
Net increase (decrease) in cash and cash equivalents	**60**	148	(104)
Cash and cash equivalents beginning of year	**643**	495	599
Cash and Cash Equivalents End of Year	**$ 703**	$ 643	$ 495

The accompanying notes are an integral part of the consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY

Dollars and shares in millions except per share amounts

	2001		2000		1999	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	3,433	$ 3,433	3,433	$ 3,433	3,434	$ 3,434
Purchase of shares	—	—	—	—	(8)	(8)
Issuance of shares	—	—	—	—	7	7
Balance at end of year	3,433	$ 3,433	3,433	$ 3,433	3,433	$ 3,433
Capital in Excess of Par Value						
Balance at beginning of year		$12,125		$12,453		$12,439
Purchase of shares		—		—		(398)
Issuance of shares		(281)		(678)		215
Other		148		350		197
Balance at end of year		$11,992		$12,125		$12,453
Retained Earnings						
Balance at beginning of year		$18,341		$13,798		$ 8,948
Net income ($2.15, $2.35 and $2.39 per share)		7,242		7,967		8,159
Dividends to shareowners ($1.025, $1.015 and $0.975 per share)		(3,448)		(3,443)		(3,312)
Other		3		19		3
Balance at end of year		$22,138		$18,341		$13,798
Guaranteed Obligations of ESOP						
Balance at beginning of year		$ (21)		$ (106)		$ (261)
Reduction of debt associated with ESOP		21		85		155
Balance at end of year		$ —		$ (21)		$ (106)
Deferred Compensation – LESOP						
Balance at beginning of year		$ (37)		$ (73)		$ (82)
Cost of LESOP trust shares allocated to employees		37		36		9
Balance at end of year		$ —		$ (37)		$ (73)
Treasury Shares						
Balance at beginning of year	(46)	$ (2,071)	(38)	$ (1,717)	(28)	$ (882)
Purchase of shares	(47)	(2,068)	(49)	(2,255)	(23)	(1,169)
Issuance of shares	14	657	41	1,901	13	334
Balance at end of year	(79)	$ (3,482)	(46)	$ (2,071)	(38)	$ (1,717)
Accumulated Other Comprehensive Income, net of tax						
Balance at beginning of year		$ (1,307)		$ (1,062)		$ (822)
Foreign currency translation adjustment, net of taxes of $(172), $(234) and $290		(320)		(435)		(336)
Reclassification adjustment to net income for cumulative translation adjustment on securities sold		—		329		—
Unrealized gains (losses) on available-for-sale securities, net of taxes of $(35), $(22) and $61		(65)		(40)		113
Less reclassification adjustment for net (gains) losses included in net income		5		(99)		(17)
Less reclassification adjustment for loss included in deferred revenue		97		—		—
Other comprehensive income (loss)		(283)		(245)		(240)
Balance at end of year		$ (1,590)		$ (1,307)		$ (1,062)
Total Comprehensive Income						
Net income		$ 7,242		$ 7,967		$ 8,159
Other comprehensive income (loss) per above		(283)		(245)		(240)
Total Comprehensive Income		$ 6,959		$ 7,722		$ 7,919

The accompanying notes are an integral part of the consolidated financial statements.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – Throughout this document, SBC Communications Inc. is referred to as "we" or "SBC". The consolidated financial statements include the accounts of SBC and its majority-owned subsidiaries. The statements reflect the merger of one of our subsidiaries with Ameritech Corporation (Ameritech) as a pooling of interests (see Note 2). Our subsidiaries and affiliates operate in the communications services industry both domestically and worldwide providing wireline and wireless telecommunications services and equipment as well as directory advertising and publishing services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships, joint ventures, including Cingular Wireless (Cingular) and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. Earnings from certain foreign investments accounted for using the equity method are included for periods ended within up to three months of our year end (see Note 7).

The preparation of financial statements in conformity with accounting principles generally accepted in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimations of probable losses and expenses. Actual results could differ from those estimates. Certain amounts in prior-period financial statements have been reclassified to conform to the current year's presentation.

Income Taxes – Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Investment tax credits earned prior to their repeal by the Tax Reform Act of 1986 are amortized as reductions in income tax expense over the lives of the assets which gave rise to the credits.

Cash Equivalents – Cash and cash equivalents include all highly liquid investments with original maturities of three months or less, and the carrying amounts approximate fair value.

Deferred Charges – Directory advertising costs are deferred until the directory is published and advertising revenues related to these costs are recognized.

Revenue Recognition – In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" (SAB 101), which we adopted effective January 1, 2000. SAB 101 addresses, among other items, when revenue relating to nonrefundable, upfront fees should be recognized. Upon adoption, we performed a detailed analysis of our activation fees and recorded deferred revenues and associated expenses accordingly. These deferred amounts will be recognized over the average customer life of five years. Expenses, though exceeding revenue, were only deferred to the extent of revenue. Accordingly, these adjustments had no significant effect on operating or net income.

Certain revenues derived from local telephone and wireless services are billed monthly in advance and are recognized the following month when services are provided. Revenues derived from other telecommunications services, principally network access, long distance and wireless airtime usage, are recognized monthly as services are provided.

Cumulative Effect of Accounting Change – Ameritech, prior to January 1, 1999, recognized revenues and expenses related to publishing directories using the "amortization" method, under which revenues and expenses were recognized over the lives of the directories, generally one year. Effective January 1, 1999, for Ameritech, the accounting was changed to the "issue basis" method of accounting, which recognizes the revenues and expenses at the time the related directory is published. The change in methodology was made because the issue basis method is generally followed in the publishing industry, including by our other directory subsidiaries, and better reflects the operating activity of the business.

The cumulative after-tax effect of applying the changes in method to prior years was recognized as of January 1, 1999, as a one-time, noncash gain of $207, or $0.06 per share, net of deferred taxes of $125. Had the current method been applied during prior periods, income before extraordinary items and cumulative effect of accounting change would not have been materially affected.

Property, Plant and Equipment – Property, plant and equipment is stated at cost. The cost of additions and substantial improvements to property, plant and equipment is capitalized. The cost of maintenance and repairs of property, plant and equipment is charged to operating expenses. Property, plant and equipment is depreciated using straight-line methods over their estimated economic lives. Most of our plant is depreciated using composite group depreciation methodology; accordingly, when a portion of our depreciable property, plant and equipment is retired in the ordinary course of business, the gross book value is reclassified to accumulated depreciation; no gain or loss is recognized on the disposition of this plant.

Software Costs – It is our policy to capitalize certain costs incurred in connection with developing or obtaining internal use software. Capitalized software costs are included in Property, Plant and Equipment and are amortized over three years.

Intangible Assets – Intangible assets consist primarily of goodwill and customer lists. These assets are amortized using the straight-line method over periods generally ranging from three to forty years. Management periodically reviews the carrying value and lives of all intangible assets based on expected future cash flows.

On January 1, 2002, we were required to adopt Statement of Financial Accounting Standards No. 141, "Business Combinations" (FAS 141) and Statement No. 142, "Goodwill and Other Intangible Assets" (FAS 142). FAS 141 requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001. Use of the pooling-of-interests method is prohibited. FAS 141 also provides new criteria to determine whether an acquired intangible asset should be recognized separately from goodwill. Adoption of FAS 142 means that we will stop amortizing goodwill. At least annually, we will test the remaining book

value for impairment using a new two-step test, which is described below. After initial adoption of the statements, any future impairments will be recorded in operating expenses.

For the fourth quarter of 2001, we reviewed the carrying values and lives of our intangible assets, including approximately $3,200 of goodwill, using the criteria of Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of" (FAS 121), which was the current accounting rule for impairment of goodwill. Our review indicated that the estimated future undiscounted cash flows were sufficient to recover the related carrying values, so no impairment was recorded.

Under FAS 142, we will also stop amortizing goodwill recorded on our equity investments. However, we will continue to test this embedded goodwill for impairment under accounting rules for equity investments, which are based on comparisons between fair value and carrying value. In addition, we will adjust the equity in net income of affiliates line item to reflect the impact of adopting these new accounting standards on the operations of our equity investments.

Cingular has determined that the FCC wireless licenses they own have an indefinite useful life because cash flows are expected to continue, and historical practice has shown that Cingular has been able to renew the licenses at each expiration period. Under FAS 142, Cingular will not amortize these wireless licenses until Cingular determines that the licenses have a finite life. Cingular is currently performing the required impairment tests under FAS 142. Cingular held approximately $7,190 of wireless licenses as of December 31, 2001, and has also determined that no impairment exists under FAS 121 as of that date.

Our existing and embedded goodwill amortization and our share of Cingular's license amortization was approximately $380 net of tax, or $0.11 per share in 2001. Amortization for these items will not occur in 2002, thus increasing our net income in 2002. Our international holdings are still reviewing the impact of FAS 141 and 142 on their own operations and these reviews will also impact us. Our current estimate of the impact on us of our international holdings ceasing amortization of goodwill is between $45 and $65 net of tax. This amount also will increase our net income in 2002.

During 2002, we will perform the first step of the required FAS 142 impairment tests as of January 1, 2002. This first step requires us to compare the carrying value of any reporting unit that has goodwill to the estimated fair value of the reporting unit. A reporting unit is one of our operating segments or a discrete component of that segment. If the current fair value is less than the carrying value, then we will perform the second step of the impairment test. This second step requires us to measure the excess of the recorded goodwill over the current value of the goodwill, and to record any excess as an impairment.

We have determined that the fair value of our investment in Sterling is less than the carrying value, and are performing the second step of the impairment test. Although we have not yet completed the impairment testing, we expect the impairment to be between $1,500 and $1,900, before taxes. We plan to complete the impairment tests on our direct investments in the first quarter of 2002. We do not expect that all of our international holdings will have completed their own impairment tests by that time. Any impairment resulting from the initial application of the statements will be recorded as a cumulative effect of accounting change as of January 1, 2002, and will reduce our net income in 2002.

Advertising Costs – Costs for advertising products and services or corporate image are expensed as incurred.

Foreign Currency Translation – Our foreign investees generally report their earnings in their own local currencies. We translate our share of their foreign assets and liabilities at exchange rates in effect at the balance sheet dates. The resulting foreign currency translation adjustments are recorded as a separate component of accumulated other comprehensive income in the accompanying consolidated balance sheets (other components of other comprehensive income are immaterial). Our share of their revenues and expenses are translated using average rates for the year. Other transaction gains and losses resulting from exchange rate changes on transactions denominated in a currency other than the local currency are included in earnings as incurred.

Derivative Financial Instruments – Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133), requires all derivatives to be recorded on the balance sheet at fair value, and requires changes in the fair value of the derivatives to be recorded in net income or other comprehensive income. We adopted FAS 133 on January 1, 2001, as a one-time, noncash cumulative effect of accounting change. However, because of our minimal use of derivatives, the adoption of this standard did not have a significant effect on our financial position or results of operations.

We do not invest in derivatives for trading purposes. From time to time, as part of our risk-management strategy, we use derivative financial instruments, including interest rate swaps, to hedge exposures to interest rate risk on debt obligations, and foreign currency forward-exchange contracts to hedge exposures to changes in foreign currency rates for transactions related to foreign investments. Derivative contracts are entered into for hedging of firm commitments only. Interest rate swap settlements are recognized as adjustments to interest expense in the consolidated statements of income when paid or received. Foreign currency forward-exchange contracts are set up to coincide with firm commitments. Gains and losses are deferred until the underlying transaction being hedged occurs and then are recognized as part of that transaction (see Note 9).

NOTE 2. COMPLETION OF MERGERS

In October 1999, SBC and Ameritech completed the merger of an SBC subsidiary with Ameritech in a transaction in which each share of Ameritech common stock was exchanged for 1.316 shares of SBC common stock (equivalent to approximately 1,446 million shares). Ameritech became a wholly owned subsidiary effective with the merger, and the transaction has been accounted for as a pooling of interests and a tax-free reorganization. Financial statements for prior periods have been restated to include the accounts of Ameritech. Transaction costs related to the

merger were $77 ($48 net of tax). Of this total, $25 ($16 net of tax) was included in expenses in 1999.

Post-Merger Initiatives

Upon completion of the merger, we reviewed operations throughout the merged company. Based on these merger integration reviews, we made certain strategic decisions, integrated certain operations and consolidated some administrative and support functions resulting in one-time charges. The following table summarizes the charges recorded in 1999 for the merger-related reviews and decisions:

One-time charges	Pre-tax	After-tax
Reorganization	$ 582	$ 379
Impairments/asset valuation	690	472
Wireless conversion	220	143
Regulatory and legal	164	102
Merger approval	31	19
Other items and estimates of other obligations	79	342
Total one-time charges	$1,766	$1,457

One-time charges incurred in the third and fourth quarter of 1999 totaled $1,766 ($1,457 net of tax). These charges included various regulatory and legal issues, merger approval and other related costs of $274 ($174 net of tax). In addition, these charges included costs related to strategic decisions reached by the review teams of $1,492 ($1,283 net of tax) in 1999. At December 31, 2001 and 2000, anticipated remaining cash expenditures related to the accruals for the Ameritech merger decisions totaled $14 and $147. Remaining accruals for anticipated cash expenditures for decisions related to the 1998 pooling of interests with Southern New England Telecommunications Corp. (SNET) and decisions related to the 1997 pooling of interests with Pacific Telesis Group (PAC) were $0 at December 31, 2001 and approximately $11 at December 31, 2000.

Reorganization – We centralized several key functions that will support the wireline operations including network planning, strategic marketing and procurement. We also consolidated a number of corporatewide support activities, including research and development, information technology, financial transaction processing and real estate management. These initiatives resulted in the creation of some jobs and the elimination and realignment of others, with many of the affected employees changing job responsibilities and in some cases assuming positions in other locations.

We recognized net charges of approximately $582 ($379 net of tax) during the fourth quarter of 1999 in connection with these initiatives. The charges were comprised mainly of postemployment benefits, primarily related to severance, and costs associated with closing duplicate operations, primarily contract cancellations. Other charges, arising out of the mergers related to relocation, retraining and other effects of consolidating certain operations, are being recognized in the periods those charges are incurred. The fourth-quarter 1999 charge is net of $45 ($29 net of tax) of reversals of accruals made in connection with the SNET and PAC mergers that were related to plans now superseded by the subsequent reorganization plan.

Impairments/Asset Valuation – As a result of our merger integration plans and strategic review of domestic operations and organizational alignments, we reviewed the carrying values of the long-lived assets in the third and fourth quarter of 1999. These reviews included estimating remaining useful lives and cash flows and identifying assets to be abandoned. Where this review indicated impairment, fair market values, including, in some cases, discounted cash flows as an estimate of fair value related to those assets, were analyzed to determine the amount of the impairment. As a result of these reviews, we wrote off certain assets and recognized impairments to the value of other assets with a combined charge of $690 ($472 net of tax) in the third and fourth quarter of 1999.

The 1999 adjustments include an impairment of $300 ($224 net of tax) related to SecurityLink. This impairment adjustment, taken as a reduction in goodwill of $300, reflected a reduction of the investment to fair market value based upon the value of comparable businesses. In connection with this adjustment, we shortened the estimated life of the remaining goodwill on the security business from 40 to 15 years. In January 2001, we sold SecurityLink. In connection with the sale, we took an additional charge of $614 ($454 net of tax) in 2000 (see Note 3).

Also in 1999, we performed a review of the allowance for doubtful accounts at the Ameritech subsidiaries and recognized a charge of $212 ($135 net of tax). This charge resulted from adjusting Ameritech's estimation methods to the method we use. Other 1999 adjustments consisted primarily of valuation adjustments on certain analog switching equipment at Ameritech and certain cost investments.

Wireless Conversion – In December 1999, Ameritech notified its wireless customers that the current wireless network platform (Code Division Multiple Access or CDMA) would be converted to our network platform (Time Division Multiple Access or TDMA). As part of the conversion, we sold the CDMA network assets and leased them back over the conversion period. A charge of $220 ($143 net of tax) was recognized in the fourth quarter of 1999 to recognize the loss on the sale and leaseback, and to replace the customers' CDMA handsets.

Other Items and Estimates of Other Obligations – We performed reviews of Ameritech's accounting operations and applied consistent accounting techniques between the merging companies. As a result, we recognized charges in 1999 related to the impact of several regulatory and legal rulings of $164 ($102 net of tax). Also in 1999, we incurred a charge of $31 ($19 net of tax) for Ameritech merger approval costs. In 1999 charges for deferred taxes on Ameritech's international investments of $289, net charges related to the routine deferral of certain costs and revenues by Ameritech of $62 ($40 net of tax), and other miscellaneous items of $17 ($13 net of tax) were recognized.

NOTE 3. ACQUISITIONS, DISPOSITIONS, AND VALUATION AND OTHER ADJUSTMENTS

Acquisitions – In November 2001, we acquired the shares of Prodigy Communications Corporation (Prodigy) that we did not already own through a cash tender offer followed by a merger of a subsidiary into Prodigy. We paid approximately

$470 and assumed debt of $105. This transaction resulted in approximately $589 in goodwill, which was not amortized in 2001. The majority of the shares we bought in the cash tender offer were from persons or entities affiliated with Teléfonos de México, S.A. de C.V. (Telmex), of which we own approximately 8.1%. In the fourth quarter of 2000, in connection with a change to our agreements with Prodigy, we recognized a charge of approximately $143 ($89 net of tax). Approximately $110 of the charge was recorded in equity in net income of affiliates reflecting previously unrecognized equity losses from our investment in Prodigy.

In August 2000, we acquired wireless properties in Washington and Texas from GTE Corporation for approximately $1,349. These properties were included in the contribution to Cingular (see Note 7).

In March 2000, we acquired Sterling, a provider of electronic business integration solutions, in an all-cash tender offer valued at approximately $3,576. The assets acquired include certain intangible assets such as developed technology, trade name, assembled work force, customer relationships and goodwill, which were assigned amortization lives of between 3 and 20 years. We expensed the acquired in-process research and development of approximately $132 in March 2000. In accordance with FAS 142, we have determined that the fair value of our investment in Sterling is less than the carrying value at January 1, 2002. Although we have not yet completed the impairment testing, we expect the impairment to goodwill to be between $1,500 and $1,900, which we will record as a cumulative effect of accounting change in the first quarter of 2002.

In July 1999, we acquired wireless properties in Pennsylvania, Delaware, New Jersey and Illinois from Comcast Corporation for approximately $677 in cash and $1,400 in assumed debt. These properties were included in the contribution to Cingular (see Note 7).

In June 1999, we acquired 20% of Bell Canada, a subsidiary of BCE Inc., a publicly traded Canadian communications company, for approximately $3,447.

These acquisitions were accounted for under the purchase method of accounting. The purchase prices in excess of the underlying fair value of identifiable net assets acquired were assigned amortization lives not to exceed 40 years. However, beginning in 2002, this goodwill amount will not be amortized and goodwill will be tested annually for impairment (see Note 1). Results of operations of the properties acquired have been included in the consolidated financial statements from their respective dates of acquisition.

Dispositions – In November 2001, we sold the assets of Ameritech New Media, a cable television operation, for approximately $205, resulting in a pre-tax loss of $61. In the first quarter of 2001, in anticipation of the disposal of these cable operations and in accordance with Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of," we evaluated these operations for impairment. We estimated that the future undiscounted cash flows of these operations were insufficient to recover their related carrying values. The impairment was measured by comparing the book value to fair value of the assets as indicated by prevailing market prices. The resulting adjustment of approximately $316 ($205 net of tax) to reduce the book value of these assets, primarily writing down property, plant and equipment, was recorded in the first quarter of 2001 as a charge to operating expenses.

In January 2001, we sold SecurityLink, our electronic security services operations, for approximately $479. As a result of the pending sale, as well as a general decline in the market value of companies in the security industry, we reviewed the carrying value of our investment in SecurityLink at December 31, 2000. This review included estimating remaining useful lives and cash flows. As this review indicated impairment, fair market values, including in some cases discounted cash flows as an estimate of fair value related to those assets, were analyzed to determine the amount of the impairment. Those fair market values also were compared to market values of comparable publicly traded companies. As a result of this review, we recognized impairments to the carrying value of SecurityLink of approximately $614 ($454 net of tax) in the fourth quarter of 2000. Approximately $430 of that charge was a write-off of goodwill.

Due to our wireless property contribution to Cingular in October 2000, we were required to sell our overlapping properties, which included selected wireless properties in Louisiana and Indiana. This resulted in a pre-tax gain of $357 (see Note 7).

In August 2000, we sold our interest and TDC A/S (TDC) (formerly known as TeleDanmark A/S), an equity investee, also sold its interest in Netcom GSM, a wireless telecommunications provider in Norway, which resulted in a direct and indirect pre-tax gain of approximately $546. In August 2000, we also sold our interest in MATÁV, a Hungarian telecommunications company, to Deutsche Telekom, our partner in the investment, for approximately $2,199, resulting in a pre-tax gain of approximately $1,153.

In October 1999, we completed the required disposition, as a condition of the merger with Ameritech, of 20 Midwestern cellular properties consisting of the competing cellular licenses in several markets, including, but not limited to, Chicago, Illinois, and St. Louis, Missouri. We recognized an extraordinary gain from these sales of approximately $1,379, or $0.40 per share.

Valuation Adjustments – In January 2002, we purchased from América Móvil S.A. de C.V. (América Móvil) its approximately 50% of Cellular Communications of Puerto Rico (CCPR) for cash and a note redeemable for our investment in Telecom Américas Ltd. (Telecom Américas). This represents a forward sale of our interest in Telecom Américas. In connection with this transaction, we reviewed the values at which we would carry CCPR and our interest in Telecom Américas and recognized a charge of $390 ($262 net of tax) for the reduction of our direct and indirect book values to the value indicated by the transaction. The charges were recorded in both other income (expense) – net ($341) and equity in net income of affiliates ($49).

We have cost investments in Williams Communications Group Inc. (Williams) and alternative providers of digital subscriber line (DSL) services accounted for under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" (FAS 115). We periodically review the investments to determine whether an investment's decline in value is other than

temporary. If so, the cost basis of the investment is written down to fair value, which is the new cost basis.

In the third quarter of 2001, we recognized an other than temporary decline of $162 ($97 net of tax) in the value of shares we received as payment of future rents on land and wireless towers and related equipment. We have determined that the other than temporary decline in the value of these marketable securities should reduce the overstatement of deferred revenue for these payments that were recorded when the marketable securities were originally received. Future rent revenues will also be reduced.

In the second quarter of 2001, we concluded that the continued depressed market values for certain of our investments, as well as difficulties experienced by many similar companies, indicated the decline in value of our investments was other than temporary. As a result of these reviews, we recognized a combined charge of $401 ($261 net of tax) in the second quarter of 2001 in other income (expense) – net primarily related to our investment in Williams.

In the fourth quarter of 2000, we concluded that the precipitous decline of the market values of the alternative providers of DSL, as well as difficulties experienced by many companies in that industry, indicated the decline in value of our investments was other than temporary. As a result of these reviews, we recognized a combined charge of $214 ($134 net of tax) in the fourth quarter of 2000 in other income (expense) – net.

Comprehensive Review of Operations – During the fourth quarter of 2001, we performed a comprehensive review of operations that resulted in decisions to reduce our work force, terminate certain real estate leases and shut down certain operations. The charges related to those decisions, which we recorded as expense in 2001 are as follows:

- ***Work force reduction charges*** Our review of staffing needs led to decisions to reduce our number of management and nonmanagement employees. We recorded a charge of approximately $377 ($244 net of tax), related to severance costs under our existing plans and an enhanced retirement benefit for certain nonmanagement employees (see Note 11).
- ***Lease termination charges*** As part of a review of real estate needs for our adjusted work force, all company-leased facilities were evaluated for probability of future usefulness. For each lease having no substantive future use or benefit to us, an accrual was made which represented either the buyout provisions of the lease, a negotiated lease termination or future required payments under the lease, net of anticipated sublease rentals. We recorded a charge of approximately $138 ($90 net of tax) in relation to these leases.
- ***Asset impairments and other charges*** A review of certain nonstrategic operations indicated the need, in some cases, for either impairment or shutdown. We recorded asset impairment and shutdown costs and other charges of approximately $104 ($91 net of tax) for operations including exiting operations at InQuent Technologies Inc., the parent company of Webhosting.com.

NOTE 4. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for income before extraordinary items and cumulative effect of accounting change for the years ended December 31, 2001, 2000 and 1999 are shown in the table below:

Year Ended December 31,	2001	2000	1999
Numerators			
Numerator for basic earnings per share:			
Income before extraordinary items and cumulative effect of accounting change	**$7,260**	$7,967	$6,573
Dilutive potential common shares:			
Other stock-based compensation	**6**	6	4
Numerator for diluted earnings per share	**$7,266**	$7,973	$6,577
Denominators			
Denominator for basic earnings per share:			
Weighted average number of common shares outstanding (000,000)	**3,366**	3,392	3,409
Dilutive potential common shares (000,000):			
Stock options	**21**	33	42
Other stock-based compensation	**9**	8	7
Denominator for diluted earnings per share	**3,396**	3,433	3,458
Basic earnings per share			
Income before extraordinary items and cumulative effect of accounting change	**$ 2.16**	$ 2.35	$ 1.93
Extraordinary items	**(0.01)**	—	0.40
Cumulative effect of accounting change	**—**	—	0.06
Net income	**$ 2.15**	$ 2.35	$ 2.39
Diluted earnings per share			
Income before extraordinary items and cumulative effect of accounting change	**$ 2.14**	$ 2.32	$ 1.90
Extraordinary items	**(0.01)**	—	0.40
Cumulative effect of accounting change	**—**	—	0.06
Net income	**$ 2.13**	$ 2.32	$ 2.36

NOTE 5. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. We evaluate performance based on income before income taxes adjusted for normalizing (e.g., one-time) items that we describe below. For internal management reporting purposes, we exclude (i.e., normalize) these items from our results and analyze them separately. We have five reportable

segments that reflect the current management of our business: (1) wireline; (2) wireless; (3) directory; (4) international; and (5) other.

In the second quarter of 2001, we moved the results of the SBC Services unit from the other segment to the wireline segment because the SBC Services unit now primarily supports the wireline segment. We have restated all prior period information for this change, and this had no effect on our consolidated results.

The wireline segment provides landline telecommunications services, including local, network access, long distance services, messaging, Internet services, and sells customer premise and private business exchange equipment.

Prior to the fourth quarter of 2000, the wireless segment included our consolidated businesses that provided wireless telecommunications services and sold wireless equipment. In October 2000, we contributed substantially all of our wireless businesses to Cingular and began reporting results from Cingular's operations as equity in net income of affiliates in the Consolidated Financial Statements. However, for internal management reporting purposes, we analyze Cingular's results using proportional consolidation and therefore will discuss Cingular's results on that basis for segment reporting.

The directory segment includes all directory operations, including Yellow and White Pages advertising and electronic publishing. All investments with primarily international operations are included in the international segment. The other segment includes all corporate operations and Ameritech's paging, cable television and SecurityLink operations. SecurityLink was sold in January 2001, and we sold Ameritech New Media, Ameritech's cable television operations, in November 2001.

Normalized results for 2001 exclude the following items:

- Pension settlement gains of $1,097 ($688 net of tax) related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.
- Combined charges of $401 ($261 net of tax) primarily related to valuation adjustments of Williams as well as certain other cost investments accounted for under FAS 115. The charges resulted from an evaluation that the decline was other than temporary.
- Reduction of a valuation allowance of $120 ($78 net of tax) on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.
- Combined charges of $316 ($205 net of tax) related to impairment of our cable operations.
- A charge of $390 ($262 net of tax) indicated by a transaction pending as of December 31, 2001 to reduce the direct and indirect book value of our investment in Telecom Américas.
- A charge of $197 (with no tax effect) for costs related to TDC's decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.
- A charge of $197 ($128 net of tax) representing a proposed settlement agreement with the Illinois Commerce Commission (ICC) related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.
- Combined charges of $619 ($425 net of tax) associated with our comprehensive review of operations in the fourth quarter of 2001, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

Normalized results for 2000 exclude the following items:

- Gains of $1,886 ($1,248 net of tax) related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates, and from the contribution of our investment in ATL – Algar Telecom Leste S.A. (ATL), a Brazilian telecommunications company, to Telecom Américas.
- Gains of $238 ($155 net of tax) on the sale of Telmex L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the Debt Exchangeable for Common Stock (DECS).
- Pension settlement gains of $512 ($328 net of tax) associated with pension litigation, first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program net of enhanced pension and postretirement benefits associated with that program (see Note 12).
- Costs of $1,205 ($800 net of tax) associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.
- A charge of $132 (with no tax effect) related to in-process research and development from the March 2000 acquisition of Sterling (see Note 3).
- Combined charges of $971 ($677 net of tax) related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115, and the restructure of agreements with Prodigy, including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment (see Note 3).
- Gains of $357 ($99 net of tax) primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

Normalized results for 1999 exclude the following items:

- Charges totaling $1,766 ($1,457 net of tax) including recognition of impairment of long-lived assets, adjustments to the estimate of allowance for doubtful accounts, estimation of deferred taxes on international investments, wireless conversion costs and other items (see Note 2).
- Elimination of income of $197 ($119 net of tax) from the incremental impacts of overlapping wireless properties sold in October 1999 relating to the Ameritech merger.
- Pension settlement gains of $566 ($368 net of tax) associated with lump sum pension payments that exceeded the projected service and interest costs.
- Gains of $131 ($77 net of tax) recognized from the sale of property by an international equity affiliate.
- A reduction of $44 ($27 net of tax) related to a portion of a first-quarter 1998 charge to cover the cost of consolidating security monitoring centers and company-owned wireless retail stores.

In the tables below, the Wireline, Wireless, Directory, International and Other columns represent the results of each such operating segment. The Elim. column reflects intercompany transactions that are eliminated upon consolidation and the elimination of 60% of our intercompany transactions with Cingular. The Cingular de-consolidation column removes the proportionally consolidated results of Cingular (reflected in the wireless segment) and includes these results in the equity in net income of affiliates line item.

Segment results, including a reconciliation to SBC consolidated results, for 2001, 2000 and 1999 are as follows:

At December 31, 2001 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular De-consolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$40,657	$ 8,647	$4,382	$ 152	$ 535	$ (72)	$54,301	$ (8,393)	$ —	$45,908
Intersegment revenues	30	—	86	33	54	(203)	—	—	—	—
Total operating revenues	40,687	8,647	4,468	185	589	(275)	54,301	(8,393)	—	45,908
Operations and support expenses	24,041	5,957	1,898	238	151	(275)	32,010	(5,714)	(353)	25,943
Depreciation and amortization expenses	8,381	1,232	36	3	207	—	9,859	(1,170)	388	9,077
Total operating expenses	32,422	7,189	1,934	241	358	(275)	41,869	(6,884)	35	35,020
Operating income	8,265	1,458	2,534	(56)	231	—	12,432	(1,509)	(35)	10,888
Interest expense	1,205	538	—	49	883	(917)	1,758	(159)	—	1,599
Interest income	29	25	4	(15)	1,248	(917)	374	308	—	682
Equity in net income of affiliates	—	(11)	—	800	14	—	803	1,038	(246)	1,595
Other income (expense) – net	2	8	5	384	15	—	414	(1)	(622)	(209)
Income before income taxes	7,091	942	2,543	1,064	625	—	12,265	(5)	(903)	11,357
Segment assets	70,879	14,231	2,764	9,454	57,257	(44,748)	N/A	(13,515)	N/A	96,322
Investment in equity method investees	120	1,314	21	8,196	3,441	—	N/A	(1,125)	N/A	11,967
Expenditures for additions to long-lived assets	11,032	40	24	—	93	—	N/A	—	N/A	11,189

At December 31, 2000 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular De-consolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$39,707	$ 7,941	$4,251	$ 320	$ 1,014	$ (22)	$53,211	$ (1,814)	$ (23)	$51,374
Intersegment revenues	184	1	89	8	86	(368)	—	—	—	—
Total operating revenues	39,891	7,942	4,340	328	1,100	(390)	53,211	(1,814)	(23)	51,374
Operations and support expenses	23,472	5,348	2,008	458	571	(390)	31,467	(1,339)	755	30,883
Depreciation and amortization expenses	7,867	1,083	32	17	352	—	9,351	(253)	650	9,748
Total operating expenses	31,339	6,431	2,040	475	923	(390)	40,818	(1,592)	1,405	40,631
Operating income	8,552	1,511	2,300	(147)	177	—	12,393	(222)	(1,428)	10,743
Interest expense	1,298	424	4	174	895	(1,157)	1,638	(46)	—	1,592
Interest income	37	1	55	17	1,234	(1,157)	187	92	—	279
Equity in net income of affiliates	(12)	12	—	862	(1)	—	861	72	(36)	897
Other income (expense) – net	47	(121)	10	372	90	—	398	14	2,149	2,561
Income before income taxes	7,326	979	2,361	930	605	—	12,201	2	685	12,888
Segment assets	65,948	14,478	2,808	12,282	57,567	(42,230)	N/A	(12,202)	N/A	98,651
Investment in equity method investees	(5)	232	20	9,394	2,777	—	N/A	(40)	N/A	12,378
Expenditures for additions to long-lived assets	12,093	856	35	—	140	—	N/A	—	N/A	13,124

At December 31, 1999 or for the year ended	Wireline	Wireless	Directory	International	Other	Elim.	Normalized Results	Cingular Deconsolidation	Normalizing Adjustments	As Reported
Revenues from external customers	$37,050	$ 6,624	$4,045	$ 242	$ 1,041	$ —	$49,002	$ —	$529	$49,531
Intersegment revenues	322	1	81	13	97	(514)	—	—	—	—
Total operating revenues	37,372	6,625	4,126	255	1,138	(514)	49,002	—	529	49,531
Operations and support expenses	21,422	4,464	2,081	249	639	(514)	28,341	—	1,039	29,380
Depreciation and amortization expenses	6,828	918	33	17	342	—	8,138	—	415	8,553
Total operating expenses	28,250	5,382	2,114	266	981	(514)	36,479	—	1,454	37,933
Operating income	9,122	1,243	2,012	(11)	157	—	12,523	—	(925)	11,598
Interest expense	1,188	226	9	235	701	(941)	1,418	—	12	1,430
Interest income	55	24	6	23	960	(941)	127	—	—	127
Equity in net income of affiliates	(2)	42	—	739	2	—	781	—	131	912
Other income (expense) – net	61	(200)	2	186	(381)	—	(332)	—	(22)	(354)
Income before income taxes	8,048	883	2,011	702	37	—	11,681	—	(828)	10,853
Segment assets	53,763	11,559	2,422	12,613	44,699	(41,841)	N/A	—	N/A	83,215
Investment in equity method investees	31	216	48	10,372	(19)	—	N/A	—	N/A	10,648
Expenditures for additions to long-lived assets	8,781	988	52	1	482	—	N/A	—	N/A	10,304

Geographic Information

Our investments outside of the United States are primarily accounted for under the equity method of accounting, and accordingly, we do not include in our operating revenues and expenses, the revenues and expenses of our individual investees. Therefore, less than 1% of total operating revenues for all years presented are from outside the United States.

Long-lived assets consist primarily of net property, plant and equipment; net goodwill; and the book value of our equity investments, and are shown in the table below:

December 31,	2001	2000
United States	**$57,174**	$53,885
Canada	**3,429**	3,593
Denmark	**1,959**	3,024
Belgium	**876**	861
Mexico	**725**	738
France	**478**	406
South Africa	**415**	596
Other foreign countries	**314**	189
Total	**$65,370**	$63,292

NOTE 6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized as follows at December 31:

	Lives (years)	2001	2000
Land	—	**$ 601**	$ 592
Buildings	35-45	**10,645**	9,864
Central office equipment	3-10	**52,164**	47,094
Cable, wiring and conduit	10-50	**49,008**	47,143
Other equipment	5-15	**10,277**	10,529
Software	3	**2,044**	1,438
Under construction	—	**2,785**	3,093
		127,524	119,753
Accumulated depreciation and amortization		**77,697**	72,558
Property, plant and equipment – net		**$ 49,827**	$47,195

Our depreciation expense was $8,596, $8,480 and $8,175 for 2001, 2000 and 1999.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases for 2001, 2000 and 1999 were $799, $755 and $707. At December 31, 2001, the future minimum rental payments under noncancelable operating leases for the years 2002 through 2006 were $361, $306, $301, $215 and $161 with $574 due thereafter. Capital leases are not significant.

NOTE 7. EQUITY INVESTMENTS

Investments in equity affiliates are accounted for under the equity method of accounting. Our equity investments include Cingular and various international investments.

The following table is a reconciliation of our investments in equity affiliates:

	2001	2000	1999
Beginning of year	**$12,378**	$10,648	$7,412
Additional investments	**184**	783	3,702
Cingular contributions	**506**	2,688	—
Equity in net income	**1,595**	897	912
Dividends received	**(840)**	(376)	(445)
Currency translation adjustments	**(528)**	(849)	(707)
Dispositions and other adjustments	**(1,328)**	(1,413)	(226)
End of year	**$11,967**	$12,378	$10,648

The currency translation adjustment for 2001 primarily reflects the effect of exchange rate fluctuations on our investments in Bell Canada, Telkom S.A. Limited (Telkom), Telmex and América Móvil. Dispositions and other adjustments for 2001 reflect the return of capital in Cingular and the combination of diAx A.G. (diAx) with TDC.

The currency translation adjustment for 2000 primarily reflects the effect of exchange rate fluctuations on our investments in TDC, Telmex, Telkom and Bell Canada. Dispositions and other adjustments for 2000 reflect the sale of Telmex L shares, the sale of our investment in MATÁV and the contribution of ATL to Telecom Américas.

The currency translation adjustment for 1999 primarily reflects the effect of exchange rate fluctuations on our investments in TDC and Belgacom S.A. (Belgacom). Dispositions and other adjustments for 1999 reflect the sale of portions of Telmex L shares and the sale of our investment in Chile.

Undistributed earnings from equity affiliates were $2,858 and $2,140 at December 31, 2001 and 2000, including $1,109 and $80 from Cingular.

Wireless

We account for our 60% economic interest in Cingular under the equity method of accounting because we share control equally with our 40% partner. Cingular serves approximately 21.6 million customers, is the second-largest wireless operator in the United States and has approximately 219 million potential customers in 41 states, the District of Columbia, Puerto Rico and the United States Virgin Islands.

The following table presents summarized financial information for Cingular at December 31, or for the period then ended:

	2001 (12 months)	2000 (3 months)
Income Statement		
Operating revenues	**$14,108**	$ 3,060
Operating income	**2,551**	381
Net income	**1,692**	127
Balance Sheet		
Current assets	**$ 2,820**	$ 2,343
Noncurrent assets	**19,706**	15,575
Current liabilities	**3,261**	3,467
Noncurrent liabilities	**13,235**	12,000

Prior to the fourth quarter of 2000, our wireline operations recorded network access revenue from interconnection agreements with our wireless properties. This revenue was eliminated in the consolidation process. For operations contributed to Cingular, this network access revenue is no longer eliminated, but does not have a material impact on our net income since the revenue is mostly offset when we record our share of equity income from Cingular. The incremental amount of network access revenue from Cingular, which was previously eliminated, was approximately $120 during 2001 and $37 for the fourth quarter of 2000.

Prior to the fourth quarter of 2000, our other segment recorded interest income on notes receivable with our wireless properties that was eliminated in the consolidation process. For operations contributed to Cingular, this interest income is no longer eliminated. However, this does not have a material impact on our net income because the interest income is mostly offset when we record our share of equity income in Cingular. The interest income from Cingular was approximately $555 in 2001 and $154 for the fourth quarter of 2000.

In the second quarter of 2001, we netted approximately $2,500 of payables to Cingular with our notes receivable from Cingular. In addition, based on our revised expectations of when Cingular will repay the amount owed, we reclassified the notes receivable from Cingular from current to noncurrent assets. At December 31, 2001, we had notes receivable from Cingular of $5,924 bearing interest at the rate of 7.5%.

In October 2001, Cingular announced it plans to begin upgrading its network to EDGE (Enhanced Data Rates for Global Evolution) third-generation wireless data technology. Cingular targets completion of the upgrade for early 2004 and approximates capital expenditures of 18 to 19 dollars per potential customer in the affected Cingular coverage area. We expect funding for this upgrade to be provided by Cingular.

International

Our investments in equity affiliates include a 20% interest in Bell Canada, the largest supplier of telecommunications services in Canada; an 8.1% interest in Telmex, Mexico's national telecommunications company; an 8.0% interest in América Móvil, a wireless provider in Mexico and Latin America that was spun off from Telmex in 2001; and a 41.6% interest in TDC, the national communications provider in Denmark.

In January 2001, TDC increased its investment in Sunrise, a Swiss landline and Internet operator; purchased a 70% stake in diAx, a Swiss mobile and landline operator; and consolidated its Swiss operations by subsequently merging diAx with Sunrise. As part of this transaction, TDC obtained our 40% interest in diAx, and we received 1,200 million Swiss francs (approximately $783) in cash and notes. Due to the nature of our investment in TDC, we accounted for the consideration received as a dividend from an equity investee.

Other international equity investments that we hold include a 17.5% interest in Belgacom, the national communications provider in Belgium; an 18% interest in Telkom, the state-owned telecommunications company of South Africa; and a 15% interest in Cegetel S.A., a joint venture providing a broad range of telecommunications offerings in France. TDC also holds a 16.5% interest in Belgacom.

The following table presents summarized financial information of our significant international investments accounted for using the equity method, taking into account all adjustments necessary to conform to GAAP but excluding our purchase adjustments, including goodwill, at December 31 or for the year then ended:

	2001	2000	1999
Income Statements			
Operating revenues	**$44,662**	$40,190	$32,776
Operating income	**11,598**	11,911	8,941
Net income	**5,838**	5,714	4,892
Balance Sheets			
Current assets	**$12,491**	$17,092	
Noncurrent assets	**47,395**	37,052	
Current liabilities	**17,495**	16,490	
Noncurrent liabilities	**25,539**	25,318	

At December 31, 2001, we had goodwill, net of accumulated amortization, of approximately $4,747 related to our international investments in equity affiliates. Equity in net income of affiliates in future periods will reflect our adoption of FAS 142 (see Note 1).

Based on the December 31, 2001, quoted market price, the aggregate market value of our investment in TDC was approximately $3,168. The fair value of our investment in Telmex, based on the equivalent value of Telmex L shares at December 31, 2001, was approximately $1,856. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2001, was approximately $1,032. Our weighted average share of operating revenues shown above was 17% in 2001 and 2000 and 19% in 1999.

NOTE 8. DEBT

Long-term debt of SBC and its subsidiaries, including interest rates and maturities, is summarized as follows at December 31:

		2001	2000
Notes and debentures			
1.84% – 5.98%	2001 – 2007[1]	**$ 5,800**	$ 2,831
6.03% – 7.85%	2001 – 2048[2]	**14,006**	14,584
8.85% – 10.50%	2001 – 2016	**240**	556
		20,046	17,971
Unamortized discount – net of premium		**(170)**	51
Total notes and debentures		**19,876**	18,022
Capitalized leases		**248**	84
Total long-term debt, including current maturities		**20,124**	18,106
Current maturities of long-term debt		**(2,991)**	(2,614)
Total long-term debt		**$17,133**	$15,492

[1]Includes $250 of 5.95% debentures maturing in 2038 with a put option by holder in 2005.
[2]Includes $125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006.

At December 31, 2001, the aggregate principal amounts of long-term debt and weighted average interest rate scheduled for repayment for the years 2002 through 2006 were $2,991 (4.1%), $1,330 (6.0%), $832 (6.6%), $1,112 (6.8%) and $2,840 (5.9%) with $11,189 (6.8%) due thereafter. As of December 31, 2001, we were in compliance with all covenants and conditions of instruments governing our debt. Substantially all of our outstanding long-term debt is unsecured.

Financing Activities

During 2001, approximately $3,334 in long-term notes matured. In addition to these maturities, we redeemed notes totaling approximately $1,320 and issued approximately $5,750 of new notes whose proceeds were used primarily to pay down short-term borrowings and for general corporate purposes.

In March 2001, we paid the principal amount of each of the DECS, as adjusted by the exchange rate specified in the DECS, in the form of cash, which we received from settlement of our note receivable with characteristics similar to the DECS.

In March 2001, we issued two, one-year notes for approximately $500 each, which carry variable interest rates. Each note's interest is calculated based on the London Interbank Offer Rate (LIBOR), one recalculating monthly at the LIBOR less 1 basis point and the other recalculating quarterly at the LIBOR less 2.5 basis points.

In March 2001, we also issued approximately $1,250 of 10-year, 6.25%, global notes and in April 2001, we issued approximately $2,000 of five-year, 5.75%, global notes. The March and April 2001 global notes are redeemable at any time, in whole or in part, and under certain circumstances, at a premium.

In June 2001, we issued approximately $500 of 7.00% notes due 2041. We may redeem the notes, in whole or in part, at any time on or after June 13, 2006.

In June 2001, we also privately sold $1,000 of 20-year annual Puttable Reset Securities. The notes will bear interest at 4.25% until June 2002, at which time an investment bank has an annual option to require us to remarket or redeem the notes. If the option is exercised, the investment bank will reset the interest rate and remarket the notes for another 12-month term. If the bank does not exercise its option on that reset date, we will be required to redeem the notes at par. The notes are classified as short-term debt.

In July and August 2001, we redeemed approximately $615 of multiple bonds with maturities up to 40 years and interest rates ranging from 5.8% to 8.5%.

In October and November 2001, we redeemed approximately $665 of multiple bonds with maturities up to 40 years and interest rates ranging from 4.4% to 6.9%.

In February 2002, we issued approximately $1,000 of 10-year, 5.875%, global notes. The notes will pay interest semiannually, beginning in August 2002, and are redeemable at any time, in whole or in part, and under certain circumstances, at a premium.

Debt maturing within one year consists of the following at December 31:

	2001	2000
Commercial paper	**$6,039**	$ 6,437
Current maturities of long-term debt	**2,991**	2,614
Other short-term debt	**3**	1,419
Total	**$9,033**	$10,470

The weighted average interest rate on commercial paper debt at December 31, 2001 and 2000 was 2.07% and 6.51%. We have lines of credit with several banks totaling $3,700, all of which may be used to support commercial paper borrowings. We had no borrowings outstanding under these lines of credit as of December 31, 2001 or 2000.

NOTE 9. FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of our long-term debt, including current maturities and other financial instruments, are summarized as follows at December 31:

	2001		2000	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Notes and debentures	**$19,876**	**$20,315**	$18,022	$17,592
TOPrS	**—**	**—**	1,000	990
Preferred stock of subsidiaries	**350**	**350**	820	820

The fair values of our notes and debentures were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates. The fair value of the Trust Originated Preferred Securities (TOPrS) was estimated based on quoted market prices. The carrying amounts of preferred stock of subsidiaries and commercial paper debt approximate fair values. Our short-term investments and customer deposits are recorded at amortized cost and the carrying amounts approximate fair values. Our notes receivable from Cingular are recorded at face value and the carrying amounts approximate fair values.

TOPrS Redemption – Pacific Telesis Financing I and II (the Trusts) were formed in 1996 for the exclusive purpose of issuing preferred and common securities representing undivided beneficial interests in the Trusts and investing the proceeds from the sales of TOPrS in unsecured subordinated debt securities of PAC. Under certain circumstances, dividends on TOPrS could be deferred for up to a period of five years.

In February 2001, we redeemed prior to maturity approximately $500 of the TOPrS with an interest rate of 7.56%, and in June 2001, we redeemed the remaining $500 of the TOPrS with an interest rate of 8.50%. The TOPrS had an original maturity of 30 years and were included on the balance sheet as corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. Due to this early redemption, we recognized an extraordinary loss of $18, net of taxes of $10, during 2001.

Preferred Stock Redemptions – In April 1998, a subsidiary issued, through private placements, 3,250 shares in multiple series of stated rate auction preferred stock (STRAPS). Net proceeds from these issuances totaled $322. Dividends are cumulative from the date of issuance and accrue at varying rates, which are adjusted periodically through separate auctions on each series. In November and December of 2001, we redeemed the STRAPS at par.

In June 2001, we redeemed $60 of variable rate Series B Preferred Stock of a subsidiary that was not subject to mandatory redemption. In August 2001, we redeemed $85 of 7.04% Series A Preferred Stock of a subsidiary that was subject to mandatory redemption in 2001.

Preferred Stock Issuances by Subsidiaries – In June 1997 and December 1999, a subsidiary issued $250 and $100 of preferred stock in private placements. The holders of the preferred stock may require SBC's subsidiary to redeem the shares after May 20, 2004. Holders receive quarterly dividends based on a rolling three-month LIBOR. The dividend rate for the December 31, 2001, payment was 3.37%.

The preferred stock of subsidiaries discussed above is included in other noncurrent liabilities on the consolidated balance sheets.

Derivatives – We use interest rate swaps to manage interest rate risk. Related gains and losses are reflected in net income when the underlying transaction being hedged occurs. The notional amounts, carrying amounts and estimated fair values of our derivative financial instruments are summarized as follows at December 31:

	Notional Amount	Carrying Amount	Fair Value
2001			
Interest rate swaps	**$ 580**	**$0**	**$5**
2000			
Interest rate swaps	$1,020	$0	$4

NOTE 10. INCOME TAXES

Significant components of our deferred tax liabilities and assets are as follows at December 31:

	2001	2000
Depreciation and amortization	**$ 6,749**	$ 7,683
Equity in foreign affiliates	**586**	789
Deferred directory expenses	**498**	533
Other	**3,777**	1,794
Deferred tax liabilities	**11,610**	10,799
Employee benefits	**1,619**	2,069
Currency translation adjustments	**871**	698
Allowance for uncollectibles	**286**	205
Unamortized investment tax credits	**106**	122
Other	**1,329**	2,052
Deferred tax assets	**4,211**	5,146
Deferred tax assets valuation allowance	**140**	156
Net deferred tax liabilities	**$ 7,539**	$ 5,809

The decrease in the valuation allowance is the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets. The valuation allowance is maintained in deferred tax assets for certain unused federal and state loss carryforwards.

The components of income tax expense are as follows:

	2001	2000	1999
Federal:			
Current	**$1,803**	$3,249	$2,883
Deferred – net	**1,712**	1,051	814
Amortization of investment tax credits	**(44)**	(71)	(85)
	3,471	4,229	3,612
State and local:			
Current	**206**	575	421
Deferred – net	**405**	113	247
Foreign	**15**	4	—
	626	692	668
Total	**$4,097**	$4,921	$4,280

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes, extraordinary items and cumulative effect of accounting change is as follows:

	2001	2000	1999
Taxes computed at federal statutory rate	**$3,975**	$4,511	$3,798
Increases (decreases) in income taxes resulting from:			
Amortization of investment tax credits over the life of the plant that gave rise to the credits	**(28)**	(46)	(55)
State and local income taxes – net of federal income tax benefit	**407**	450	440
Contributions of appreciated investments	**(208)**	—	(12)
Other – net	**(49)**	6	109
Total	**$4,097**	$4,921	$4,280

NOTE 11. PENSION AND POSTRETIREMENT BENEFITS

Pensions – Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. Management employees participate in either cash balance or defined lump sum pension plans with a new minimum based upon a stated percentage of employees' adjusted career income adopted in 2001. The pension benefit formula for most nonmanagement employees is based on a flat dollar amount per year according to job classification. Most employees can elect to receive their pension benefits in either a lump sum payment or annuity.

Our objective in funding the plans, in combination with the standards of the Employee Retirement Income Security Act of 1974 (as amended), is to accumulate funds sufficient to meet the plans' benefit obligations to employees upon their retirement. Contributions to the plans are made to a trust for the benefit of plan participants. Plan assets consist primarily of stocks, U.S. government and domestic corporate bonds, index funds and real estate.

Effective with the Ameritech merger, we performed a midyear valuation affecting the net pension benefit for all pension plans in 1999. Additionally, per our joint venture agreement with BellSouth, our employees that were previously leased to Cingular became Cingular employees on or before December 31, 2001, and the pension assets and liabilities related to those former employees were transferred to Cingular. The amounts that follow reflect the impacts and assumptions of the midyear valuation and the transfer of employees to Cingular.

The following table presents the change in the pension plan projected benefit obligation for the years ended December 31:

	2001	2000
Benefit obligation at beginning of year	**$25,577**	$25,685
Service cost – benefits earned during the period	**550**	525
Interest cost on projected benefit obligation	**1,847**	1,927
Amendments	**317**	425
Actuarial loss	**1,512**	940
Special termination benefits	**164**	1,104
Transfer to Cingular	**(167)**	—
Benefits paid	**(4,740)**	(5,029)
Benefit obligation at end of year	**$25,060**	$25,577

The following table presents the change in pension plan assets for the years ended December 31 and the pension plans' funded status at December 31:

	2001	2000
Fair value of plan assets at beginning of year	**$40,814**	$ 45,958
Actual return on plan assets	**(2,798)**	95
Transfer to Cingular	**(290)**	—
Benefits paid	**(5,011)**	(5,239)
Fair value of plan assets at end of year[1]	**$32,715**	$ 40,814
Funded status	**$ 7,655**	$ 15,237
Unrecognized prior service cost	**1,946**	1,963
Unrecognized net gain	**(1,852)**	(11,395)
Unamortized transition asset	**(412)**	(683)
Prepaid pension cost[2]	**$ 7,337**	$ 5,122

[1]Plan assets include SBC common stock of $14 at December 31, 2001, and $18 at December 31, 2000.
[2]Represents net amount recognized in our consolidated balance sheets. Accrued pension liability was $0 at December 31, 2001 and 2000.

Net pension benefit is composed of the following:

	2001	2000	1999
Service cost – benefits earned during the period	**$ 550**	$ 525	$ 584
Interest cost on projected benefit obligation	**1,847**	1,927	1,831
Expected return on plan assets	**(3,515)**	(3,149)	(2,951)
Amortization of prior service cost	**81**	43	(35)
Recognized actuarial gain	**(413)**	(491)	(273)
Net pension benefit	**$(1,450)**	$(1,145)	$ (844)

Significant weighted-average assumptions used in developing pension information include:

	2001	2000	1999
Discount rate for determining projected benefit obligation	**7.50%**	7.75%	7.75%
Long-term rate of return on plan assets	**9.50%**	8.50%	8.50%
Composite rate of compensation increase	**4.25%**	4.25%	4.25%

The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to previously rendered employee service. It is measured based on assumptions concerning future interest rates and employee compensation levels. At December 31, 2001, we determined our 7.5% discount rate based on a range of factors including the rates of return on high-quality, fixed-income investments available at the time of measurement. During 2001, we reduced our discount rate by 0.25%, resulting in an increase in our pension plan benefit obligation of approximately $471 at December 31, 2001. For each of the three years ended 2001, our actual 10-year return on investments exceeded 10%, including the effect of the negative returns in 2001; this, along with future expectations, was the rationale behind the change in our expected long-term rate of return on plan assets from 8.5% to 9.5% in 2001. A 0.25% change in the expected long-term rate of return causes a change of approximately $90 in net pension benefit. Should actual experience differ from the actuarial assumptions, the projected benefit obligation and net pension benefit will be affected.

During 2001, as part of our force-reduction program, an enhanced retirement program (ERB) was offered to eligible PTG nonmanagement employees. The ERB program offered eligible employees who voluntarily decided to terminate employment an enhanced pension benefit and increased eligibility for postretirement medical and dental benefits. Approximately 1,400 employees accepted this offer and terminated employment before the end of December 31, 2001. Enhanced pension benefits related to this program were recognized as an expense of $164 in 2001.

In October 2000, we implemented a voluntary enhanced pension and retirement program (EPR) to reduce the number of management employees. The program offered eligible management employees who decided to terminate employment an enhanced pension benefit and increased eligibility for postretirement medical and dental benefits. Approximately 7,000 of the employees who accepted this offer terminated employment before December 31, 2000; however, under the program, approximately 2,400 employees were retained for up to one year. Enhanced pension benefits related to this program were recognized as an expense of $1.1 billion in 2000. We recognized $896 in net settlement and curtailment gains in the fourth quarter of 2000 and $940 in settlement gains in 2001 primarily associated with the EPR program. In addition to the net pension benefit and EPR amounts, we also recognized $423 in net settlement gains in 2001, $1.2 billion in 2000 and $566 in 1999.

We anticipate that additional lump sum payments will be made in 2002 in connection with the force reductions resulting from the comprehensive review of operations we conducted in the fourth quarter of 2001 (see Note 3). These payments may require the recognition of additional settlement gains in 2002.

In December 2001 and 2000, under the provisions of Section 420 of the Internal Revenue Code, we transferred $286 and $220 in pension assets to a health care benefit account for the reimbursement of certain retiree health care benefits paid by us.

Supplemental Retirement Plans – We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. These plans include supplemental defined pension benefits as well as compensation deferral plans, some of which include a corresponding match by us based on a percentage of the compensation deferral. Expenses related to these plans were $166, $195 and $149 in 2001, 2000 and 1999. Liabilities of $1,479 and $1,408 related to these plans have been included in other noncurrent liabilities in our consolidated balance sheets at December 31, 2001 and 2000.

Postretirement Benefits – We provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. We maintain Voluntary Employee Beneficiary Association trusts to fund postretirement benefits. Assets consist principally of stocks and U.S. government and corporate bonds.

The following table sets forth the change in the accumulated postretirement benefit obligation (APBO) for the years ended December 31:

	2001	2000
Benefit obligation at beginning of year	**$17,802**	$15,511
Service cost – benefits earned during the period	**256**	245
Interest cost on APBO	**1,316**	1,201
Amendments	**(605)**	(134)
Actuarial loss	**2,395**	1,776
Special termination benefits	**9**	79
Transfer to Cingular	**(36)**	—
Benefits paid	**(997)**	(876)
Benefit obligation at end of year	**$20,140**	$17,802

The following table sets forth the change in plan assets for the years ended December 31 and the plans' funded status at December 31:

	2001	2000
Fair value of plan assets at beginning of year	**$ 7,220**	$ 7,871
Actual return on plan assets	**(641)**	(401)
Employer contribution	**—**	42
Benefits paid	**(304)**	(292)
Fair value of plan assets at end of year[1]	**$6,275**	$7,220
Funded status	**$(13,865)**	$(10,582)
Unrecognized prior service cost (benefit)	**(28)**	680
Unrecognized net loss	**3,962**	203
Accrued postretirement benefit obligation	**$ (9,931)**	$ (9,699)

[1]Plan assets include SBC common stock of $13 at December 31, 2001, and $1 at December 31, 2000.

Postretirement benefit cost is composed of the following:

	2001	2000	1999
Service cost – benefits earned during the period	**$ 256**	$ 245	$ 260
Interest cost on APBO	**1,316**	1,201	1,050
Expected return on assets	**(665)**	(549)	(504)
Amortization of prior service cost	**94**	147	157
Recognized actuarial (gain) loss	**13**	(33)	(13)
Postretirement benefit cost	**$1,014**	$1,011	$ 950

The fair value of plan assets restricted to the payment of life insurance benefits was $968 and $1,114 at December 31, 2001 and 2000. At December 31, 2001 and 2000, the accrued life insurance benefits included in the APBO were $614 and $593.

In addition to the postretirement benefit cost reported in the table above, we recognized $107 in net curtailment losses in 2000 associated with EPR. Enhanced benefits related to the EPR program were recognized as an expense of $71 in 2000. Enhanced benefits related to the ERB program were recognized as an expense of $9 in 2001.

The assumed medical cost trend rate in 2002 is 8.0% for retirees 64 and under and 9.0% for retirees 65 and over, decreasing to 5.0% in 2007, prior to adjustment for cost-sharing provisions of the medical and dental plans for certain retired employees. The assumed dental cost trend rate in 2002 is 5.0%. A one percentage-point change in the assumed health care cost trend rate would have the following effects:

	One Percentage-Point Increase	One Percentage-Point Decrease
Effect on total of service and interest cost components	$ 214	$ 172
Effect on APBO	2,308	1,900

Significant assumptions for the discount rate, long-term rate of return on plan assets and composite rate of compensation increase used in developing the APBO and related postretirement benefit costs were the same as those used in developing the pension information. The reduction of our discount rate by 0.25% during 2001 resulted in an increase in our postretirement benefit obligation of approximately $599 at December 31, 2001. A 0.25% change in the expected long-term rate of return causes a change of approximately $18 in postretirement benefit cost. Should actual experience differ from the actuarial assumptions, the APBO and postretirement benefit cost will be affected. Due to the Ameritech merger, a midyear valuation also was performed for all postretirement benefit plans in 1999. The amounts above reflect the impacts and assumptions of the midyear valuation and the 2001 transfer of employees to Cingular.

NOTE 12. EMPLOYEE STOCK OWNERSHIP PLANS

We maintain contributory savings plans that cover substantially all employees. Under the savings plans, we match a stated percentage of eligible employee contributions, subject to a specified ceiling.

As a result of past mergers, we had six leveraged ESOPs as part of our existing savings plans. Five of the ESOPs were funded with notes issued by the savings plans to various lenders, the proceeds of which were used to purchase shares of SBC's common stock in the open market. The original principal amounts were paid off in 2000 with our contributions to the savings plans, dividends paid on SBC shares and interest earned on funds held by the ESOPs. We extended the terms of certain ESOPs through previous internal refinancing of the debt, resulting in unallocated shares remaining in one of those ESOPs at December 31, 2001 and two at December 31, 2000.

One ESOP purchased PAC treasury shares in exchange for a promissory note from the plan to PAC. All PAC shares were exchanged for SBC shares effective with the merger April 1, 1997. The provisions of the ESOP were unaffected by this exchange. This promissory note from the plan to PAC was paid off in 2001 with our contributions to the savings plans, dividends paid on SBC shares and interest earned on funds held by the ESOPs.

Our match of employee contributions to the savings plans is fulfilled with shares of stock allocated from the ESOPs and with purchases of SBC's stock in the open market. Shares held by the ESOPs are released for allocation to the accounts of employees as employer-matching contributions are earned. Benefit cost is based on a combination of the contributions to the savings plans and the cost of shares allocated to participating employees' accounts. Both benefit cost and interest expense on the notes are reduced by dividends on SBC's shares held by the ESOPs and interest earned on the ESOPs' funds.

Information related to the ESOPs and the savings plans is summarized below:

	2001	2000	1999
Benefit expense – net of dividends and interest income	**$185**	$134	$ 90
Interest expense – net of dividends and interest income	—	5	10
Total expense	**$185**	$139	$100
Company contributions for ESOPs	**$177**	$ 47	$104
Dividends and interest income for debt service	**$ 58**	$ 93	$ 75

SBC shares held by the ESOPs are summarized as follows at December 31 (in millions):

	2001	2000
Unallocated	**4**	8
Allocated to participants	**76**	103
Total	**80**	111

NOTE 13. STOCK-BASED COMPENSATION

Under our various plans, senior and other management and nonmanagement employees and nonemployee directors have received stock options, performance stock units, and other nonvested stock units. Stock options issued through December 31, 2001, carry exercise prices equal to the market price of the stock at the date of grant and have maximum terms ranging from five to ten years. Beginning in 1994 and ending in 1999, certain Ameritech employees were awarded grants of nonqualified stock options with dividend equivalents. Depending upon the grant, vesting of stock options may occur up to four years from the date of grant. Performance stock units are granted to key employees based upon the common stock price at the date of grant and are awarded in the form of common stock and cash at the end of a two- or three-year period, subject to the achievement of certain performance goals. Nonvested stock units are valued at the market price of the stock at the date of grant and vest over a three- to five-year period. As of December 31, 2001, we were authorized to issue up to 133 million shares of stock (in addition to shares that may be issued upon exercise of outstanding options or upon vesting of performance stock units or other nonvested stock units) to officers, employees and directors pursuant to these various plans.

We measure compensation cost for these plans using the intrinsic value-based method of accounting as allowed in Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123). Accordingly, no compensation cost for our stock option plans has been recognized. Had compensation cost for stock option plans been recognized using the fair value-based method of accounting at the date of grant for awards in 2001, 2000 and 1999 as defined by FAS 123, our net income would have been $7,008, $7,800 and $7,969 (i.e., lower by $234, $167 and $190), and basic net income per share would have been $2.08, $2.30 and $2.34. The compensation cost that has been charged against income for our other stock-based compensation plans totaled $0, $19 and $42 for 2001, 2000 and 1999. These amounts include $(33), $(23) and $2 in 2001, 2000 and 1999 for the mark-to-market effect on dividend equivalents.

For purposes of these pro forma disclosures, the estimated fair value of the options granted is amortized to expense over the options' vesting period. The fair value for these options was estimated at the date of grant, using a Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 2001, 2000 and 1999: risk-free interest rate of 4.51%, 6.67% and 5.31%; dividend yield of 2.37%, 2.19% and 1.65%; expected volatility factor of 24%, 16% and 15%; and expected option life of 4.0, 4.6 and 4.5 years.

Information related to options is summarized below (shares in millions):

	Number	Weighted-Average Exercise Price
Outstanding at January 1, 1999	146	26.26
Granted	26	48.70
Exercised	(19)	23.13
Forfeited/Expired	(4)	39.06
Outstanding at December 31, 1999 (116 exercisable at weighted-average price of $26.91)	149	30.24
Granted	51	39.62
Exercised	(30)	24.22
Forfeited/Expired	(14)	41.05
Outstanding at December 31, 2000 (101 exercisable at weighted-average price of $29.22)	156	33.53
Granted	76	43.41
Exercised	(13)	24.41
Forfeited/Expired	(12)	43.09
Outstanding at December 31, 2001 (109 exercisable at weighted-average price of $32.36)	**207**	**$37.21**

Information related to options outstanding at December 31, 2001:

Exercise Price Range	$10.90-$17.39	$17.40-$29.99	$30.00-$35.49	$35.50-$59.00
Number of options (in millions):				
Outstanding	6	51	7	143
Exercisable	6	51	7	45
Weighted-average exercise price:				
Outstanding	$15.48	$24.13	$34.17	$43.02
Exercisable	$15.48	$24.13	$34.17	$43.95
Weighted-average remaining contractual life	2.54 years	4.43 years	6.30 years	8.47 years

The weighted-average, grant-date fair value of each option granted during 2001, 2000 and 1999 was $8.37, $8.31 and $9.31.

As of December 31, additional shares available under stock options with dividend equivalents were approximately 1 million in 2001 and 2000 and 2 million in 1999.

NOTE 14. SHAREOWNERS' EQUITY

Share Repurchase – From time to time, we repurchase shares of common stock for distribution through our employee benefit plans or in connection with certain acquisitions. In November 2001, the Board of Directors authorized the repurchase of up to 100 million shares of SBC common stock. This is in addition to the authorization to repurchase 100 million shares in January 2000. As of January 31, 2002, we have repurchased a total of approximately 99 million shares of our common stock of the 200 million authorized to be repurchased.

We have entered into a series of put options on SBC stock with institutional counterparties. The put options are exercisable only at maturity and expire in February, May and December 2002. We have a maximum potential obligation to purchase 9,000,000 shares of our common stock at a weighted average exercise price of $37.45. Three million of the put options expired on February 15, 2002, with the remaining options having a weighted average exercise price of $39.14. We have the right to settle the put options by physical settlement of the options or by net share settlement using shares of the SBC common stock. We received cash of $38 in 2001 and $65 in 2000 from these transactions, which was credited to shareowners' equity.

NOTE 15. SUBSIDIARY FINANCIAL INFORMATION

We have fully and unconditionally guaranteed certain outstanding capital securities of Pacific Bell Telephone Company (PacBell) and Southwestern Bell Telephone Company (SWBell), each of which is a wholly owned subsidiary of SBC. These securities are reflected on our consolidated balance sheet. In accordance with SEC rules, we are providing the following condensed consolidating financial information.

The Parent column presents investments in all subsidiaries under the equity method of accounting. PacBell and SWBell are listed separately because each has securities that we have guaranteed that would otherwise require SEC periodic reporting. All other wholly owned subsidiaries that do not have securities guaranteed by us that would require separate reporting are presented in the Other column. The consolidating adjustments column (Adjs.) eliminates the intercompany balances and transactions between our subsidiaries.

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$10,842	$11,802	$24,766	$(1,502)	$45,908
Total operating expenses	(141)	7,391	8,722	20,550	(1,502)	35,020
Operating Income	141	3,451	3,080	4,216	—	10,888
Interest expense	528	365	362	928	(584)	1,599
Equity in net income of affiliates	6,696	—	—	1,593	(6,694)	1,595
Royalty income (expense)	471	(414)	(471)	414	—	—
Other income (expense) – net	423	6	1	630	(587)	473
Income Before Income Taxes	7,203	2,678	2,248	5,925	(6,697)	11,357
Income taxes	(39)	1,088	830	2,218	—	4,097
Income Before Extraordinary Items	7,242	1,590	1,418	3,707	(6,697)	7,260
Extraordinary Items	—	—	—	(18)	—	(18)
Net Income	$7,242	$ 1,590	$ 1,418	$ 3,689	$(6,697)	$ 7,242

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$10,356	$11,580	$30,778	$(1,340)	$51,374
Total operating expenses	(199)	7,437	8,636	26,097	(1,340)	40,631
Operating Income	199	2,919	2,944	4,681	—	10,743
Interest expense	504	391	383	1,379	(1,065)	1,592
Equity in net income of affiliates	7,417	—	—	961	(7,481)	897
Royalty income (expense)	460	(407)	(460)	407	—	—
Other income (expense) – net	728	2	10	3,104	(1,004)	2,840
Income Before Income Taxes	8,300	2,123	2,111	7,774	(7,420)	12,888
Income taxes	333	847	778	2,963	—	4,921
Net Income	$7,967	$ 1,276	$ 1,333	$ 4,811	$(7,420)	$ 7,967

Condensed Consolidating Statements of Income
For the Twelve Months Ended December 31, 1999

	Parent	PacBell	SWBell	Other	Adjs.	Total
Total operating revenues	$ —	$9,718	$11,173	$29,567	$ (927)	$49,531
Total operating expenses	(228)	7,459	8,358	23,271	(927)	37,933
Operating Income	228	2,259	2,815	6,296	—	11,598
Interest expense	206	388	384	1,393	(941)	1,430
Equity in net income of affiliates	8,137	—	—	937	(8,162)	912
Other income (expense) – net	113	42	6	528	(916)	(227)
Income Before Income Taxes	8,272	1,913	2,437	6,368	(8,137)	10,853
Income taxes	106	752	896	2,526	—	4,280
Income Before Extraordinary Items and Cumulative Effect of Accounting Change	8,166	1,161	1,541	3,842	(8,137)	6,573
Extraordinary Items	—	—	—	1,379	—	1,379
Cumulative Effect of Accounting Change	(7)	(1,010)	(274)	1,498	—	207
Net Income	$8,159	$ 151	$ 1,267	$ 6,719	$(8,137)	$ 8,159

Condensed Consolidating Balance Sheets
December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Cash and cash equivalents	$ 445	$ 4	$ 99	$ 155	$ —	$ 703
Accounts receivable – net	4,238	2,223	1,919	13,535	(12,539)	9,376
Other current assets	304	381	838	978	—	2,501
Total current assets	4,987	2,608	2,856	14,668	(12,539)	12,580
Property, plant and equipment – net	118	13,522	15,588	20,599	—	49,827
Goodwill – net	—	—	—	3,577	—	3,577
Investments in equity affiliates	35,226	—	—	14,907	(38,166)	11,967
Other assets	8,140	2,382	428	11,140	(3,719)	18,371
Total Assets	$48,471	$18,512	$18,872	$64,891	$(54,424)	$96,322
Debt maturing within one year	$ 8,094	$ 2,594	$ 3,914	$ 2,654	$ (8,223)	$ 9,033
Other current liabilities	690	3,598	3,629	11,314	(4,316)	14,915
Total current liabilities	8,784	6,192	7,543	13,968	(12,539)	23,948
Long-term debt	4,137	3,673	2,868	10,125	(3,670)	17,133
Postemployment benefit obligation	57	2,860	2,996	3,926	—	9,839
Other noncurrent liabilities	3,002	1,816	1,369	6,773	(49)	12,911
Total shareowners' equity	32,491	3,971	4,096	30,099	(38,166)	32,491
Total Liabilities and Shareowners' Equity	$48,471	$18,512	$18,872	$64,891	$(54,424)	$96,322

Condensed Consolidating Balance Sheets
December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Cash and cash equivalents	$ 436	$ 9	$ 52	$ 146	$ —	$ 643
Accounts receivable – net	9,503	2,219	2,111	10,439	(14,128)	10,144
Other current assets	631	474	697	1,059	—	2,861
Total current assets	10,570	2,702	2,860	11,644	(14,128)	13,648
Property, plant and equipment – net	138	13,028	14,984	19,045	—	47,195
Goodwill – net	—	—	—	3,719	—	3,719
Investments in equity affiliates	30,072	—	—	17,058	(34,752)	12,378
Other assets	3,750	2,061	272	20,478	(4,850)	21,711
Total Assets	$44,530	$17,791	$18,116	$71,944	$(53,730)	$98,651
Debt maturing within one year	$ 8,918	$ 1,776	$ 2,648	$ 4,607	$ (7,479)	$10,470
Other current liabilities	2,527	3,795	4,112	16,102	(6,649)	19,887
Total current liabilities	11,445	5,571	6,760	20,709	(14,128)	30,357
Long-term debt	568	4,293	3,976	11,505	(4,850)	15,492
Postemployment benefit obligation	83	2,817	2,993	3,874	—	9,767
Other noncurrent liabilities	1,971	1,535	1,314	6,752	—	11,572
Corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts	—	—	—	1,000	—	1,000
Total shareowners' equity	30,463	3,575	3,073	28,104	(34,752)	30,463
Total Liabilities and Shareowners' Equity	$44,530	$17,791	$18,116	$71,944	$(53,730)	$98,651

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2001

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 1,150	$ 3,395	$ 3,285	$12,880	$(5,905)	$14,805
Net cash from investing activities	1,328	(2,397)	(2,996)	(5,416)	1,094	(8,387)
Net cash from financing activities	(2,469)	(1,003)	(242)	(7,455)	4,811	(6,358)
Net Increase (Decrease) in Cash	$ 9	$ (5)	$ 47	$ 9	$ —	$ 60

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 2000

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 3,853	$ 3,197	$ 4,152	$ 5,311	$(2,447)	$ 14,066
Net cash from investing activities	(4,154)	(2,679)	(3,630)	(3,873)	166	(14,170)
Net cash from financing activities	637	(521)	(519)	(1,626)	2,281	252
Net Increase (Decrease) in Cash	$ 336	$ (3)	$ 3	$ (188)	$ —	$ 148

Condensed Consolidating Statements of Cash Flows
Twelve Months Ended December 31, 1999

	Parent	PacBell	SWBell	Other	Adjs.	Total
Net cash from operating activities	$ 2,434	$ 3,233	$ 4,393	$ 9,772	$(3,158)	$ 16,674
Net cash from investing activities	(364)	(2,437)	(2,882)	(4,708)	(282)	(10,673)
Net cash from financing activities	(2,284)	(799)	(1,522)	(4,940)	3,440	(6,105)
Net Increase (Decrease) in Cash	$ (214)	$ (3)	$ (11)	$ 124	$ —	$ (104)

NOTE 16. ADDITIONAL FINANCIAL INFORMATION

	December 31,	
Balance Sheets	2001	2000
Accounts payable and accrued liabilities:		
Accounts payable	$ 3,959	$ 5,018
Accounts payable – Cingular	—	2,514
Advance billing and customer deposits	1,317	1,322
Compensated future absences	1,017	837
Accrued interest	486	440
Accrued payroll	669	986
Other	4,011	4,315
Total	$11,459	$15,432

Statements of Income	2001	2000	1999
Advertising expense	$ 354	$ 774	$ 812
Interest expense incurred	$1,718	$1,693	$1,511
Capitalized interest	(119)	(101)	(81)
Total interest expense	$1,599	$1,592	$1,430

Statements of Cash Flows	2001	2000	1999
Cash paid during the year for:			
Interest	$1,546	$1,681	$1,516
Income taxes, net of refunds	2,696	3,120	2,638

No customer accounted for more than 10% of consolidated revenues in 2001, 2000 or 1999.

NOTE 17. CONTINGENT LIABILITIES

In addition to issues specifically discussed elsewhere, we are party to numerous lawsuits, regulatory proceedings and other matters arising in the ordinary course of business. In our opinion, although the outcomes of these proceedings are uncertain, they should not have a material adverse effect on the company's financial position, results of operations or cash flows.

NOTE 18. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share	Diluted Earnings Per Share	Stock Price High	Stock Price Low	Stock Price Close
2001								
First	**$11,190**	**$ 2,659**	**$1,854**	**$0.55**	**$0.54**	**$53.06**	**$39.50**	**$44.63**
Second	**11,477**	**3,077**	**2,071**	**0.62**	**0.61**	**45.68**	**38.20**	**40.06**
Third	**11,338**	**2,822**	**2,072**	**0.62**	**0.61**	**47.50**	**39.74**	**47.12**
Fourth	**11,903**	**2,330**	**1,245**	**0.37**	**0.37**	**47.25**	**36.50**	**39.17**
Annual	**$45,908**	**$10,888**	**$7,242**	**2.15**	**2.13**			
2000								
First	$12,553	$ 3,076	$1,822	$0.54	$0.53	$49.00	$34.81	$42.13
Second	13,191	2,998	1,851	0.54	0.54	50.00	40.44	43.25
Third	13,422	2,846	2,999	0.89	0.88	50.19	38.44	49.88
Fourth	12,208	1,823	1,295	0.38	0.38	59.00	41.75	47.75
Annual	$51,374	$10,743	$7,967	2.35	2.32			

We reclassified all four quarters of 2000 to conform with the current year's presentation. The first and second quarters of 2001 include extraordinary losses of $10 and $8 for a total of $18, or $0.01 per share, related to the early redemption of $1,000 of our corporation-obligated mandatorily redeemable preferred securities of subsidiary trusts. There were also normalizing (e.g., one-time) items which are included in the information above but are excluded from the information that management uses to evaluate the performance of each segment of the business (see Note 5).

The quarterly impact of the year 2001 normalizing items was as follows:

- Pension settlement gains of $526 ($329 net of tax) in the first quarter, $315 ($189 net of tax) in the second quarter, $123 ($72 net of tax) in the third quarter and $133 ($98 net of tax) in the fourth quarter related to management employees, primarily resulting from a fourth-quarter 2000 voluntary retirement program net of costs associated with that program.
- Combined charges of $401 ($261 net of tax) in the second quarter primarily related to valuation adjustments of Williams as well as certain other cost investments accounted for under FAS 115. The charges resulted from an evaluation that the decline was other than temporary.
- Reduction of a valuation allowance of $120 ($78 net of tax) in the second quarter on a note receivable related to the sale of SecurityLink. The note was collected in July 2001.
- Combined charges of $316 ($205 net of tax) in the first quarter related to impairment of our cable operations.
- A charge of $390 ($262 net of tax) indicated by a transaction pending as of December 31, 2001 to reduce the direct and indirect book value of our investment in Telecom Américas.
- A charge of $197 (with no tax effect) in the fourth quarter for costs related to TDC's decision to discontinue nonwireless operations of its Talkline subsidiary and our impairment of the goodwill we allocated to Talkline.
- A charge of $197 ($128 net of tax) in the fourth quarter representing a proposed settlement agreement with the ICC related to a provision of the Ameritech merger. The amount represents an estimate of all future savings to be shared with our Illinois customers.
- Combined charges of $619 ($425 net of tax) in the fourth quarter associated with our comprehensive review of operations, which resulted in decisions to reduce work force, terminate certain real estate leases and shut down certain operations (see Note 3).

The quarterly impact of the year 2000 normalizing items was as follows:

- Gains of $1,699 ($1,125 net of tax) in the third quarter related to the sale of direct and indirect investments in MATÁV and Netcom GSM, two international equity affiliates and $187 ($123 net of tax) in the fourth quarter from the contribution of our investment in ATL to Telecom Américas.
- Gains of $238 ($155 net of tax) in the third quarter on the sale of Telmex L shares associated with our private purchase of a note receivable with characteristics that essentially offset future mark-to-market adjustments on the DECS.
- Pension settlement gains of $250 ($161 net of tax) in the first quarter, $124 ($80 net of tax) in the second quarter, $29 ($19 net of tax) in the third quarter and $109 ($68 net of tax) in the fourth quarter associated with pension litigation; first-quarter payments primarily related to employees who terminated employment during 1999 and gains resulting from a voluntary retirement program net of enhanced pension and postretirement benefits associated with that program (see Note 12).
- Costs of $141 ($117 net of tax) in the first quarter, $239 ($153 net of tax) in the second quarter, $400 ($258 net of tax) in the third quarter and $425 ($272 net of tax) in the fourth quarter associated with strategic initiatives and other adjustments resulting from the merger integration process with Ameritech.
- A charge of $132 (with no tax effect) in the first quarter related to in-process research and development from the March 2000 acquisition of Sterling.
- Combined charges of $971 ($677 net of tax) related to valuation adjustments of SecurityLink and certain cost investments accounted for under FAS 115 and the restructure of agreements with Prodigy, including the extension of a credit facility and recognition of previously unrecognized equity losses from our investment.
- Gains of $357 ($99 net of tax) in the fourth quarter primarily related to our required disposition of overlapping wireless properties in connection with our contribution of operations to Cingular.

REPORT OF MANAGEMENT

The consolidated financial statements have been prepared in conformity with generally accepted accounting principles in the United States. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management, as is all other information included in the Annual Report, unless otherwise indicated.

The financial statements of SBC Communications Inc. (SBC) have been audited by Ernst & Young LLP, independent auditors. Management has made available to Ernst & Young LLP all of SBC's financial records and related data, as well as the minutes of shareowners' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate.

Management has established and maintains a system of internal accounting controls that provides reasonable assurance as to the integrity and reliability of the financial statements, the protection of assets from unauthorized use or disposition and the prevention and detection of fraudulent financial reporting. The concept of reasonable assurance recognizes that the costs of an internal accounting controls system should not exceed, in management's judgment, the benefits to be derived.

Management also seeks to ensure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communication programs aimed at ensuring that its policies, standards and managerial authorities are understood throughout the organization. Management continually monitors the system of internal accounting controls for compliance. SBC maintains an internal auditing program that independently assesses the effectiveness of the internal accounting controls and recommends improvements thereto.

The Audit Committee of the Board of Directors, which consists of nine directors who are not employees, meets periodically with management, the internal auditors and the independent auditors to review the manner in which they are performing their respective responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have access to the Audit Committee at any time.

Edward E. Whitacre Jr.

Edward E. Whitacre Jr.
Chairman of the Board and
Chief Executive Officer

Randall Stephenson

Randall Stephenson
Senior Executive Vice President and
Chief Financial Officer

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareowners
SBC Communications Inc.

We have audited the accompanying consolidated balance sheets of SBC Communications Inc. (the Company) as of December 31, 2001 and 2000, and the related consolidated statements of income, shareowners' equity, and cash flows for each of the three years in the period ended December 31, 2001. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of SBC Communications Inc. at December 31, 2001 and 2000, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

Ernst + Young LLP

San Antonio, Texas
February 8, 2002