

ROBERT F. WILHELM
ENGINEERING MANAGER
A.T.&T. LONG LINES DEPARTMENT
32 AVENUE OF THE AMERICAS-ROOM 2008
NEW YORK, NY 10013

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The 90th Annual Meeting of share owners will be held at 2 p.m. on Wednesday, April 16, 1975, in the Anaheim Convention Center, Anaheim, California. Anyone planning to attend the meeting should write to the Secretary of the Company for an admission card.

The financial results reported herein are for the American Telephone and Telegraph Company and its principal telephone subsidiaries, consolidated.

If you need further information:

—An Annual Statistical Report, with additional data on our operations, is available on request.

—AT&T's annual report to the Securities and Exchange Commission, Form 10-K, is available on request.

—Financial statements of AT&T alone and annual reports of the Bell Telephone operating companies and of the Western Electric Company, manufacturing and supply unit of the Bell System, are also available.

—Share owners who are blind may obtain the AT&T report in braille or on talking records.

Address requests to the Secretary, American Telephone and Telegraph Company, 195 Broadway, New York, New York 10007. The telephone number of the Company is (212) 393-9800.

The Company maintains stock transfer offices at 180 Fulton St., New York, N.Y. 10007 and also at: 185 Franklin St., Boston, Mass. 02107; 225 West Randolph St., Chicago, Ill. 60606; and 140 New Montgomery St., San Francisco, Calif. 94105.

Inquiries on securities, dividends or interest payments should be addressed to AT&T Co., P. O. Box 2018, New Brunswick, New Jersey 08903.



John D. deButts, chairman of the board, with Robert D. Lilley, president, (left) and William L. Lindholm, vice chairman.

Report of the Chairman of the Board

Dear Share Owner:

In 1974 the Bell System provided better earnings—and dividends—for its investors, better service for its customers and better jobs for its employees.

Despite a laggard economy, our business continued to grow. We handled a volume of business over seven per cent larger than in 1973. Revenues increased 11.3 per cent and net income applicable to AT&T common shares 4.7 per cent.

Earnings per share from operations were \$5.27 compared to \$4.98 in 1973.

At its meeting in August, the Board of Directors increased the quarterly dividend on AT&T common shares from 77 cents to 85 cents, effective with the payment of October 1, 1974. This was the ninth increase in quarterly dividends since 1958.

Since then dividend increases have kept pace with the increase in the cost of living. Today, in a further development of the company's dividend policy, AT&T management explicitly recognizes its obligation to commit its energies to maintaining the integrity of its common share dividend in the face of inflation. Only on the basis of investor confidence can we assure the continuing flow of new investment that growth of our services requires.

Financing

Continuing the experience of recent years, internal sources provided the larger share of the Bell companies' capital requirements in 1974—about 60 per cent compared to less than 50 per cent in some prior years. For the remainder—some \$4.2 billion—we relied principally on debt financing.

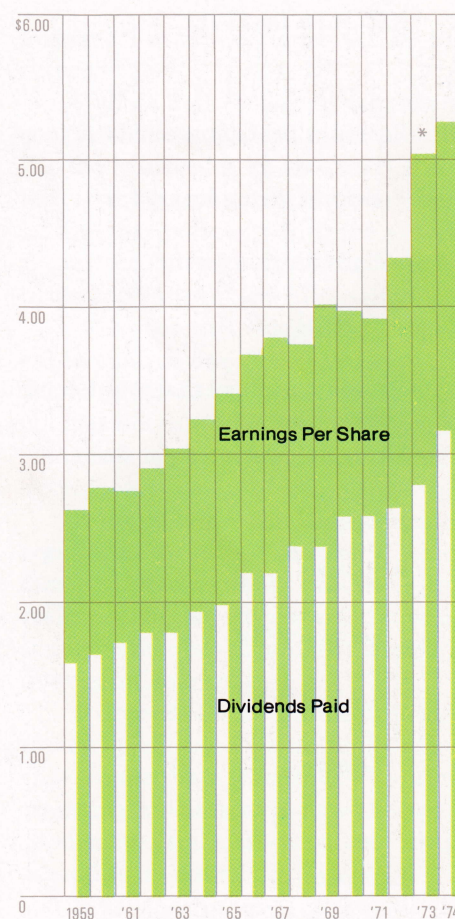
During the year, 13 Bell operating companies sold issues of debt totaling \$2.4 billion at interest costs ranging from 8.11 to 10.14 per cent. In addition,

in May AT&T issued \$500 million in long term debentures at 8.88 per cent. In November, a combination offering of \$300 million in long term debentures and a like amount in intermediate term notes was deferred until January because of unsettled market conditions in the wake of the Justice Department's antitrust suit against the Bell System (see below).

At the end of the year the average interest cost of all outstanding long and intermediate term Bell System debt stood at 6.62 per cent compared to 6.34 per cent at the end of 1973 and 4.79 per cent five years ago. Mitigating the rise in our debt ratio—49.8 per cent at the end of the year—was the purchase of \$184 million in common equity by share owners participating in our Dividend Reinvestment and Stock Purchase Plan.

Last month the company announced an improvement in this plan that will enable share owners to purchase shares with reinvested common dividends at a five per cent discount, beginning with the April 1 dividend payment. It is anticipated that the revised plan will stimulate purchase of additional shares, thereby providing a larger continuing source of new equity capital for AT&T. However, the need to stem—and, it is hoped, reverse—the rise in the Bell System's debt ratio in the interest of maintaining a sound capital structure clearly calls for additional modes of equity financing in the years ahead. In the interest of providing increased flexibility in this regard, share owners are being asked to vote at the 1975 Annual Meeting to eliminate preemptive rights.

Whether—between now and the date of their expiration in May—market conditions will favor exercise of the warrants we issued in 1970 remains to be seen. In the interim, our own efforts are addressed to achieving an earnings



*Includes 8 cents per share profit on sale of Comsat stock.

Since 1958, AT&T has increased the dividend on its common shares nine times. The current annual dividend rate of \$3.40, which became effective last October, reflects continued earnings improvement. In 1974, earnings per common share rose to \$5.27.

performance that, should the market turn, will produce a market price for our shares sufficiently above their exercise price to assure us the \$1.6 billion in new equity capital that exercise of the warrants would produce.

Continued earnings improvement in the face of what appeared at year's end to be a still-deepening recession will challenge the management capabilities of the Bell companies in the months ahead. How far into the current year the sharp decline in revenue growth we experienced in 1974's final

RESULTS IN BRIEF	1974	1973	1972	1971	1970
Earnings per Common Share					
Before extraordinary item	\$ 5.27	\$ 4.98	\$ 4.34	\$ 3.92	\$ 3.99
Extraordinary item*	<u>—</u>	<u>.08</u>	<u>—</u>	<u>—</u>	<u>—</u>
Total	<u>\$ 5.27</u>	<u>\$ 5.06</u>	<u>\$ 4.34</u>	<u>\$ 3.92</u>	<u>\$ 3.99</u>
Based on average shares outstanding (000)	557,815	554,258	549,501	549,304	549,266
Dividends declared per share	\$ 3.24	\$ 2.87	\$ 2.70	\$ 2.60	\$ 2.60
Revenues					
	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>	<i>Millions</i>
Local service	\$12,813	\$11,419	\$10,363	\$ 9,135	\$ 8,456
Toll service	12,461	11,278	9,771	8,633	7,874
Other	<u>1,435</u>	<u>1,334</u>	<u>1,218</u>	<u>1,111</u>	<u>998</u>
	<u>26,709</u>	<u>24,031</u>	<u>21,352</u>	<u>18,879</u>	<u>17,328</u>
Expenses					
Operating	16,716	15,000	13,518	12,075	10,868
Income taxes	2,313	2,138	1,824	1,562	1,700
Other taxes	2,454	2,212	1,983	1,752	1,565
Interest	<u>2,056</u>	<u>1,734</u>	<u>1,495</u>	<u>1,288</u>	<u>1,003</u>
	<u>23,539</u>	<u>21,084</u>	<u>18,820</u>	<u>16,677</u>	<u>15,136</u>
Income before extraordinary item	3,170	2,947	2,532	2,202	2,192
Extraordinary item*	<u>—</u>	<u>46</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net income	3,170	2,993	2,532	2,202	2,192
Preferred dividend requirements	<u>232</u>	<u>186</u>	<u>146</u>	<u>49</u>	<u>—</u>
Income applicable to common shares	<u>\$ 2,938</u>	<u>\$ 2,807</u>	<u>\$ 2,386</u>	<u>\$ 2,153</u>	<u>\$ 2,192</u>

*Net gain on sale of Communications Satellite Corporation common stock.

MANAGEMENT ANALYSIS OF RESULTS IN BRIEF

Revenues from local and toll services and other income have increased 54 per cent since 1970 for several reasons: increases in the number of telephones in service and growth in local and long distance calling volumes, higher rates authorized by regulatory commissions, increased sales of telephone directory advertising and increased net income from Western Electric. In the last quarter of 1974, revenue growth declined, reflecting the downturn in general economic conditions.

Operating expenses rose from \$10.9 billion in 1970 to \$16.7 billion in 1974 principally because of wage increases—including cost of living allowances—and increases in costs of materials, supplies and services.

Income taxes have increased from \$1.7 billion in 1970 to \$2.3 billion in 1974 as our taxable income has risen, although some relief was provided in 1971 by a reduction in the corporate income tax rate from 49.2 per cent to 48 per cent.

Other taxes, which have risen from \$1.6 billion in 1970 to \$2.5 billion in 1974, includes primarily increased state and local property taxes. Gross receipts taxes also rose as our taxable revenues increased, and social security taxes have increased because of higher statutory rates and expanded taxable wage bases.

Interest expense has increased from \$1.0 billion in 1970 to \$2.1 billion in 1974, reflecting the additional cost and amount of long and intermediate term debt capital obtained by the Bell companies to help finance their construction programs. Over the same period our needs for interim debt remained fairly constant, although interest rates for this debt rose to the 12 per cent level in 1974.

Market and Dividend Information. The principal market for trading in AT&T common stock is the New York Stock Exchange. Market and dividend data for the last two fiscal years are listed below.

1973					
Quarter	1st	2nd	3rd	4th	
High	55	54 $\frac{1}{8}$	53 $\frac{1}{8}$	52 $\frac{1}{8}$	
Low	49 $\frac{1}{4}$	50 $\frac{1}{4}$	46 $\frac{5}{8}$	45 $\frac{3}{8}$	
Dividend paid	\$.70	\$.70	\$.70	\$.70	
1974					
Quarter	1st	2nd	3rd	4th	
High	53	49 $\frac{7}{8}$	46 $\frac{3}{4}$	48	
Low	49 $\frac{1}{4}$	45 $\frac{3}{4}$	39 $\frac{5}{8}$	40	
Dividend paid	\$.77	\$.77	\$.77	\$.85	

months will extend is, of course, uncertain. However, we look to the determined application of the same measures that achieved the earnings improvement of the year just past—stringent spending controls, continuing productivity advances and, wherever necessary, repricing of our services—to produce a still further improvement in 1975. We look to that improvement to provide us a sufficient range of financing options to assure that, among alternatives, we can choose those which best serve the long run interest of our share owners.

In any event, recent adjustments in the Bell companies' construction programs to take account of slower growth will reduce the Bell System's new money requirements to a level several hundred million dollars below what appeared necessary when those programs were first drafted a number of months ago.

Economic Policy

Ours is a strong business—strong in its service capability and strong in the financial structure that undergirds it.

We are strong because down through the years the managers of this business, being charged with providing a vital public service, have felt it their duty to pursue financial policies that would assure continuity of that service and provide for its constant improvement. Accordingly, they strove for earnings sufficient to that end—no more and no less. Shunning expedients, they recognized that only "quality earnings"—that is, earnings based on substantive operating performance—would merit the trust of investors and their readiness—year after year—to commit their savings to our charge and, through us, to the advance of communications in this country. In short, concerned as they were with current per-

formance, their allegiance was to the future.

Today's Bell System management continues in that tradition. Approaching the hundredth anniversary of our industry, we must necessarily ask ourselves what policies will serve as well in our second century as the policies of our forerunners served our first.

What becomes immediately apparent in confronting this question is the degree to which our future depends on policies not our own but which we as citizens have a responsibility to help shape.

It depends on the disposition of regulators to authorize rate changes that reflect—in timely fashion—the realities of higher costs and the equally stringent realities of a highly competitive capital market.

It depends on the public's attitude toward profit and its understanding that inadequate earnings—by constraining investment in new and more productive facilities—hurt consumers as well as investors.

It depends on the stability of our money markets and the degree of encouragement they give to a broad base of public participation in the ownership of enterprise.

It depends on government fiscal policy and the firmness with which it signals a real determination to curb inflation and thereby provide Americans some basis for confidence that what they save—and invest—will grow in value and not waste away as a consequence of forces they feel themselves helpless to control.

Nineteen seventy-four was a time of widespread anxiety with respect to our country's economic prospects. It is not to minimize the hardships that the combination of recession and inflation impose that I say that our economy is intrinsically stronger and its institutions more resilient than some of our

gloomier prophets assert. In short, I confess myself an optimist with respect to our prospects for economic recovery and a significant slowdown of the rate of inflation.

Current anxieties have served a useful purpose in focusing public attention on economic issues that, depending on how we solve them, will have a crucial bearing not only on the immediate prospects of our economy but on its long term future as well. I refer specifically to a potential shortfall in capital formation that may jeopardize the nation's ability to meet its economic—and social—goals in the years ahead.

The urgency of action to encourage capital formation may be sufficiently dramatized by pointing out that by conservative estimate U.S. utilities alone—the power companies, the telephone companies, Bell and Independent, that together with transportation form the infrastructure of our society—must over the next decade seek new money in the order of \$500 billion if they are to meet currently anticipated needs. If the utilities don't grow, the rest of the economy can't. Telephone companies, large and small, must act now to assure that—two years hence, five years hence—the plant will be in place to supply the essential services we are chartered to provide. We can't "wait out" today's high capital costs.

Confronted with those costs, some electric companies have felt obliged to cut back on construction at the risk of future capacity shortages. The Bell System does not propose to do so. At the same time it should be pointed out that the construction that cost us \$10 billion in 1974 would have cost us but little more than \$6 billion 10 years ago and that we had to go into the market for a goodly share of those extra dollars in a period of inflation and intense competition for capital that pushed interest rates for high grade securities like our

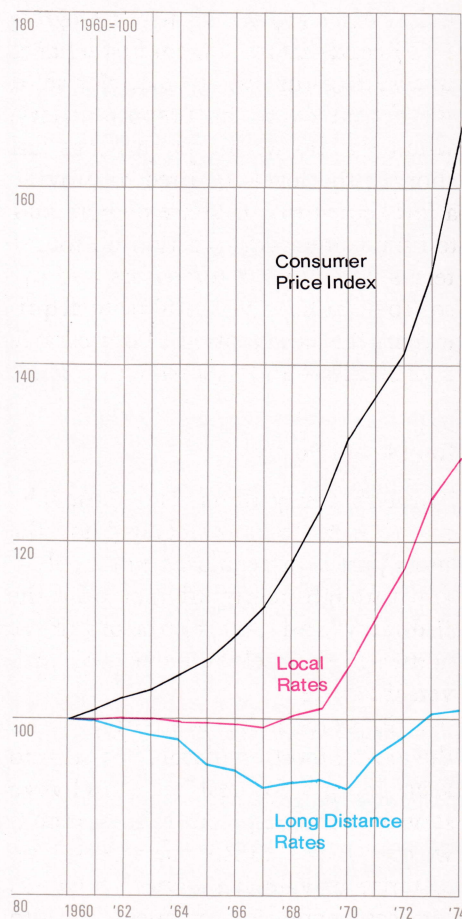
own above the 10 per cent level.

In view of these circumstances, we have urged—and continue to urge—upon the Administration and the Congress the adoption of permanent measures that will on the one hand encourage investors to invest and on the other enhance industry's ability to attract and generate the capital it requires to meet the public's needs.

To these ends we have been encouraged by Congressional consideration of the recommendation that *re-invested* share owner dividends—as in our Dividend Reinvestment and Stock Purchase Plan—be exempted from immediate taxation. This, we believe, would provide a powerful incentive to increased capital formation, at the same time providing a strong signal that public policy favors a broad base of public participation in the ownership of enterprise. We hope that like consideration will be given to measures to liberalize tax rates and holding periods on capital gains and losses.

We have been encouraged, too, by proposals that utilities be permitted to apply the investment tax credit at the rate applicable to other industries. We believe that enactment of such a measure, together with steps to assure the adequacy of depreciation rates, would significantly accelerate the translation of new technology—and the lower costs it achieves—into service to the public. Certainly, however, any limitation that would preclude full application of any increase in the investment tax credit to *all* utilities would be discriminatory.

No one of these measures by itself or all of them together, however, will provide as sustained a stimulus to capital formation as a recognition on the part of regulators and the public that what most encourages investors to invest is the expectation of profit. Regulation that thwarts that expectation—in the



Although the Consumer Price Index has increased 67 per cent since 1960, local telephone rates have gone up only 29 per cent and long distance rates have remained virtually unchanged in that period.

name of fighting inflation—exacerbates the very ills it purports to combat. What is more, it fails in its responsibilities to the future.

These matters, we believe, merit the thoughtful—and urgent—attention of government, not only in the interest of surmounting our immediate economic ills but in order to pave the way for a sustained realization of the nation's strength over the years ahead.

For our part, we shall continue to pursue unrelentingly the advances in productivity and efficiency that con-

tributed so significantly to our progress in 1974 and that remain our first reliance in assuring our own future. Nor shall we flinch from the responsibility, wherever and whenever earnings fall short of the level required to provide a fair return to our share owners and to finance new construction on sound terms, to go to our regulators and say so. To do otherwise would be to acquiesce in the slow erosion of our service capabilities—and this we will not do.

Regulatory Policy

Through nearly all its history, the telephone industry has operated for the most part as a regulated monopoly—and through nearly all that time the industry and its regulators have addressed themselves to one goal: universal service.

To promote that goal our aim and the aim of most regulators has been to keep charges for residence exchange service as low as possible. To that end, we have looked to other services—long distance, private line services, business services, extension phones, etc.—to produce revenues sufficiently above their costs to help meet the common costs of all services. Deprived entirely of this support, the price of residence telephone service would increase sharply, in some places nearly double.

In recent years, the Federal Communications Commission has pursued a policy of promoting "competition" in certain sectors of our industry, notably in the provision of private line services for business and in the supply of terminal equipment—switchboards, key systems and the like.

In the terminal market, our competitors are unregulated and therefore free to price as they please. Our rates, on the other hand, are fixed by tariffs that must be approved by regulatory commissions.

In the intercity private line field, competitors may pick and choose what routes they will serve. We must serve all—regardless of profitability.

Our position on this matter can be simply stated.

In our industry, we believe competition—or, more precisely, *regulated* competition that is, in effect, a government-imposed allocation of the market—is adverse to the interest of the public. This development, should it continue, will impair service by fragmenting responsibility for it and it will add to its costs. Consequently, we have opposed this trend, and have called for a moratorium on its extension until its potential impact on the public has been fully explored.

We recognize that we are not the final arbiters of the public interest and if, after weighing all the facts, government should conclude that the advantages to some people that competition might afford are worth some compromise of the interests of most people, all we ask in that event is the opportunity to compete on the same ground rules as everybody else.

To put the current situation briefly, the moratorium on extending competition we sought has not been forthcoming. Nor have we been released from all regulatory restrictions that preclude us from competing back fully.

We believe that this is a matter of sufficient moment to the American people that we have taken every opportunity over the past year to make its implications clear to the public at large and their elected representatives. Our concern is the prospect that if so crucial a matter is decided case by case—and in the absence of a comprehensive examination of its long term consequences—the American people may one day discover that the foundation stones on which the nation's telecommunications service has been built have been swept

away one by one and no prospects remain of restoring them.

Antitrust Suit

On November 20, 1974 the Justice Department filed an antitrust suit against the Bell System charging monopolization and conspiracy to monopolize the supply of telecommunications service and equipment in this country. If there is any merit in this action, it is that it has served to bring into dramatic focus issues of which the general public had been largely unaware but which, depending on how they are resolved, can have large public consequences.

On November 26 I addressed a letter to all share owners expressing our confidence that we are not in violation of the antitrust laws and our determination to contest the Justice Department's action vigorously. Nothing has happened since to change that confidence or alter that determination.

To review our position on this matter, we believe the Justice Department's action unwarranted for these reasons:

First, because the Justice Department's charges are groundless. We have not sought to suppress competition illegally. Where we believe competition adverse to the public interest we have not hesitated to state our convictions. But where competition has been mandated by appropriate authority, we have conscientiously abided by that judgment and the law.

More fundamentally, the fact that the Bell companies have operated substantially without competition in the territories they serve reflects not a unilateral effort to deny opportunities to others but the dictates of a national policy that has governed our industry for generations—that is, that in the telecommunications industry the public interest is best served by regulation

rather than competition.

That policy grew out of the nation's experience of the bitter competition that characterized the telephone industry in the early days of this century and the recognition, born of that experience, that in our industry competition breeds a wasteful duplication of facilities and obstructs rather than facilitates the ready connection of any telephone with any other that is the industry's basic function.

Accordingly, for a great many years the operations of the Bell companies—their prices and profits and the adequacy of their services—have been rigorously regulated by public authority on both the Federal and state levels. That this arrangement works well is evident from the fact that private enterprise operating under government regulation has provided the U.S. a telecommunications service that in terms of its quality, availability and low cost is unrivalled in the world. To supplant long standing national policy, as the Justice Department would, simply in the interest of competition for competition's sake—and without any showing of the public benefits thereof—would not only ignore the lessons of history but deny the future the proven benefits of that policy.

Second, the Justice Department's suit, should it succeed in its aim of breaking up the Bell System, would thereby fragment responsibility for the service process. This process is, because it *must* be in an enterprise as intricately interrelated as ours is and therefore so dependent on the precise, *systematic* organization of its resources, a continuous one extending uninterruptedly from invention through manufacture and supply to customer service. Separating Bell Laboratories from Western Electric and both from the Bell telephone companies would destroy this process. It would obstruct innovation by impairing the close working relationships that link



In 1916, when this figure was first installed atop AT&T headquarters in New York, the Bell System was already structured essentially as it now is. Originally named the "Genius of Electricity," it is widely known today as the Spirit of Communications and has become a symbol of the service commitment that links the million people who comprise the Bell System.

the people who design telephone facilities with the people who build and operate them. More fundamentally, it would destroy the very purpose that gives direction to the Laboratories' creative energies. And it would deprive the public of the economies that derive from aggregating the material requirements of the telephone companies and programming their supply.

At the same time divestiture of Western Electric would deny the telephone companies—and their customers—the advantages of an affiliated manufacturer committed not to objectives of its own but to theirs. Only a company linked in purpose to its customers would assume, as Western Electric does, responsibility for providing products of the exacting quality good telephone service requires at the lowest cost over their entire service life. Only such a company would continuously address itself, considerations of competition aside, to reducing the cost and improving the serviceability of its products. And only such a company would provide—year-in and year-out—continued assurance of delivery of those products on a where-wanted, when-wanted basis.

It is service, then, that dictates the shape of our business—its integrated structure. To this end we have sought not a monopoly but a system. The basic structure of that system has remained unchanged for the better part of a hundred years. Again and again over the years, Congress has had an opportunity to change it. But again and again its appropriateness has been confirmed. We are confident that it will be again.

Third, the Justice Department's aim of separating all or part of AT&T's Long Lines Department from some or all of the Bell telephone companies would seriously impair our ability to manage the nationwide telecommuni-

cations network. That network, although it spans a continent and comprised though it be of literally trillions of separate parts, is nonetheless a single integrated entity and must be operated that way. To do its job the network must be constantly reconfigured—day by day, hour by hour, minute by minute—to match the ebb and flow of traffic. Centralized planning is essential to assure optimum performance at least cost. And should disaster strike anywhere, Systemwide resources must be—and are—at-the-ready to restore service as promptly as humanly possible. To impair these capabilities is to risk severe damage to a unique national resource, the value of which is best evidenced by the fact that most Americans so readily take it for granted.

In sum, our reasons for opposing the Justice Department's action are one reason. That action, should it succeed, would hurt the public. Telephone service would deteriorate and it would cost much, much more. The Bell System's response to the Justice Department's suit was filed in the District Court in Washington, D.C. on February 4, 1975.

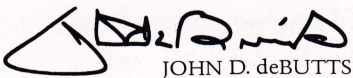
The American people, we recognize, will judge the merits of our position on their experience of our performance. Down through the years that performance has been spurred not by competition but by the clear and undivided responsibility for service that has been its guiding principle.

In response to this principle our industry has brought telephone service to virtually every American household. It has provided the nation with the most advanced telecommunications service in the world. Its record of technological innovation is unmatched by any other industry and over the years since World War II it has improved productivity at a pace nearly twice that of the general economy. In short, in the very attributes

competition is supposed to enhance—in pricing performance, in innovation, in the availability of its services—our industry has far outpaced the general economy.

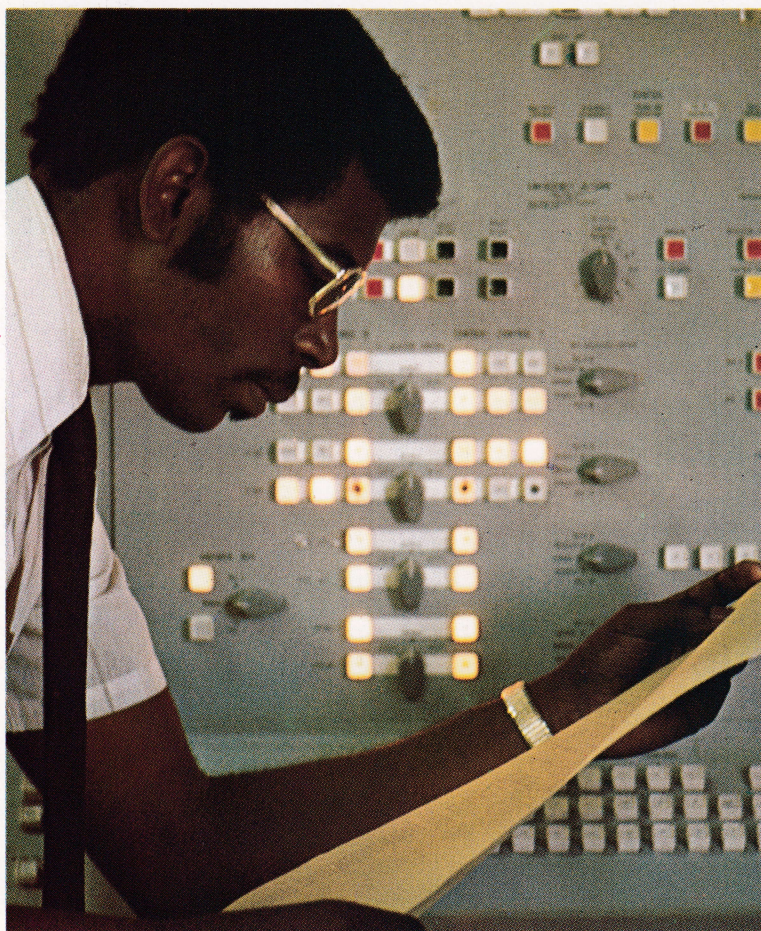
That record continued throughout the year just past. In 1974 we achieved a level of performance—in terms of the quality of our service and the efficiency with which it was provided—in which Bell System people may take just pride.

And so, too—for their part in it—may the five million investors who provided the resources on which that performance was based.


JOHN D. deBUTTS

February 11, 1975

Bell System people provided more and better service — more efficiently



Operations



In 1974 the Bell telephone companies handled some 457 million calls per average business day—25 million more than in 1973. Not one of those calls was precisely like any other. Some were business calls, some family calls, some simply social. Some were calls to next door; some crossed the country; others were routed overseas. But each one... at the time... to someone... was special.

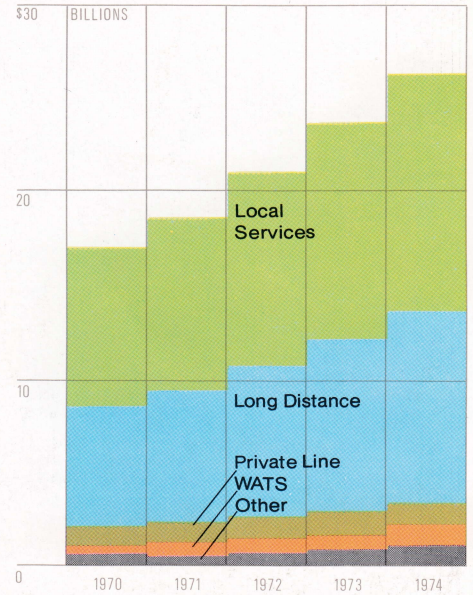
Of these millions of calls, all but a mere fraction went through to their destinations without incident or interruption. That this should be so most people nowadays take for granted.

Telephone people—including the men and women of the Bell telephone companies and AT&T's Long Lines Department, whose job it is to manage and operate this network, and of Western Electric and Bell Laboratories, who constantly enhance its capabilities—would not have it otherwise. It is in fact their aim. What follows is an accounting of some of the things they did in 1974 to achieve that aim.

Our business continued to grow

Growth in demand for service continued during most of 1974, but declined toward the latter part of the year.

During the year we added 4.3 million new telephones—47 per cent of them residence extension phones—bringing the total of Bell System telephones in service to over 114 million. The volume of long distance messages



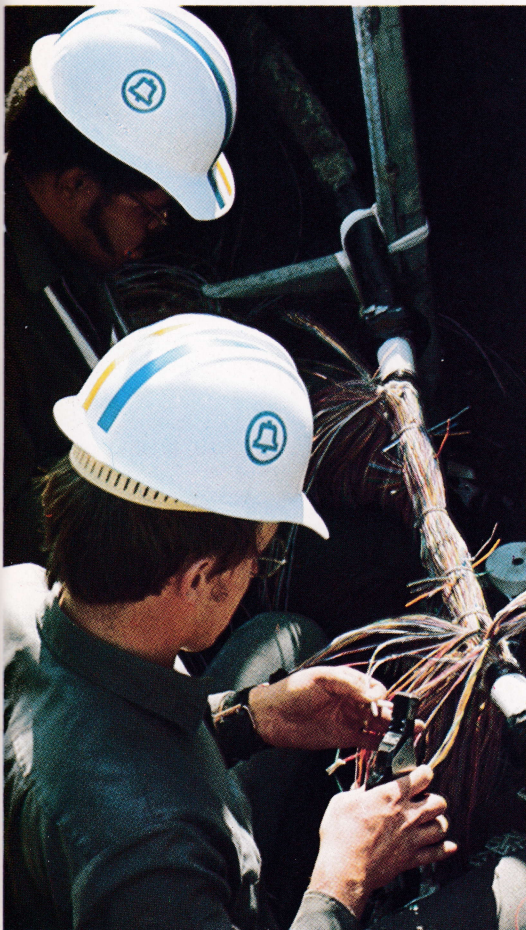
Revenues from local and long distance message service as well as from other Bell System services grew in each of the last five years—reaching more than \$26 billion in 1974.

increased 7.5 per cent over 1973.

Strongest growth came in overseas calling—up 20 per cent over '73—and residence extensions, which grew by 2.1 million. Wide Area Telecommunications Service (WATS) continued to attract more and more customers as it has in every year since its introduction in 1961.

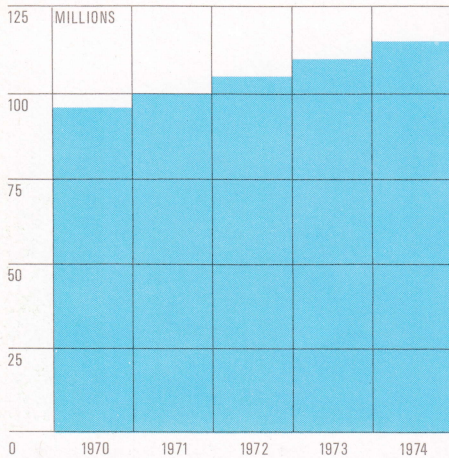
Revenues increased 11.3 per cent over 1973, operating expenses 11.4 per cent. An unrelenting effort to control costs, combined with necessary rate increases, contributed to a further improvement in our rate of earnings on average capital—8.5 per cent in 1974 compared to 8.3 per cent in '73, 7.7 per cent in '72.

Of 1974's revenues, 43.8 per cent came from monthly charges to our business and residence customers, 38.1 per cent from charges for long distance calls—with most of the remainder coming from specialized business services,

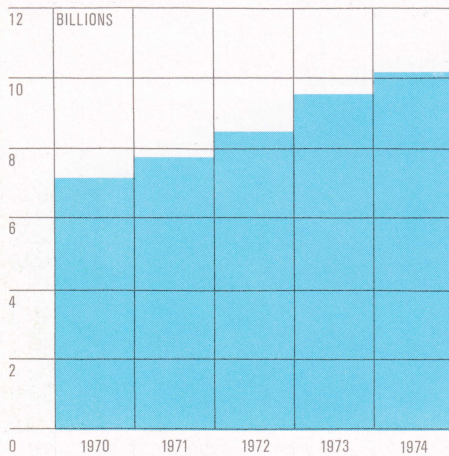


Top row, from left: Vince Hession, construction engineer for New Jersey Bell; Ethelmayree Davidson, TSPS operator for Mountain Bell; and Ann Sorenson, PBX installer for Pacific Telephone. Center, Marsha Pittman, directory assistance operator for Southwestern Bell. Bottom row, from left: Roland Atkins, ESS central office foreman for Bell of Pennsylvania; Mittie Thompson, Susie Hutsell and Patricia Foust, service representatives for South Central Bell; and Steven Brown (top) and William Schwartz are cable splicers for Indiana Bell.

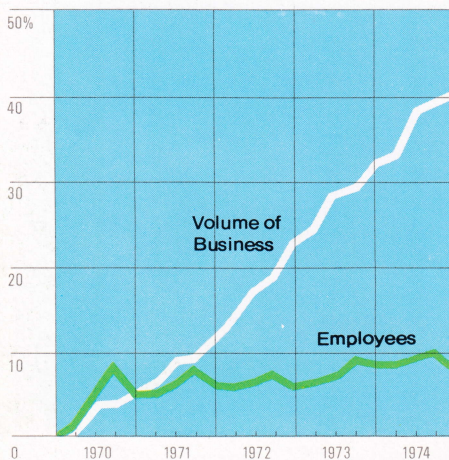
Volume of business continued to grow...



Telephones: Bell System telephones in service have risen from under 97 million in 1970 to over 114 million in 1974.



Long distance messages handled by the Bell companies totaled 10.2 billion in 1974—a 54 per cent increase since 1969.



Volume of business: We have handled a growing volume of business without significant increases in telephone company employees.



Our 500th No. 1 Electronic Switching System went into operation in Springfield, Illinois, where Earl Farrar, of Illinois Bell, works as a central office foreman.

coin telephones and directory advertising.

We made service better

In 1974 the Bell System improved the level of its service to customers—and today the service difficulties so widely publicized a half-dozen years ago persist only in a few isolated instances. On a nationwide basis, service is better than it has ever been in our history. We know this from our own stringent measurements of the technical performance of our facilities and our own appraisals of the responsiveness of employees. And we know it from our customers themselves as evidenced in our surveys of customer attitudes.

Traditionally the telecommunications network—its capacity and the quality of its performance—has reflected a sustained construction effort necessarily matched not to the short term ups and downs of the economy but to the long term growth in the nation's needs for telecommunications services. Thus—despite 1974's economic uncertainties—we continued to plan and build for the future.

We continued to build

During the year the Bell System companies spent \$10 billion for construction, some \$750 million more than the year before. By making more efficient use of our existing plant investment and through extensive efforts to control our capital expenditures—including careful and repeated reviews of major construction projects—we have managed in recent years to hold our construction spending at a fairly even level in terms of constant dollars.

Of our 1974 construction budget, 62 per cent was spent to meet current and anticipated growth requirements; 24 per cent went to replace damaged or obsolete equipment, relocate facilities and provide for customer movement;

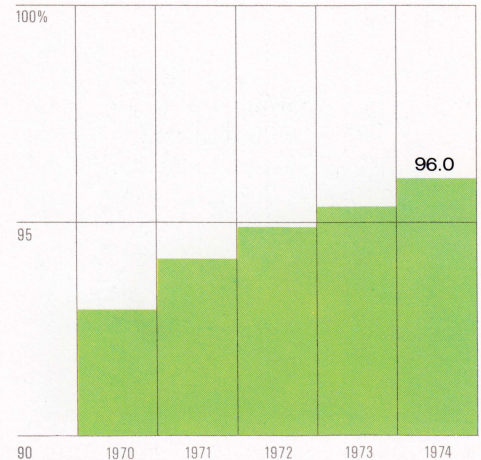
and 14 per cent was spent for modernization, including most notably the introduction of new and improved transmission, switching and traffic operating facilities.

A new coaxial cable system capable of transmitting up to 132,000 simultaneous conversations was placed in service last spring between Pittsburgh and St. Louis and we currently are converting a number of our older coaxial cable facilities to this newer system. At the same time new transmission techniques are enabling us to increase the circuit capacity of most of our major interstate microwave radio relay routes.

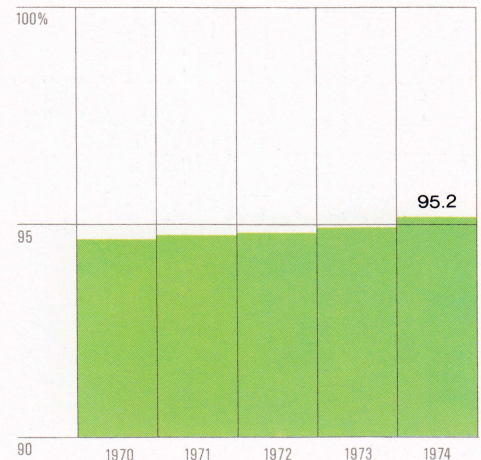
By converting and upgrading existing cable and microwave facilities, we are enlarging the telecommunications network with a minimum of the capital expense that would be required to construct entirely new transmission routes.

Looking beyond the capabilities of microwave and coaxial cable to the still higher-capacity facilities that will be needed in the 1980s, a new kind of transmission system—millimeter waveguide—ultimately will be able to carry almost a half-million conversations through a precision-engineered, copper-lined steel tube. An 8.7-mile millimeter waveguide link has been installed in New Jersey and is being used to evaluate the new system under field conditions.

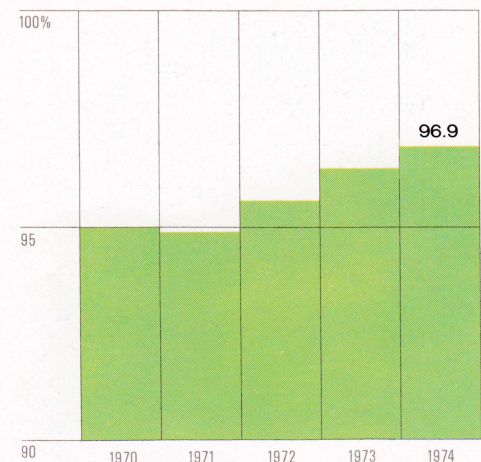
Earth stations for our domestic satellite system, which will go into service early in 1976, are under construction in California, Illinois, Pennsylvania and Georgia. Using three satellites, one a backup, leased from Comsat General Corporation, this new system will provide added flexibility to the telecommunications network. The GTE Satellite Corporation, which had planned to build its own domestic satellite system, has asked for FCC ap-



Installations: In 1974 the Bell companies met 96 per cent of their appointments to install telephones on time.



Telephones without reported troubles in 1974 averaged 95.2 per cent per month—up from 94.6 per cent in 1970.



Long distance calls: 96.9 per cent went through to their destinations in 1974 without interruptions or other difficulties.



Under construction near Hawley, Pennsylvania, is one of four Bell System earth stations that in 1976 are scheduled to become the terrestrial links of our domestic satellite communications system. Satellites will give added flexibility to the telecommunications network.

proval to join with AT&T in operating a single system that would have seven earth stations, including the four owned by AT&T.

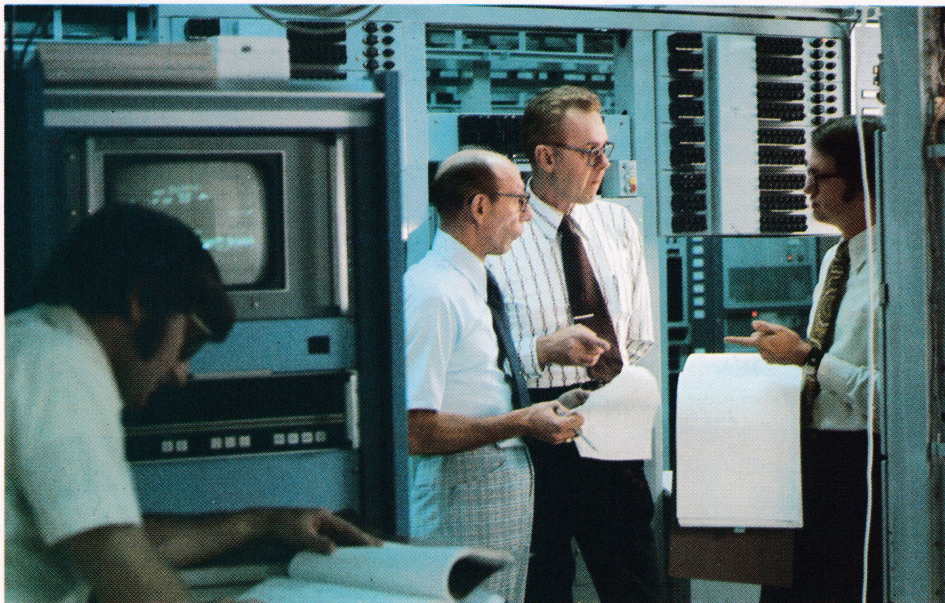
In overseas service, the *Cable Ship Long Lines* last year laid a third under-sea cable between California and Hawaii to help handle trans-Pacific telecommunications traffic, which has been growing at a rate of 16 per cent a year. This 845-circuit cable is being extended across the Pacific to Guam and Okinawa this year.

A milestone in the Bell System's program of replacing older central office equipment was reached last year when our 500th No. 1 Electronic Switching System (ESS) went into operation in Springfield, Illinois. By the end of 1974, 645 of our local switching offices had been converted to electronic switching, and some 14 million telephones were being served through these exchanges.

Besides being more efficient, reliable and economical than electromechanical switching machines, the new electronic systems allow us to offer customers new optional services, such as speed calling of frequently dialed numbers; automatic forwarding of calls to another number; three-way calling; and call waiting, to alert the customer that another call is waiting on the line.

The Bell System's first Electronic Switching System designed specifically for long distance communications has been installed in Chicago and will undergo testing before being placed in commercial service in early 1976. This new switching system, culminating one of the most extensive development programs in Bell System history, will be able to handle at least 350,000 calls an hour, about three times as many as the most advanced toll switching system now in use.

The Bell System in 1974 continued



to refine old methods and find new and better ways of doing its job. As a consequence, productivity continued to improve.

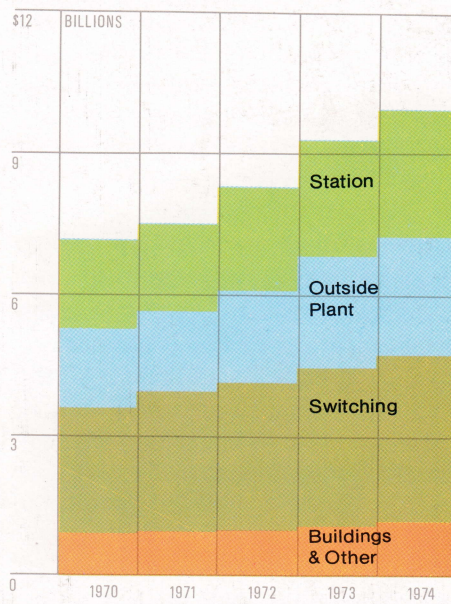
Productivity improved

At the start of 1970 we employed 79.4 employees per 10,000 telephones, at the end of last year only 69.3. To put the matter another way, in 1974 we handled 34 per cent more business than in 1970—with only four per cent more telephone employees.

To increase operator efficiency and facilitate customer dialing of person, credit card and third number calls, 2,200 Traffic Service Position System (TSPS) consoles were installed in 1974. Some 16,900 of these multipurpose electronic consoles were in service at the end of the year.

In 1976 we will begin implementing a major change in the way the network operates. With a new system called Common Channel Inter-office Signaling, we will transmit the information needed to establish the connection for a call on a separate circuit from the one on which the call

The Bell System's first Electronic Switching System designed specifically for long distance calls will go into commercial service in early 1976. From left: Richard Light and Norman F. Czarnecki, Western Electric; Harry Compton, Bell Laboratories; and John Foster, Long Lines.



Construction: Since 1969 our construction expenditures have totaled \$42 billion.

itself is carried. When this system is fully installed in both the local and toll portions of the network, the interval between the time a number is dialed and the telephone rings will be reduced to less than two seconds. Aside from improving the utilization of circuits, this system will provide more flexibility in routing calls and enable us to offer new customer services.

In another effort to obtain optimum use of the network and reduce our operating expenses, we are encouraging customers to dial long distance calls themselves and to make more of their calls during off-peak hours. In 1974, 85 per cent of all long distance calls were dialed directly—twice as many as five years ago.

More customers were able to dial their own overseas calls last year, too, as 542 additional central offices were equipped for international direct distance dialing. By the end of 1974, six million Bell System customers in 200 cities and towns throughout the country had this capability.

As new and larger-capacity transmission systems have been introduced, our investment costs have continued to decline. Ten years ago, the average investment per circuit mile for interstate facilities was \$25, compared to approximately \$16 in 1974 and only about \$2 for our newest coaxial cable system.

We introduced new services

Once there was just what Bell System people call POTS—for plain old telephone service. Today, as the nation's communications needs become more and more diversified, we are constantly adapting our network to a wider and wider spectrum of customer requirements and developing the facilities to meet them.

In 1974 we completed the first five-city segment of a new transmission system that will be devoted entirely to data



A new electronic Private Branch Exchange system was developed for use in the increasingly competitive market for business telecommunications equipment. Kenneth J. Whalen, AT&T vice president for marketing, is shown with the console of the new system.

service. After protracted consideration, the FCC has authorized us to begin offering Dataphone® Digital Service over this system and to build and operate digital facilities for 19 additional cities. Regrettably, however, the FCC's order requires us to charge higher rates than we believe necessary for service to these 19 additional cities, thus denying customers the full advantages of the economies the new system affords. In any event, the new system will mean increased reliability and accuracy in the transmission of medium and high-speed data communications—and we look forward to extending it to 96 cities within two years.

We look forward, too, to the opportunity to implement a new Bell

Laboratories-developed concept in mobile communications that will make more efficient use of the frequency spectrum and provide us at the same time the opportunity to make what has admittedly been a far from satisfactory service as good as the telephone service customers experience in their homes and offices. While the FCC has expanded the portion of the frequency spectrum available for mobile communications, that expansion is insufficient to permit reaching the full potential of the new system. We hope the Commission will reconsider and release the adjacent frequency spectrum it has held in reserve.

To discern developing communications needs and to enhance revenues, the Bell companies continued to strengthen their marketing and sales forces and to diversify their service offerings.

Early in 1975, for example, we announced the introduction of a new electronic Private Branch Exchange (PBX) system developed by Bell Laboratories. This Dimension* PBX uses solid-state technology and a miniaturized computer which provide the flexibility to add features in the future to meet the changing needs of customers. The first Dimension systems will offer 60 customer features, including some not available in any other single PBX system.

Most Bell System operating companies have begun offering in one or more locations decorator-type Design Line* telephones, and last year a successful marketing trial was completed for our new Touch-a-Matic® telephone, with which customers can dial any one of 31 numbers by touching a single button.

The Bell companies look to a growing line of new products and services, knowledgeably represented, to maintain their leadership in the increasingly

*Trademarks of AT&T Co.



Decorator-type Design Line telephones, manufactured in different styles and colors, are being offered by Bell telephone companies in a growing number of locations.

competitive business communications market.

In the intercity private line field, the Bell System's costs on routes its competitors seek to serve are significantly lower than theirs. However, in this field, in the absence of a regulatory moratorium on new construction that unnecessarily duplicates telephone company facilities or, lacking that, full freedom for the telephone companies to respond to the competition they face—revenue losses, while thus far confined to a few major routes, could in time prove significant.

We sought higher rates

To help meet their capital requirements in the face of double-digit inflation, Bell System operating companies filed applications for higher telephone rates in most jurisdictions last year. Increases that were approved by regulatory agencies during the year will add about \$500 million annually to Bell System revenues.

In January 1975, for only the second time in 22 years, we requested FCC approval to increase rates for most interstate calls. The new rates would provide an additional \$433 million a year after taxes in interstate net income. At the same time customers would be given more opportunities to save money on their interstate calls—including a new one-minute initial period, 24 hours a day, for direct-dialed calls and discounts of 35 per cent in the evenings and 60 per cent at night and on weekends. By promoting more efficient use of telephone facilities, our proposal would produce cost savings of some \$192 million.

To relieve all ratepayers of charges that only some of them occasion, we continued last year to move toward more usage-sensitive and cost-related pricing for some services, including directory assistance, installation and

To connect the nation's telephones, a single integrated network



As president of AT&T's Long Lines Department, Richard R. Hough heads an organization responsible for managing the integrated network of facilities that connects the nation's telephone companies, both Bell and Independent, with each other and links them to 246 countries and territories overseas.



A third undersea cable laid between the U.S. mainland and Hawaii in 1974 will be extended to Guam and Okinawa this year. Long Lines employees Roger Hamm, left, and Harry C. Pahl work on the California end with the Cable Ship Long Lines in the background.

coin service. We also put into effect in 1974 new rates for intercity private line services, which are used mainly by businesses. The new private line rate

structure, a departure from our traditional nationwide average pricing practices, relates rates more directly to the costs of providing these services

and is more competitive with the rates charged by specialized common carriers.

In times of change, we changed

For half-a-century and more, the operating forces of the Bell telephone companies have been deployed in keeping with their three main functions: Traffic, Plant and Commercial. The endurance of this organizational structure is testimony to its strengths. What now leads us to change it is the prospect that interdepartmental coordination, once safely assumed on the basis of long experience, can no longer be taken for granted in the face of the volume and variety of customer service needs we confront today. Accordingly in recent years, AT&T and the telephone companies, each according to its needs, have been moving in the direction of a form of organization that places the *entire* responsibility for customer service and for coordination of all three of our operating disciplines at a lower level in the organization. The aim: to establish *total* responsibility for service as close to our customers as possible.

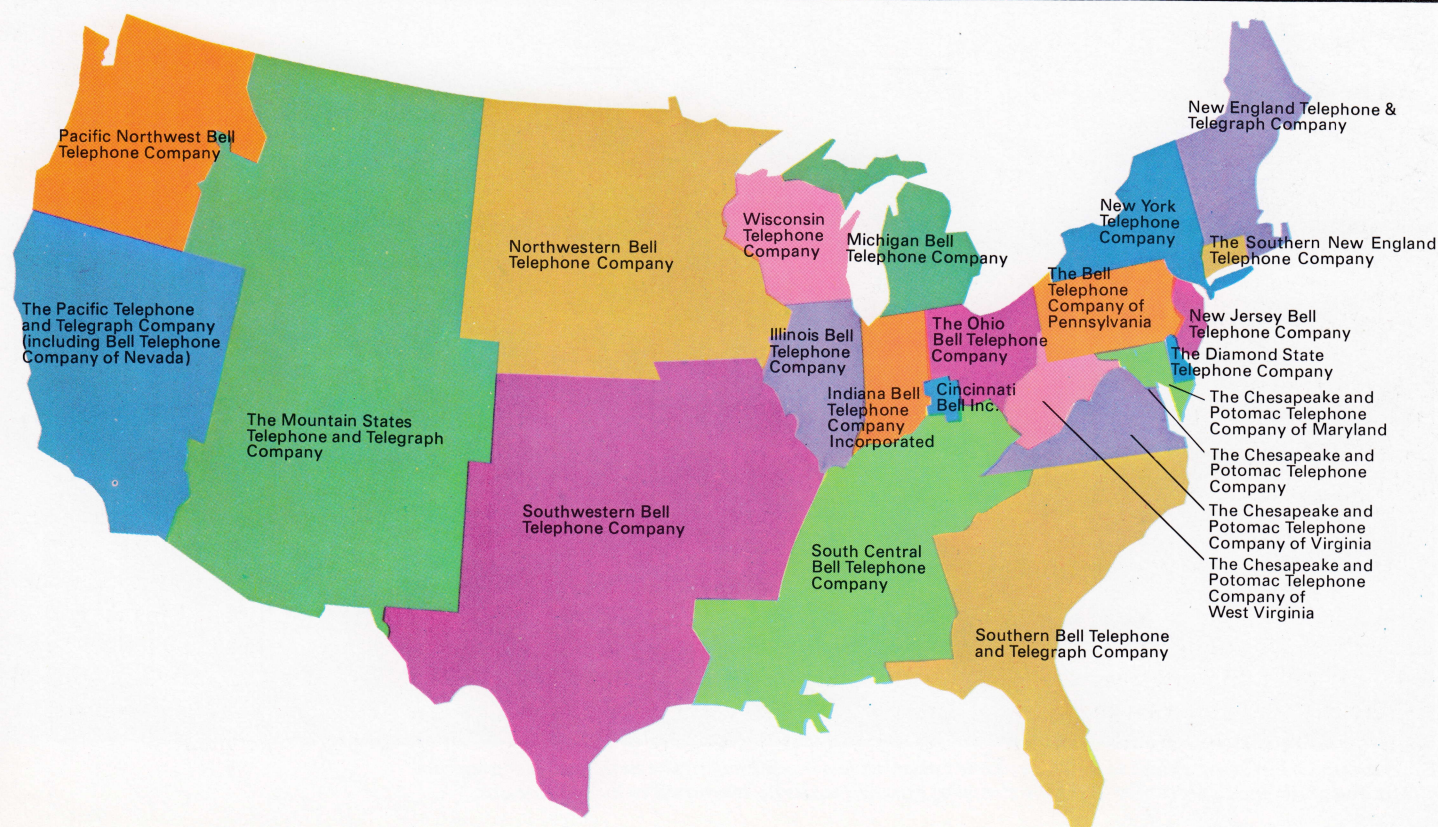
At the same time a number of the telephone companies have responded to the increasing complexity of our network, particularly in major metropolitan areas, by reconstituting a portion of their engineering and plant forces as network management departments.

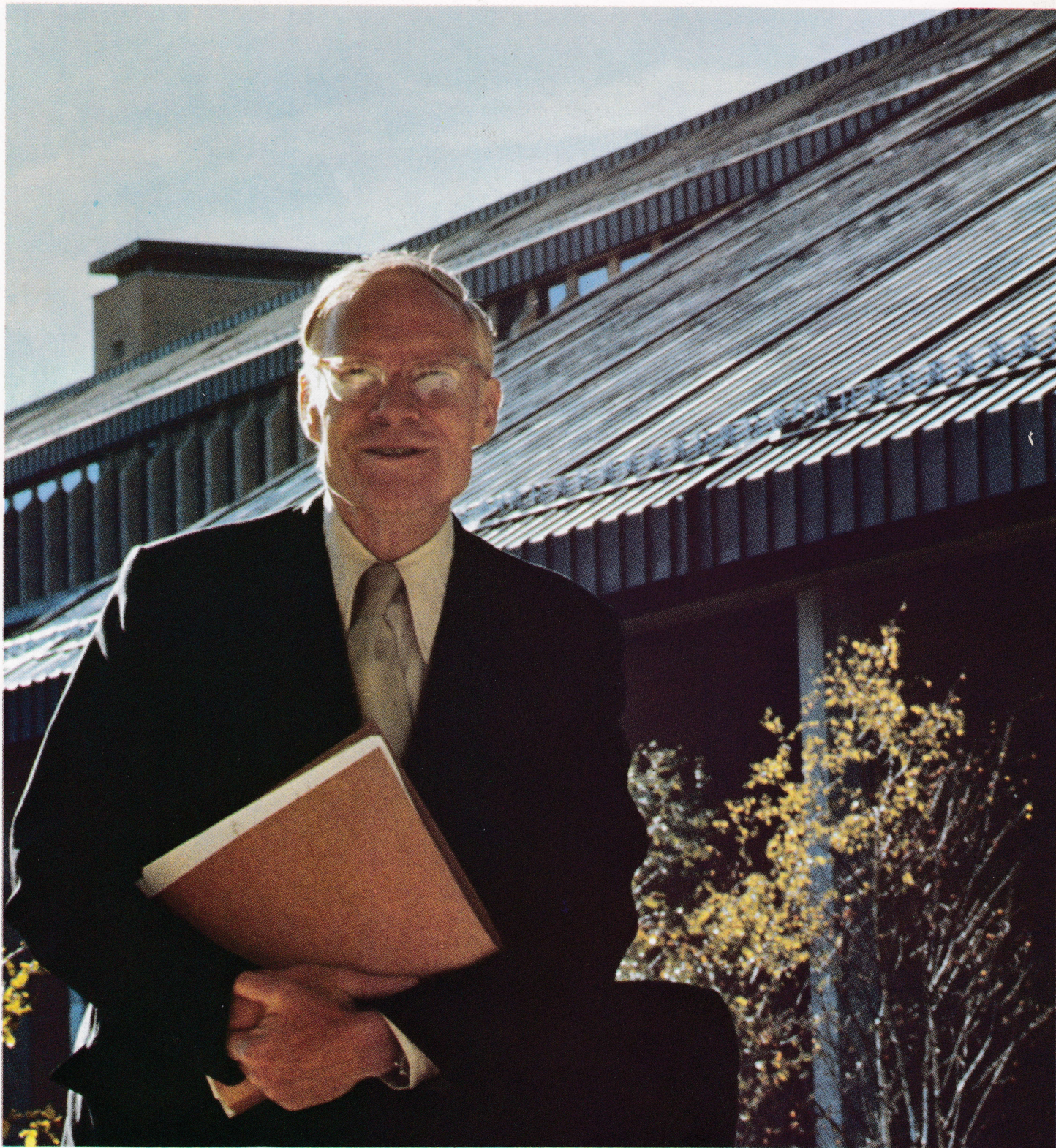
By 1974 we had gained sufficient experience of these organizational developments to recommend their System-wide adoption—again with variations as local conditions require.

In response to a request from the Commonwealth of Puerto Rico, AT&T agreed last year to provide advice and assistance to the Puerto Rico Telephone Authority for a period of five years. American Bell Inc., a wholly-owned subsidiary of AT&T, was established to carry out this agreement.

About 80 per cent of the nation's telephones are served by Bell System telephone subsidiaries, which operate in every state but Hawaii and Alaska. Of the 21 principal operating telephone companies, all are wholly-owned by AT&T but four: Mountain Bell (88.6%); Pacific Northwest Bell (89.3%); New England Telephone (85.4%); and Pacific Telephone (89.8%). AT&T has a minority ownership in Southern New England Telephone (16.6%) and Cincinnati Bell (25.7%). AT&T acquired full ownership in 1974 of the Illinois Bell Telephone Company, having previously held 99.3 per cent of that company's shares. In January, 1975 the company disposed of its remaining shares of Bell Canada stock. AT&T owns the Western Electric Company and, together with Western, Bell Telephone Laboratories. AT&T's Long Lines Department manages the interstate network for the Bell System.

Name	Area served	Telephones served as of 12/31/74 (in thousands)
New England Telephone & Telegraph Company	Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	5,886
The Southern New England Telephone Company	Connecticut	2,267
New York Telephone Company	New York and portion of Connecticut	11,795
New Jersey Bell Telephone Company	New Jersey	5,408
The Bell Telephone Company of Pennsylvania	Pennsylvania	6,976
The Diamond State Telephone Company	Delaware	448
The Chesapeake and Potomac Telephone Company	Washington, D.C.	981
The Chesapeake and Potomac Telephone Company of Maryland	Maryland	2,902
The Chesapeake and Potomac Telephone Company of Virginia	Virginia	2,422
The Chesapeake and Potomac Telephone Company of West Virginia	West Virginia	775
Southern Bell Telephone and Telegraph Company	Florida, Georgia, North Carolina, South Carolina	9,484
South Central Bell Telephone Company	Alabama, Kentucky, Louisiana, Mississippi, Tennessee	8,037
The Ohio Bell Telephone Company	Ohio	4,530
Cincinnati Bell Inc.	Cincinnati, portions of Kentucky, Indiana	1,003
Michigan Bell Telephone Company	Michigan	5,309
Indiana Bell Telephone Company, Incorporated	Indiana	1,928
Wisconsin Telephone Company	Wisconsin	2,032
Illinois Bell Telephone Company	Illinois and portion of Indiana	6,985
Northwestern Bell Telephone Company	Iowa, Minnesota, Nebraska, North Dakota, South Dakota	4,773
Southwestern Bell Telephone Company	Arkansas, Kansas, Missouri, Oklahoma, Texas	12,802
The Mountain States Telephone and Telegraph Company	Arizona, Colorado, Idaho, Montana, New Mexico, Utah, Wyoming and portion of Texas	5,497
Pacific Northwest Bell Telephone Company	Oregon, Washington and portion of Idaho	2,952
The Pacific Telephone and Telegraph Company (including Bell Telephone Company of Nevada)	California, Nevada	12,548





Dr. William O. Baker, president of Bell Telephone Laboratories: "...we have in the Bell System's integrated affairs and skills the opportunity to see the thrust of human creativity converted to human benefits."

It is now 50 years since AT&T announced a plan to organize a new company for the purpose of carrying on the Bell System's research and development program—a company “to be known,” as the announcement put it, “by some such name as the Bell Telephone Laboratories.”

Today Bell Telephone Laboratories is universally acknowledged to be the foremost center of communications technology in the world. The transistor was invented there—just one, albeit the most celebrated, in a continuous stream of innovations that have not only contributed to the steady advance of the Bell System's own technology but have enriched the technology of a wide spectrum of other industries, including the computer industry. Innovations at Bell Laboratories also have opened whole new scientific vistas—radio astronomy is a case in point—and significantly strengthened the nation's defense and space exploration capabilities.

What distinguishes Bell Laboratories is its purpose. The number and notability of its innovations notwithstanding, it sees its mission not as a random quest for “breakthroughs” but as a systematic, programmed undertaking aimed at constant improvement of Bell System service. Central to this effort are its continuing innovations in the nationwide telecommunications network—the materials, devices and apparatus that make up the network, the systems in which they are arrayed and the methods by which the whole is managed and maintained.

In this effort the Laboratories does not stand alone. Rather does it draw its strength from its continuous relationships with AT&T, the Bell operating companies and Western Electric—from AT&T drawing overall guidance, from the operating companies its perceptions of what is needed, from Western

Electric its sense of the do-ability of its undertakings.

“We at Bell Laboratories,” its president, Dr. William O. Baker, has said, “depend on this structure to translate our innovations into useful products just as fully as our creativity depends on our own human resources and laboratory facilities.”

Last year, as it has for the past half-century, Bell Laboratories continued to enrich the technology of communications, ensuring thereby that—tomorrow as today—this country will continue to have the most advanced and the most economical telecommunications system in the world.

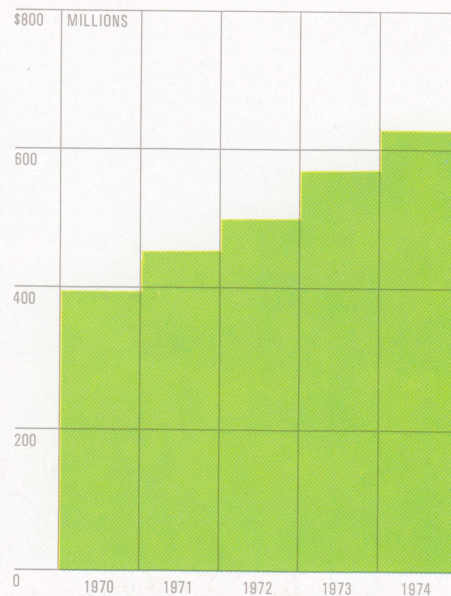
Research bears fruit

Among the many research projects underway at Bell Laboratories is one exploring the use of light for transmitting telephone calls, data and video signals, and the creation last year of new ultrapure glass fibers brought closer the day when an optical communications system will become an operating reality. The glass in these optical fibers must be so pure that a fiber a mile long is as transparent as an ordinary window pane a fraction of an inch thick. With recent developments, Bell Laboratories can now achieve this degree of purity.

Progress also was made in 1974 in devising techniques for splicing these tiny fibers and in developing better, longer-lasting light sources for generating the optical signals.

In the future these hair-thin fibers—carrying telecommunications traffic on beams of light pulses—may help relieve the problem of overcrowded utility cables in under-the-street conduits as well as increase substantially the capacity of our long distance network.

Another research effort culminated in the development of a new family of alloys made of copper, nickel and tin.



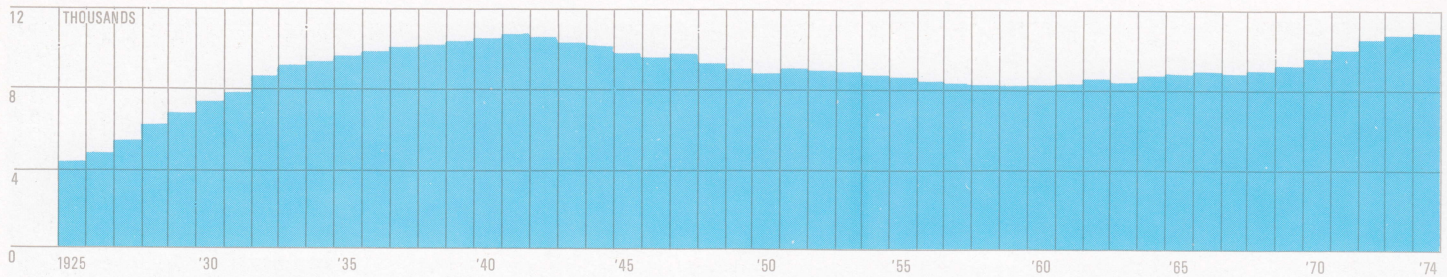
R&D: Reflecting our commitment to assuring high quality service in the future, expenditures for research and development in the Bell System in 1974 amounted to \$630 million, 58 per cent more than in 1970.

These new alloys are stronger, easier to form and will be less costly in the long run than the copper-based materials currently used in the manufacture of relays and connectors and for making springs used in telecommunications equipment.

Transmission, switching improved

In the technologies of switching and transmission, last year was notable both for the new developments achieved and for the progress made in implementing and improving innovations of past years.

The Bell System's new Dataphone® Digital Service, for which operating approval was granted by the FCC in 1974, employs a system developed by Bell Laboratories for using the lower portion of existing microwave channels to transmit information in digital or pulse form. This system—called Data Under Voice (DUV)—is one of the elements that makes it possible to provide



a long distance data network with minimum capital expense.

Among the software—that is, programming—changes developed for central office electronic switching equipment in 1974 were those providing hotels and motels with room-to-room dialing, direct station billing and instantaneous charge information.

Designing new equipment

Scientists and engineers at the Laboratories continued last year to design new, improved equipment to meet specialized needs of business and residential customers and to make telephone service easier to use by the handicapped and the hospitalized.

The newest addition to the Bell System family of data sets, Dataphone 9600, became available in 1974. It can be used for transmitting data up to 9600 bits per second over a single voice-grade channel.

Other 1974 product developments at Bell Labs included the Transaction* telephone, which—among other applications—can be used by merchants and banks to verify a customer's credit within seconds, and an Amplifying Handset—scheduled for an introductory trial this year—that upgrades party-line service and reduces the cost of providing telephone service in rural areas.

A device called the Signalman call announcer was developed by Bell Laboratories and offered for use by persons who, because of hearing problems

Patents: Even as old patents expire, enough new ones have been awarded to the Bell System to maintain no fewer than 8,200 patents in force every year since 1932. Many of these patents, widely licensed with other industries, have helped to advance the pace of the nation's technological progress, created new industries and stimulated the economy.

or other reasons, need to be alerted visually when a phone rings. This new device makes customers aware of incoming calls by activating an electrical appliance, such as a lamp. For patients confined to bed in hospitals or nursing homes, a mobile public telephone that can be rolled from place to place also was developed in 1974.

Helping manage the network

To help the telephone companies prevent network problems before they occur, Bell Labs is developing a new computer-based maintenance system called the Central Office Maintenance Management System. This new administrative tool helps telephone company supervisors to schedule, monitor and control maintenance operations for equipment units in switching machines, trunk lines and power systems. Automatic maintenance is playing an increasingly larger role in helping telephone company people to reduce operating costs and to provide more reliable telecommunications service.

For a number of years Bell Laboratories, with the support of other Bell System units, has been working to improve telephone company record-

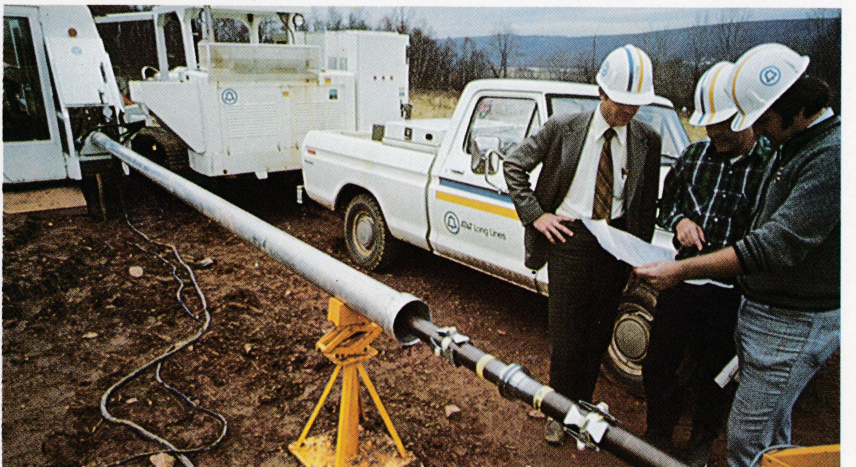
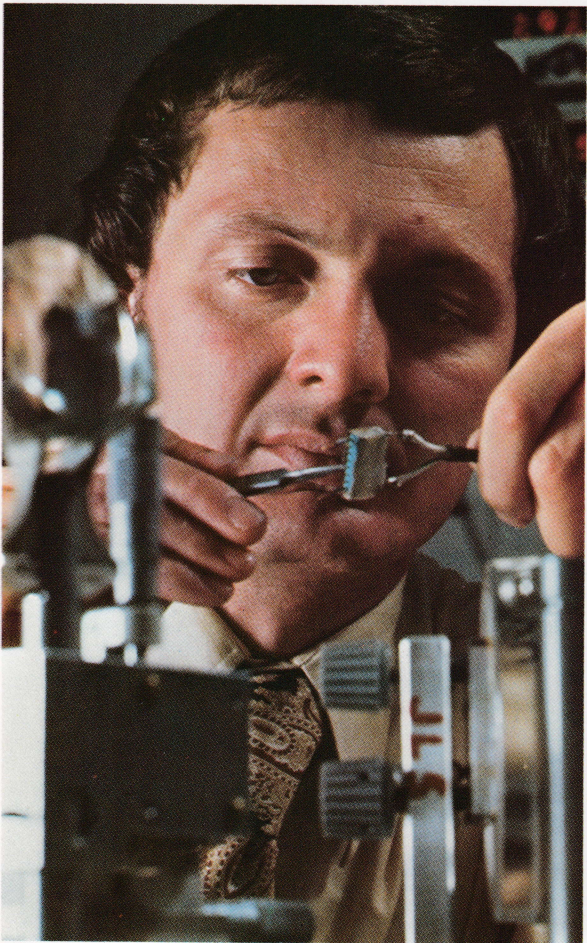
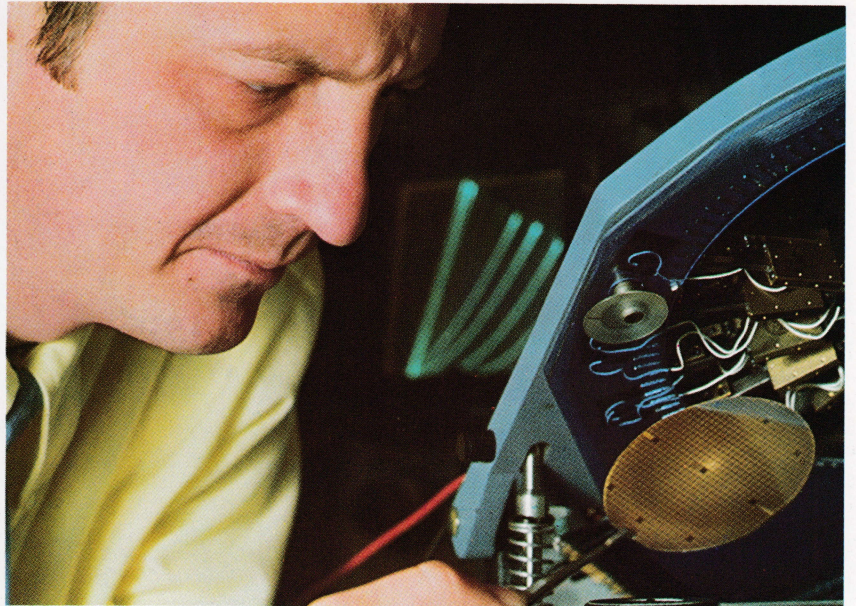
keeping and information-handling procedures. The result has been a number of highly computerized systems developed by the Business Information Systems organization within Bell Labs. The implementation of these systems accelerated markedly last year.

For example, about five per cent of our whitepages directories are currently being produced by an automated system called DIR/ECT, and within a few years 50 per cent of them will be handled by this method. Another system, the Plug-In Inventory Control System, is in use in several Bell operating companies and is expected to provide savings of some \$750 million over a 10-year period.

The achievements of Bell Laboratories in 1974, significant as they were, represent only a continuation of the remarkable performance of this organization throughout its 50-year history. For the public and the other units of the Bell System, as well as for Bell Laboratories itself, it has been a rewarding half-century.

The efforts of Bell Laboratories people are directed toward improving service for the public. Clockwise from lower left: Joseph Shay studies solar cell materials; Suzanne Nagel conducts optical fiber research; Allan Moline works on new integrated circuit fabrication processes; John Stanaway develops training equipment for TSPS operators; and Don Rutledge, Robert dePotere (of Western Electric) and Bill Lashevicki (of AT&T Long Lines) supervise construction of a millimeter waveguide system. Center, Tom Dennis helps design new high-speed data sets.

*Trademark of AT&T Co.





Western Electric's efficient performance helps assure economical service for Bell System customers. Here, Western Electric employees in Shreveport, Louisiana, assemble telephone sets. From left: Brenda Procell, Sue Johnson and Brenda Herrington.

Manufacture and Supply

In 1974 the Western Electric Company continued to place in production new and improved products that incorporated the latest advances in communications technology. While the company's sales were up slightly in current dollars, its actual sales volume was level with 1973. Earnings were adversely affected by inflated costs of materials and a four-week strike that halted operations at 16 of its manufacturing plants.

That its earnings declined by only 1.5 per cent in a year of economic and operational uncertainties is traceable in large measure to the company's pursuit of cost reductions in the products it manufactures and the sustained application of rigorous cost controls in every phase of its business.

Sales reach \$7.4 billion

Western Electric's sales in 1974 totaled \$7.4 billion, or about 4.9 per cent above 1973. The total resulted from sales, in the main, to:

- The Bell System: \$6.7 billion, about 8.3 per cent above 1973.
- The U.S. Government: \$490 million, about 29.5 per cent less than in 1973.

Western Electric earned \$311 million in 1974 and its return on average invested capital was 9.5 per cent.

During the year, Western contributed importantly to the continued improvement and expansion of the nationwide telecommunications network by delivering to the Bell companies 311 billion conductor feet of exchange cable, nine million telephones and 4.9 million lines of central office equipment.

Cost controls kept prices down

Strict attention to cost and expense control throughout the company helped Western Electric last year to limit its price increases for apparatus and equip-



More efficient and speedier delivery of equipment and supplies to the telephone companies will result from Western Electric's construction of regional Material Management Centers. Behind Western Electric President Donald E. Procknow is a display of areas served by the new centers.

ment to nine per cent—compared with an increase of 19 per cent in the prices of electrical machinery and equipment, as reported in the Bureau of Labor Statistics' Wholesale Price Index. Western's prices for cable and wire rose 21 per cent, reflecting the cost of copper, which went up 27 per cent during the year.

Adding to Western Electric's ability to hold down prices were record savings of \$164 million for the year from the company's engineering cost reduction program, among the most intensively administered such programs in all of industry.

Evidence of Western Electric's superior price performance is provided by price comparison studies conducted regularly by AT&T. Where valid comparisons can be made, Western Electric's prices on the average range from 15 to 35 per cent below the lowest

prices of other suppliers of telephone apparatus, cable, telecommunication supplies, and transmission and switching equipment.

In addition to its success in keeping prices down, the company continued to provide improved quality in its products and greater efficiency in their manufacture.

With raw materials like plastics and petrochemicals becoming increasingly scarce and costly, Western Electric pressed its efforts to find new production techniques that would save vital raw materials in short supply. For example, in 1974 the company began building a pilot plant for recycling scrap telephone wire, using a new process to reclaim valuable petrochemical materials and copper.

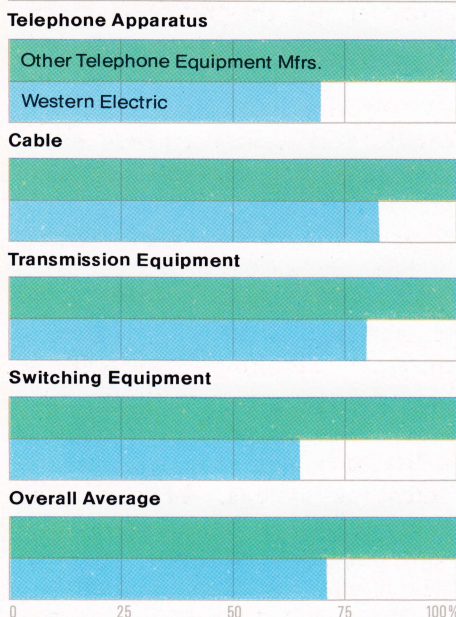
And last year Western Electric reduced its energy requirements by 20 per cent from its projected consumption based on 1972's usage, thereby making a major contribution to the Bell System's overall energy savings.

Putting technology to use

A very significant manufacturing achievement in 1974 was the production of the first No. 4 Electronic Switching System. With its high call-carrying capacity, this new system—developed by Bell Laboratories—will enable the Bell operating companies to handle the growing volume of long distance messages with fewer machines than would be required with electromechanical switching systems.

Meanwhile, Western Electric made important improvements in conventional switching systems. The company delivered to the Bell telephone companies the first models of a platform-mounted switching module—an assembly of switching equipment which provides service for from 200 to 1,200 customer lines.

In a reflection of new technology



Western Electric's prices on the average range from 15 to 35 per cent below the lowest prices of other suppliers of comparable telecommunications products.

and changing customer needs, Western estimates that about 40 per cent of its total sales of manufactured items in 1976 will consist of products introduced since 1972.

But while the rate of introduction of new products has sharply increased in recent years, Western also has made a determined effort to reduce the interval between development and delivery. In 1974, for example, the normal three-year development-to-delivery schedule for one electronic centralized maintenance system, which automatically reports the condition of telephone lines in the central office, was reduced to one year—a speedup directly attributable to Western's close collaboration with Bell Laboratories from the early design stage to full-scale production.

Changes in the way Western Electric serves and supplies the telephone companies contributed significantly to the Bell System's improving efficiency.

During 1974 the first three regional Material Management Centers went into operation to help gather and speed delivery of an ever-expanding store of communications supplies to the Bell telephone companies. Four more of these new centers are planned.

Other companies participated

Western Electric continued last year to look to other organizations, as well as itself, to participate in serving the needs of the Bell System operating companies. In 1974 Western purchased \$3.4 billion in supplies, materials for manufacturing operations and transportation services from over 50,000 suppliers in 4,500 cities. More than 90 per cent of these suppliers were small businesses having fewer than 500 employees.

In 1974 Western purchased for the telephone companies about \$600 million of telecommunications products from other suppliers—this in addition to the estimated \$300 million of such products that the companies themselves purchased directly from outside suppliers. Also, the company awarded two seven-year contracts amounting to \$190 million for the manufacture of about 68 billion conductor feet of telephone exchange cable.

To further facilitate opportunities for suppliers interested in selling their products to the Bell companies, AT&T last year established a Purchased Products Division in its General Departments. This new division serves as the Bell System's interface with general trade manufacturers of telecommunications products and evaluates their applicability to Bell System needs.

During 1974 Western Electric met its commitment to the Federal government and the nation's defense by turning over to the U.S. Army a functioning SAFEGUARD antiballistic missile defense system in North Dakota.

Reflecting a no-growth year, employment in Western Electric dropped to 189,972 in 1974 from 206,608 at the end of 1973. Also, last summer's month-long walkout by some 63,000 manufacturing employees before ratification of a new three-year labor contract slowed the company's deliveries and sales for a time. By year-end, however, the company had met nearly all its commitments to the Bell companies.

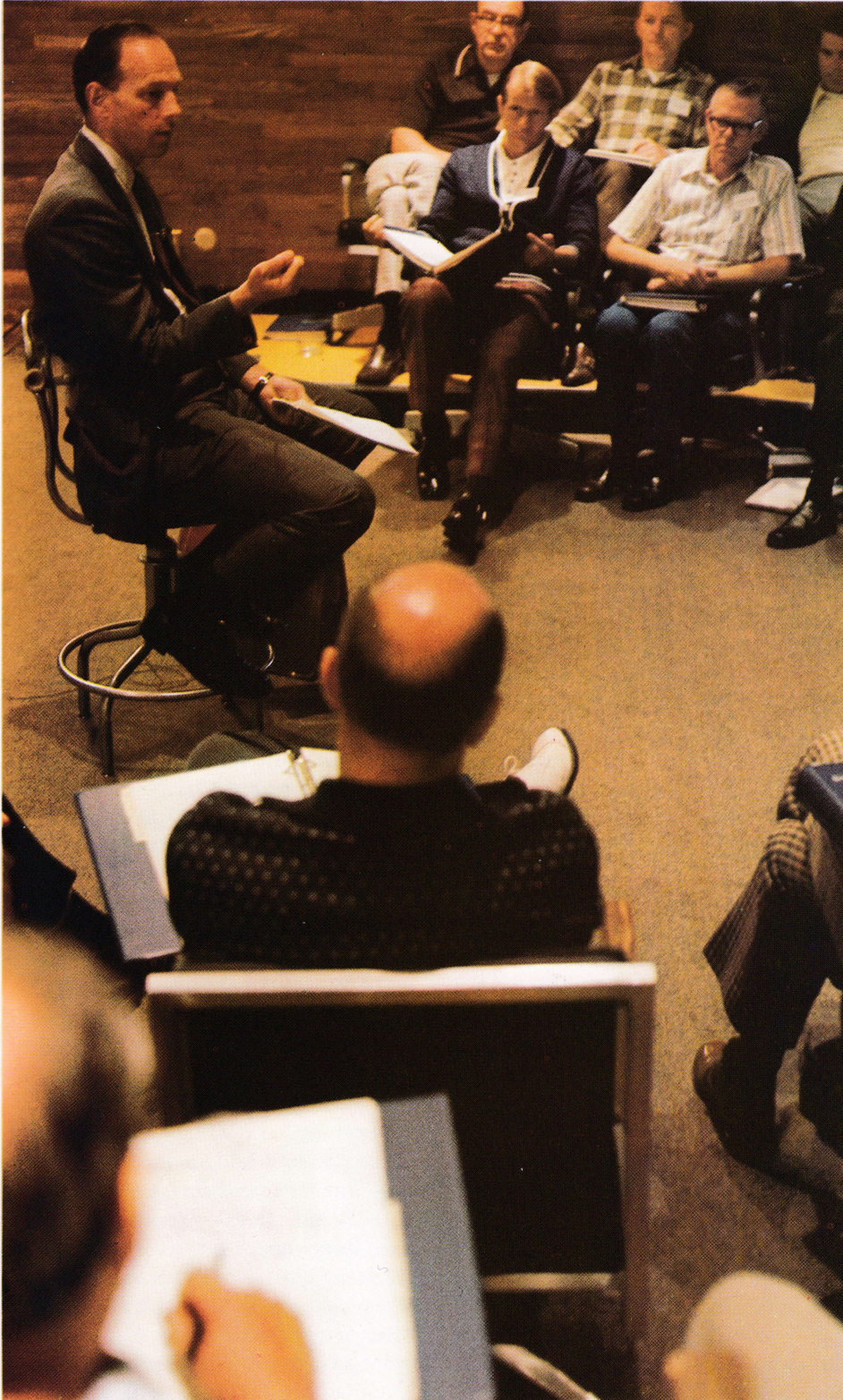
Western Electric appraised

Western Electric's role in the Bell System was, as it has been from time to time in the past, the subject of considerable scrutiny last year in regulatory and legislative proceedings, including Phase II of the FCC's interstate rate investigation and at hearings held by the U.S. Senate Subcommittee on Antitrust and Monopoly.

In an independent appraisal of Western Electric operations prepared for the FCC as part of its Phase II inquiry, the nationally known auditing firm of Touche Ross & Company noted in part: "Western Electric's efficient performance has resulted in lower costs than otherwise would have been incurred. Because of Western's pricing policies and practices, these lower costs have not increased profits, but have been passed on to the operating companies in the form of lower prices."

The report continued: "The effect of the interrelationship between Bell and Western Electric is to operate Western, not as a manufacturing concern, but as an integral part of a vertically integrated communications firm. These interrelationships result in a favorable impact on Western's costs, prices and service to operating companies... The interrelationships between Bell, Western and Bell Laboratories have generally reduced costs and investment..."

Conduct of the Business



Policy issues confronting the telecommunications industry are the focus of discussions at the Bell System's Corporate Policy Seminar. AT&T Vice President and Treasurer William L. Mobraaten talks to Bell managers at a recent session.

Down through the years Bell System management has recognized its accountability to three constituencies—share owners, customers, employees. And it has recognized, as well, an accountability that transcends all three—the public interest. Not only the scale of our business but more importantly the fact that we have been entrusted with providing an essential public service obliges us—almost uniquely among American enterprises—to match our decisions and actions to the expectations of the society we serve. In a nation as diverse as ours and with so many contending interests, what constitutes the public interest is not always easy to discern or, being discerned, is not always easy to attain. Sometimes, being human, we fall short of our aim. But that aim remains the same: to conduct this enterprise as what in fact it is—a public trust.

What follows is an accounting of the way we met some important aspects of that responsibility in 1974.

Affirmative Action

Among the nation's goals from its beginnings, equality of opportunity has in recent years taken on an urgency that challenges all the major institutions of our society to adapt their employment practices to new standards that have been embodied in the law of the land. What precisely the law requires is widely contested—and certainly its obligations have yet to be equally applied throughout all of industry.

What was not controversial within the Bell System, however, was our obligation, whatever others might do, to conform our practices to our best understanding of what the law requires of us. Accordingly, in 1973 the Bell companies entered into an agreement with the U.S. Department of Labor, the

Profile of Bell System employees by job category

 = 10,000 Employees

Scientists and engineers



Production employees



Central office installers



Distribution and supply employees



Construction and outside craft employees



Telephone installers and repair employees



Central office maintenance employees



Telephone operators



Service representatives



Sales persons



Secretaries, typists and clerks



Professionals and specialists



Managers



The Bell System employs approximately a million people in designing, building and operating its nationwide network. The chart above illustrates how they are deployed to provide service.

Equal Employment Opportunity Commission and the Justice Department on a comprehensive program aimed at facilitating the movement of qualified women and minority group members into better jobs.

Last year the Bell companies made real progress toward achieving the objectives established by this program. Where further progress in meeting objectives is required, the companies are working with the government to develop action programs to bring this about.

The number of minority employees in the telephone companies was 124,400 at the end of 1974, a 5.5 per cent increase over the year before. Minority employees in management jobs rose to 12,300, a 22.4 per cent increase over 1973. Women make up 33.4 per cent of the total Bell System management force, and their representation in higher management jobs increased 40.2 per cent over 1973.

During the year we added 3,400 women to inside craft jobs, bringing to 14.1 per cent the number of women occupying these jobs. By year's end there were 8,000 male operators—5.8 per cent of the total.

In 1974 we instituted a new promotion pay policy for first and second level Bell management employees. Under an agreement reached with the Federal government, approximately 25,000 employees at these levels—about 60 per cent of them women and minority employees—received salary increases. The agreement also provided for back pay awards of about \$7 million to some 7,000 management people.

In another agreement, 2,000 women manufacturing employees of Western Electric will receive compensatory payments estimated at \$800,000. This action was taken by the company in recognition that policies and practices existing prior to 1970 may have

restricted hourly-graded women employees in its manufacturing division from certain entry level jobs or may have delayed their promotion.

New Labor Contracts

In mid-1974 the Bell System negotiated new agreements with unions representing 750,000 employees that will add some \$3 billion annually to our employment costs by the end of the three-year contract period. For the first time, bargaining on major issues, primarily wages and benefits, was conducted on a national level.

These negotiations were conducted in a period of acute national concern about inflation and the Bell System negotiators recognized their obligation to reach a settlement that would not only assure fair treatment of our employees but would avoid adding an unnecessary burden of cost to the public. We believe the agreements reached achieved that difficult balance.

Except for a month-long walkout by 63,000 Western Electric manufacturing employees, settlements were reached and the contracts ratified without significant work stoppages.

In addition to increases in basic wage rates, the new contracts provide for annual cost-of-living adjustments based on changes in the national Consumer Price Index. Improvements in pensions and other benefits, including a dental care plan to become effective in 1976, were also agreed upon.

Management Integrity

For generations Bell System management has recognized the appropriateness of public regulation of our operations. And we have recognized that the very nature of our business—its public character—requires that all our activities be conducted in a manner to withstand the most searching public scrutiny.

Accordingly, when allegations of misconduct were made late last year against the management of the Southwestern Bell Telephone Company in Texas and, more recently, against the management of the Southern Bell Telephone Company in North Carolina, both companies acted promptly to assure protection of their assets and good names. What must be understood about these allegations is that in both instances they arose as a consequence of investigations the companies themselves had initiated. Those investigations continue at this writing, as do investigations by various government agencies. Pending their outcome, it would be regrettable were these allegations taken for fact and conclusions drawn reflecting on Bell System management as a whole and the integrity with which it conducts the business.

In the meantime, it should be understood that Bell System policy does *not* countenance—or the law allow—any use of corporate funds for political purposes and that the Bell System has not undertaken systematically to subvert the regulatory process through clandestine political contributions, however derived. We seek the resolution of regulatory issues—and political issues—affecting our business on no other basis than the merits involved. Should wrongdoing be proved in the present instances, appropriate disciplinary action will be taken, together with prompt steps to see that it doesn't happen again.

Public Responsibilities

The Bell System's accountability to the public requires that we contribute to the achievement of broadly recognized public goals to the extent that our resources and other commitments permit.

Therefore, the Bell companies, in varying ways, participate in a wide

range of community activities on the local level and—together on the national level—work toward the achievement of national objectives.

The Bell System operates in tens of thousands of communities, including just about every major urban center in the country. In many of these communities, telephone company people are actively involved in programs, some company-sponsored, to improve educational and job opportunities, to expand recreational facilities and so on.

To help meet their community responsibilities, the companies maintain contributions programs, each separately administered according to local needs, for educational institutions, hospitals and other non-profit community undertakings. In 1974 total Bell System contributions amounted to \$19.2 million.

The Telephone Pioneers of America, an organization of veteran telephone people, continued last year to sponsor some 700 community service projects, many of them to help the blind, the deaf and other handicapped persons.

Resource Management

Because relatively little energy is expended in providing telecommunications service, the Bell System's annual energy use amounts to less than that consumed by the entire country in one-half day. But higher fuel costs and our commitment to the national goal of using energy more prudently have led the Bell System companies to give energy conservation a higher priority than ever before.

Overall energy consumption by the Bell System last year was 10 per cent—or the equivalent of 71 million gallons of oil—less than in 1973.

Even so, our total energy costs were up more than 25 per cent for the year as the result of higher prices. Our



In 1974 the Bell System used 10 per cent less energy than in 1973 while doing a bigger job, reports Hubert L. Kertz, AT&T vice president and coordinator of the Bell System's energy conservation activities.

energy costs would have been an estimated \$65 million higher than they were, however, save for our continuing such common sense conservation measures as using fewer lights, turning down thermostats, using less air conditioning and maintaining the 55 mile an hour speed limit.

It was these and other conservation measures that enabled the companies to reduce consumption even while handling a growing volume of business.

Looking to the longer term, we have established new design standards for telephone company buildings and we are pursuing ways to recycle oil-based products, including the plastic used in telephone shells.

Recycling, while it has assumed new urgency with scarcities and

increased costs of raw materials, is not new in the Bell System. For a great many years, scrap materials and obsolete or damaged apparatus have been collected by telephone people and returned for reclamation—much of it by the Nassau Recycle Corporation, a Western Electric subsidiary on New York's Staten Island.

Sandia Laboratories, which is operated by a Western Electric subsidiary, Sandia Corporation, is participating in several energy projects for the new Energy Research and Development Administration, including one to test a solar energy concept developed by Sandia researchers. The concept envisions the collection and storage of solar energy in a central location for distribution—in the form of electricity and hot water—to homes and businesses in a compact community.

Last year, the New England Telephone and Telegraph Company became the first Bell System company to use solar energy to heat part of a telephone building. The solar heating system, installed atop a new addition to a central office building in North Chelmsford, Massachusetts, is expected to reduce annual oil consumption in the structure by about half.

Human Resources

The nationwide telecommunications network is a highly automated and extraordinarily complex system that is sometimes described as the world's largest computer. But it takes people, just about one million Bell System people, to build, engineer and operate this network and to provide service that meets the needs of our customers. It takes scientists and service order clerks, economists and computer programmers, installers and operators—men and women with a broad diversity of talents and qualifications.

These employees, even more than

the vast physical resources that comprise the telecommunications network, are the real strength of the Bell System.

In 1974 the Bell System spent many millions of dollars for research and development. At the same time it spent at least a like amount to train and develop employees, teaching them skills required to provide better service, preparing them for promotion into more demanding jobs, and instructing them in the techniques of managing others.

Ever-Higher Goals

Accordingly, it was with pride that we learned late last year that *Dun's Review* had selected AT&T as one of the nation's five best managed companies—deserved recognition, we believe, of the efforts of the thousands of Bell System managers throughout the country who with each passing year meet ever-higher goals and—with each coming year—set even higher ones.

In doing so they enhance a legacy that stems in very large measure from one man, Theodore N. Vail (1845-1920). Vail was AT&T's first president and it is more to him than to any other individual that we owe the Bell System's organizational structure, its operating principles and the goals for which we strive. In January of this year Mr. Vail was selected by *Fortune's* editors for the newly established Hall of Fame for Business Leadership sponsored by Junior Achievement.

No annual report can provide an adequate accounting of the year-long undertakings of the million people who work for the Bell System. Suffice it to say here that it is to their competence and energy, their sense of common purpose and their extraordinary enterprise that the Bell System owes the fact that 1974—for all its difficulties—was another year of sustained progress for our business. □

Consolidated Financial Statements

Responsibilities for Financial Statements

The integrity and objectivity of financial data is the responsibility of management. To this end, management maintains a highly developed system of internal controls and supports an extensive program of internal audits. More fundamentally, the Company seeks to assure the objectivity and integrity of its accounts by careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility, and by communications programs aimed at assuring that its policies and standards are understood throughout the organization.

The independent auditors observe generally accepted auditing standards in expressing an informed judgment as to whether management's financial statements, considered in their entirety, present fairly the Company's financial condition and operating results. They must obtain an understanding of the Company's systems and procedures and perform tests and other procedures sufficient to provide reasonable assurance that the financial statements neither are materially misleading nor contain material errors. While their procedures involve extensive testing of Company procedures, it is neither practicable nor necessary for them to scrutinize every transaction.

The Audit Committee of the Board of Directors meets periodically with both management and the independent auditors to assure that each is carrying out its responsibilities. The independent auditors have full and free access to the Audit Committee, and meet with it, with and without management being present, to discuss auditing and financial reporting matters.

The Financial Statements on the following pages consolidate the accounts of American Telephone and Telegraph Company and its telephone subsidiaries. These companies maintain their accounts in accordance with the Uniform System of Accounts prescribed by the Federal Communications Commission.

These financial statements have been prepared in conformity with generally accepted accounting principles, which are consistent in all material respects with the accounting prescribed by the Federal Communications Com-

mission, except for investments, as discussed in Notes to Consolidated Financial Statements.

Coopers & Lybrand, Certified Public Accountants, have examined these financial statements and their report is shown below. The other auditors referred to in their report are Arthur Young & Company as auditors of Western Electric Company and Southwestern Bell Telephone Company, and Arthur Andersen & Co. as auditors of Illinois Bell Telephone Company.

R. N. Flint, *Vice President and Comptroller*

Report of Independent Certified Public Accountants

*To the Share Owners of
American Telephone and Telegraph
Company:*

We have examined the consolidated balance sheet of American Telephone and Telegraph Company and its telephone subsidiaries as of December 31, 1974 and the related statements of income and reinvested earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the consolidated financial statements of the Company and its telephone subsidiaries for the year 1973. The financial statements of two telephone subsidiaries included in the consolidated financial statements (constituting total assets of \$10,763,455,000 and \$9,559,104,000 and total operating revenues of \$4,120,782,000 and \$3,705,397,000 included in the consolidated totals for 1974 and 1973, respectively) were examined by other auditors. The consolidated financial statements of Western

Electric Company, Incorporated and Subsidiaries, the Company's principal nonconsolidated subsidiary (the investment in and net income of which are disclosed in the accompanying financial statements) were also examined by other auditors. The reports of other auditors have been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included in the consolidated financial statements for subsidiaries examined by them, is based solely upon such reports.

In our opinion, based upon our examination and the reports of other auditors, the consolidated financial statements on pages 32 to 40 present fairly the consolidated financial position at December 31, 1974 and 1973, the consolidated results of operations and the consolidated changes in financial position for the years then ended of American Telephone and Telegraph Company and its telephone subsidiaries, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
1251 Avenue of the Americas,
New York, N. Y.
February 11, 1975

Consolidated Statements of Income and Reinvested Earnings

	Thousands of Dollars	
	Year 1974	Year 1973
OPERATING REVENUES		
Local service	\$12,812,812	\$11,418,541
Toll service	12,460,875	11,278,453
Directory advertising and other	1,091,983	982,712
Less: Provision for uncollectibles	191,258	152,386
Total operating revenues	26,174,412	23,527,320
OPERATING EXPENSES		
Maintenance	5,373,970	4,830,530
Depreciation	3,690,390	3,332,403
Traffic—primarily costs of handling messages	1,996,264	1,823,646
Commercial—primarily costs of local business office operations	917,195	814,521
Marketing	1,106,746	998,276
Accounting	728,207	649,027
Provision for pensions and other employee benefits (B)	1,852,654	1,656,764
Research and fundamental development	189,883	170,129
Other operating expenses	860,500	724,838
Total operating expenses	16,715,809	15,000,134
Net operating revenues	9,458,603	8,527,186
OPERATING TAXES		
Federal income (A) (C):		
Current	678,407	931,617
Deferred	1,186,734	806,159
Investment tax credits—net	258,263	225,209
State and local income (A) (C):		
Current	98,766	112,255
Deferred	90,968	62,680
Property, gross receipts, payroll-related and other taxes	2,453,537	2,212,426
Total operating taxes	4,766,675	4,350,346
Operating income (carried forward)	\$ 4,691,928	\$ 4,176,840

For notes, see pages 37 through 40.

	Thousands of Dollars	
	Year 1974	Year 1973
Operating income (brought forward)	\$ 4,691,928	\$ 4,176,840
OTHER INCOME		
Western Electric Company net income	310,633	315,305
Interest charged construction	240,902	223,283
Miscellaneous income and deductions—net (D)	(16,948)	(35,083)
Total other income	534,587	503,505
Income before interest deductions and extraordinary item	5,226,515	4,680,345
INTEREST DEDUCTIONS	2,056,569	1,733,658
Income before extraordinary item	3,169,946	2,946,687
EXTRAORDINARY ITEM (E)	—	46,569
NET INCOME	3,169,946	2,993,256
Preferred dividend requirements	231,889	185,963
INCOME APPLICABLE TO COMMON SHARES	\$ 2,938,057	\$ 2,807,293
EARNINGS PER COMMON SHARE (after preferred dividend requirements) based on average shares outstanding, 557,815,000 in 1974 and 554,258,000 in 1973		
Before extraordinary item	\$5.27	\$4.98
Extraordinary item (E)	—	.08
Total	\$5.27	\$5.06
REINVESTED EARNINGS		
At beginning of year	\$12,673,651	\$11,475,694
Add—Net income	3,169,946	2,993,256
Miscellaneous—net	1,813	(12,387)
	15,845,410	14,456,563
Deduct—Dividends declared:		
Preferred	232,006	191,990
Common—1974, \$3.24 per share; 1973, \$2.87 per share	1,807,794	1,590,922
	2,039,800	1,782,912
REINVESTED EARNINGS AT END OF YEAR	\$13,805,610	\$12,673,651

Consolidated Balance Sheets

ASSETS	Thousands of Dollars	
	December 31, 1974	December 31, 1973
TELEPHONE PLANT—at cost		
In service	\$77,689,387	\$70,710,094
Under construction	3,335,451	3,201,504
Held for future use	121,225	93,078
	81,146,063	74,004,676
Less: Accumulated depreciation	16,210,674	15,436,611
	<u>64,935,389</u>	<u>58,568,065</u>
INVESTMENTS		
At equity (F)	3,477,879	3,243,641
At cost	87,946	63,255
	<u>3,565,825</u>	<u>3,306,896</u>
CURRENT ASSETS		
Cash and temporary cash investments—less drafts outstanding:		
1974, \$262,817,000; 1973, \$289,309,000 (G)	1,121,621	1,060,013
Receivables—less allowance for uncollectibles: 1974, \$34,944,000;		
1973, \$30,163,000	3,131,733	2,987,844
Material and supplies	449,828	369,117
Prepaid expenses	155,285	144,505
	<u>4,858,467</u>	<u>4,561,479</u>
DEFERRED CHARGES	<u>687,607</u>	<u>614,674</u>
 TOTAL ASSETS	 <u>\$74,047,288</u>	 <u>\$67,051,114</u>

For notes, see pages 37 through 40.

LIABILITIES AND CAPITAL

Thousands of Dollars
December 31, 1974 December 31, 1973

EQUITY

American Telephone and Telegraph Company		
Preferred shares (H)	\$ 3,002,941	\$ 2,983,623
(Includes excess of proceeds over stated value)		
Common shares (I)	14,955,272	14,750,953
(Includes excess of proceeds over par value)		
Reinvested earnings—see page 33	13,805,610	12,673,651
	31,763,823	30,408,227
Minority ownership interest in consolidated subsidiaries	827,824	815,068
	<u>32,591,647</u>	<u>31,223,295</u>
LONG AND INTERMEDIATE TERM DEBT (J)	<u>29,538,326</u>	<u>26,642,326</u>
INTERIM DEBT (due within one year but intended to be refinanced) (K)	<u>2,770,124</u>	<u>1,728,289</u>
OTHER CURRENT LIABILITIES (excluding interim debt)		
Accounts payable	1,891,308	1,733,660
Taxes accrued (C)	834,029	955,632
Advance billing and customers' deposits	630,187	581,125
Dividends payable	545,905	493,110
Interest accrued	531,381	464,521
	<u>4,432,810</u>	<u>4,228,048</u>
DEFERRED CREDITS		
Accumulated deferred income taxes (C)	3,317,325	2,054,086
Unamortized investment tax credits	1,357,906	1,099,643
Other	39,150	75,427
	<u>4,714,381</u>	<u>3,229,156</u>
LEASE COMMITMENTS (L)		
TOTAL LIABILITIES AND CAPITAL	<u>\$74,047,288</u>	<u>\$67,051,114</u>

**Consolidated Statements of Changes
in Financial Position**

AMERICAN TELEPHONE AND TELEGRAPH COMPANY
AND ITS TELEPHONE SUBSIDIARIES

SOURCE OF FUNDS:

	Thousands of Dollars	
	Year 1974	Year 1973
Operations		
Income before extraordinary item	\$ 3,169,946	\$ 2,946,687
Add—Expenses not requiring funds:		
Depreciation	3,690,390	3,332,403
Deferred income taxes	1,263,239	867,384
Investment tax credits—net	258,263	225,209
Less—Income not providing funds:		
Interest charged construction	240,902	223,283
Share of the income, after dividends, of companies accounted for on an equity basis . .	94,513	114,804
Total funds from operations	<u>8,046,423</u>	<u>7,033,596</u>
Proceeds from sale of investment in Communications Satellite Corporation (E)	<u>—</u>	<u>104,484</u>
Financing		
Issuance of shares (principally preferred in 1973)	223,637	1,058,985
Issuance of long and intermediate term debt	2,956,000	2,809,000
Change in interim debt—net (K)	1,041,835	(148,030)
Total funds from financing	<u>4,221,472</u>	<u>3,719,955</u>
Changes in minority ownership interest in consolidated subsidiaries	<u>12,756</u>	<u>78,418</u>
	<u>\$12,280,651</u>	<u>\$10,936,453</u>

APPLICATION OF FUNDS:

Telephone plant	\$ 9,816,812	\$ 9,077,277
Dividends	2,039,800	1,782,912
Increase in deferred charges	72,933	107,251
Repayment of long and intermediate term debt	60,000	310,000
Increase in investments of companies accounted for on an equity basis	139,725	10,406
Change in working capital	92,226	(332,017)
Other—net	59,155	(19,376)
	<u>\$12,280,651</u>	<u>\$10,936,453</u>

The change in working capital is accounted for by:

	Year 1974	Year 1973
Increase (decrease) in current assets:		
Cash and temporary cash investments, net of drafts	\$ 61,608	\$ (65,312)
Receivables	143,889	289,081
Material and supplies	80,711	31,130
Prepaid expenses	10,780	16,129
	<u>296,988</u>	<u>271,028</u>
Less—Increase (decrease) in other current liabilities (excluding interim debt):		
Accounts payable	157,648	97,107
Taxes accrued	(121,603)	348,369
Advance billing and customers' deposits	49,062	52,789
Dividends payable	52,795	54,169
Interest accrued	66,860	50,611
	<u>204,762</u>	<u>603,045</u>
Change in working capital, as above	<u>\$ 92,226</u>	<u>\$ (332,017)</u>

For notes, see pages 37 through 40.

(A) **Accounting Policies**—The financial statements reflect the application of certain accounting policies described in this note. Other policies and practices are covered in notes (B), (C) and (G). *Consolidation*—The consolidated financial statements include the accounts of the American Telephone and Telegraph Company and its telephone subsidiaries. All significant intercompany transactions are excluded from these statements except as discussed below under “*Purchases from Western Electric*.” The investment in Western Electric Company, Incorporated, an unconsolidated subsidiary, and certain other investments (where it is deemed that the Company's ownership gives it the ability to exercise significant influence over operating and financial policies) are carried at equity. All other investments are carried at cost. *Purchases from Western Electric*—Most of the telephone equipment, apparatus and materials used by the companies consolidated has been manufactured or procured for them by Western Electric Company. Contracts with the telephone companies provide that Western's prices to them shall be as low as to its most favored customers for like materials and services under comparable conditions. The consolidated financial statements reflect items purchased from Western at cost to the companies, which cost includes the return realized by Western on its investment devoted to this business. *Depreciation* — Provision in the accounts for depreciation (5.2% in 1974 and 5.1% in 1973 of the cost of depreciable plant in service) is based on straight-line composite rates. Depreciation for income tax purposes is provided on different bases and methods as explained under “*Income Taxes*” below. *Income Taxes*:
(1) Under various accelerated depreci-

ation provisions of the tax law, depreciation for income tax purposes on plant placed in service after 1969 is greater than the straight-line depreciation provided in the accounts. In addition, the companies have adopted for income tax purposes shorter depreciation lives than those used for book purposes for certain plant, as allowed in income tax regulations of the Treasury Department. Provision is included in income tax expense for the deferred income taxes resulting from the use of accelerated depreciation and shorter tax lives. Also see note (C).
(2) The effective Federal income tax rates of the Company and its telephone subsidiaries were 39.6% in 1974 and 39.1% in 1973. These rates are determined from the Statements of Income by dividing Federal income taxes by the sum of Federal income taxes, Net Income and minority ownership interest in net income—see note (D). The differences of 8.4% and 8.9% in 1974 and 1973, respectively, between these effective rates and the 48% Federal income tax statutory rate are attributable to the following factors:

	1974	1973
a. Earnings applicable to investments in companies accounted for on an equity basis, including Western Electric Company, which are reflected net of income tax	2.9%	3.1%
b. Certain taxes and payroll-related construction costs capitalized in the financial statements, but deducted for income tax purposes, net of applicable depreciation adjustments for current and prior years	2.7%	2.9%
c. Interest charged construction which is excluded from taxable		

income, net of applicable depreciation adjustments for current and prior years 1.7% 1.7%
d. Profits on telephone plant items purchased from Western Electric, which are capitalized on the books of the companies but not for tax purposes, and which reduce depreciation expense for tax purposes (.7%) (.7%)
e. Amortization of investment tax credits over the life of the plant which gave rise to the credits, which amortization reduced income tax expense for the years ended December 31, 1974 and 1973 by about \$83,389,000 and \$61,906,000, respectively 1.6% 1.2%
f. Other miscellaneous differences between the calculations of taxable income and book income before taxes2% .7%
Total 8.4% 8.9%

Research and Development—In addition to basic research and fundamental development costs, which are expensed currently, the cost of specific development and design work incurred by Western Electric Company is related to products manufactured and is included in the cost of such products (see “*Purchases from Western Electric*” above).
(B) **Provision for Pensions and Death Benefits**—The Company and its consolidated subsidiaries have non-contributory plans covering all employees and providing for service pensions and certain death benefits. These companies have accrual programs under which actuarially determined regular payments are made to

trust funds that are irrevocably devoted to service pension and death benefit purposes. The total provision for these service pensions and death benefits, including amounts charged to construction, was \$1,216,055,000 in 1974 and \$1,080,848,000 in 1973. Amendments to the plans, adopted pursuant to 1974 union contracts, provide for improved benefits for all employees and are expected to increase 1975 pension accruals by approximately \$233,000,000. Based on the latest actuarial valuation, adjusted to reflect those benefits which became effective January 1, 1975, the companies estimate that the actuarially computed value of vested benefits exceeded the cost of trust fund assets by about \$365,000,000. Compliance with the Pension Reform Act of 1974 is not expected to materially affect annual pension accruals, but pursuant to the Act, will increase vested benefits beginning January 1, 1976. The actuarially computed value of such benefits cannot be determined pending full consideration of optional vesting methods available under the Act. The accrual programs contemplate that there will be avail-

able in the funds amounts sufficient to provide benefits as stated in the plans. (C) **Treatment of Income Tax Effect of Cost of Retiring Property**—On August 1, 1974 the Federal Communications Commission (the "FCC") granted the Company and its telephone subsidiaries permission to use deferred income tax treatment currently, as well as retroactively for the years 1971, 1972 and 1973, with respect to amounts arising from differences between methods of accounting for cost of removal and salvage on the books of the companies and those used in computing income tax liability. The financial statements as of December 31, 1974 and for the year then ended reflect such permission, principally as a reclassification from current to deferred income taxes in the amount of \$247,000,000. The remaining portion of such amounts, which for the period January 1971 through July 1974 had been accounted for as decreases in Net Income, was reversed with a resultant increase in Net Income for the year 1974 of about \$11,000,000. The FCC's permission was granted pending its

issuance of rules with respect to the accounting for taxes accrued in accordance with recent Internal Revenue Service depreciation rules, some of which remain subject to clarification. The companies and their independent certified public accountants believe that the accounting pursuant to the FCC's permission is appropriate and should be reflected in the final accounting rules.

(D) **Miscellaneous Income and Deductions**—Includes as a deduction in 1974 and 1973 the minority ownership interest in net income of certain consolidated subsidiaries in the amounts of \$70,481,000 and \$67,955,000, respectively.

(E) **Extraordinary Item** — The Company's investment of \$57,915,000, at cost, in 2,896,000 shares of Communications Satellite Corporation ("Comsat") common stock was sold through a public offering in June, 1973, resulting in a gain of \$46,569,000 after income taxes of \$19,958,000.

(F) **Investments at Equity**—At December 31, 1974, dollars expressed in thousands, comprise:

Company	Per Cent Ownership	Market Value ²	Equity			
			Shares at Cost ³	Excess of Net Assets Over Cost	Advances	Total
Western Electric Co., Inc. ¹	100.0	\$ —	\$1,451,001	\$1,779,985	\$ —	\$3,230,986
The Southern New England Tel. Co.	16.6	47,801	47,562	24,863	2,100	74,525
Bell Telephone Laboratories, Inc.	50.0 ⁴	—	117,000	—	—	117,000
Cincinnati Bell Inc.	25.7	32,926	24,345	20,306	6,900	51,551
All Other	—	—	951	2,860	6	3,817
			<u>\$1,640,859</u>	<u>\$1,828,014</u>	<u>\$9,006</u>	<u>\$3,477,879</u>

¹ Total assets and liabilities of Western Electric Company, Incorporated and its subsidiaries at December 31, 1974 were \$5,239,551,000 and \$2,008,565,000, respectively.

² Where applicable, based on N. Y. Stock Exchange closing prices for 1974.

³ The Uniform System of Accounts of the Federal Communications Commission requires that investments be carried on the books of the companies at cost. In accordance with generally accepted accounting principles, certain investments are included at equity in the accompanying balance sheets. See note (A) "Consolidation."

⁴ Western Electric Company, Incorporated, owns the other 50.0 per cent of the Bell Telephone Laboratories, Incorporated.

The foregoing table includes \$20 million 2¾% First Mortgage Bonds due February 1, 1975 and \$160 million 2¾% Debentures due October 1, 1975, which were or will be refinanced on their due dates.

Since December 31, 1974, the Company and one subsidiary have sold \$850,000,000 of long and intermediate term debt. Long term financing announced as of February 11, 1975 is as follows:

Company	Date of Sale	Amount (in millions)
New York	March 11	\$200
Diamond		
State	March 25	20
South		
Central Bell	April 1	300
Chesapeake and		
Potomac of		
West Virginia	May 13	50
New England	June 3	200

The proceeds of such sales will be applied toward repayment of debt, including interim debt, and for general corporate purposes, including extensions, additions and improvements to plant.

(K) **Interim Debt**—Since 1968 it has been the practice of the Company's telephone subsidiaries partially to finance the construction of telephone plant through bank loans and commercial paper, pending long term financing. See note (J) above. In the Company's computation of ratios of debt to total capitalization (usually referred to as "debt ratios") for regulatory and other purposes, the amounts of such bank loans and commercial paper are added to long and intermediate term debt. Amounts at December 31, 1974 reflect the effects of the deferral from November 1974 to January 1975 of the Company's \$600 million issue of long and intermediate term debt due to unsettled market conditions following

the Department of Justice antitrust action against the Company in November 1974.

Outstanding, at December 31, in millions of dollars:

	1974	1973
Bank loans	\$1,269	\$1,288
Commercial		
paper	1,501	440
Total	<u>\$2,770</u>	<u>\$1,728</u>

The above debt is payable within twelve months or less after issuance. The weighted average annual interest rates for bank loans and for commercial paper outstanding at December 31, 1974 were 10.3% and 9.5%, respectively. The maximum amount at any month-end during the year 1974 was \$2,770,124,000 and the average amount outstanding during the year was approximately \$2,026,535,000 at an average interest rate of 10.3%, computed by averaging the face amount of the notes payable each day of the year and dividing such average amount into the aggregate related interest expense.

(L) **Lease Commitments**—Total rental expense for the years ended December 31, 1974 and 1973 was about \$582,159,000 and \$515,991,000, respectively. At December 31, 1974 the aggregate minimum rental commitments under noncancelable leases for the periods shown were as follows:

Years	Aggregate Minimum Noncancelable Lease Amounts
1975	\$287,051,000
1976	263,533,000
1977	228,349,000
1978	199,927,000
1979	173,807,000
1980-1984	564,080,000
1985-1989	324,331,000
1990-1994	206,591,000
Thereafter	626,450,000

(M) **Antitrust Action**—In November 1974 the Department of Justice brought a civil antitrust action naming the Company, Western Electric and Bell Telephone Laboratories as defendants, and the 23 Bell System telephone companies as co-conspirators but not defendants. The Company believes that the relief sought, which includes dismemberment of the Bell System, is adverse to the public interest and is confident that it has not been in violation of the antitrust laws and that the structure of the Bell System will remain basically unchanged. In the opinion of the Company, while this matter might not be resolved for several years, dismemberment of the Bell System would have adverse effects on its business, could affect its ability to raise capital, its credit standing and the market value of its securities, and could require an immediate payment of Federal income taxes previously deferred on intercompany profits. A lump sum payment of such deferred taxes, which are being credited to the plant accounts, would have no effect on net income but would materially increase the Company's cash requirements.

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American Telephone and Telegraph Company

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