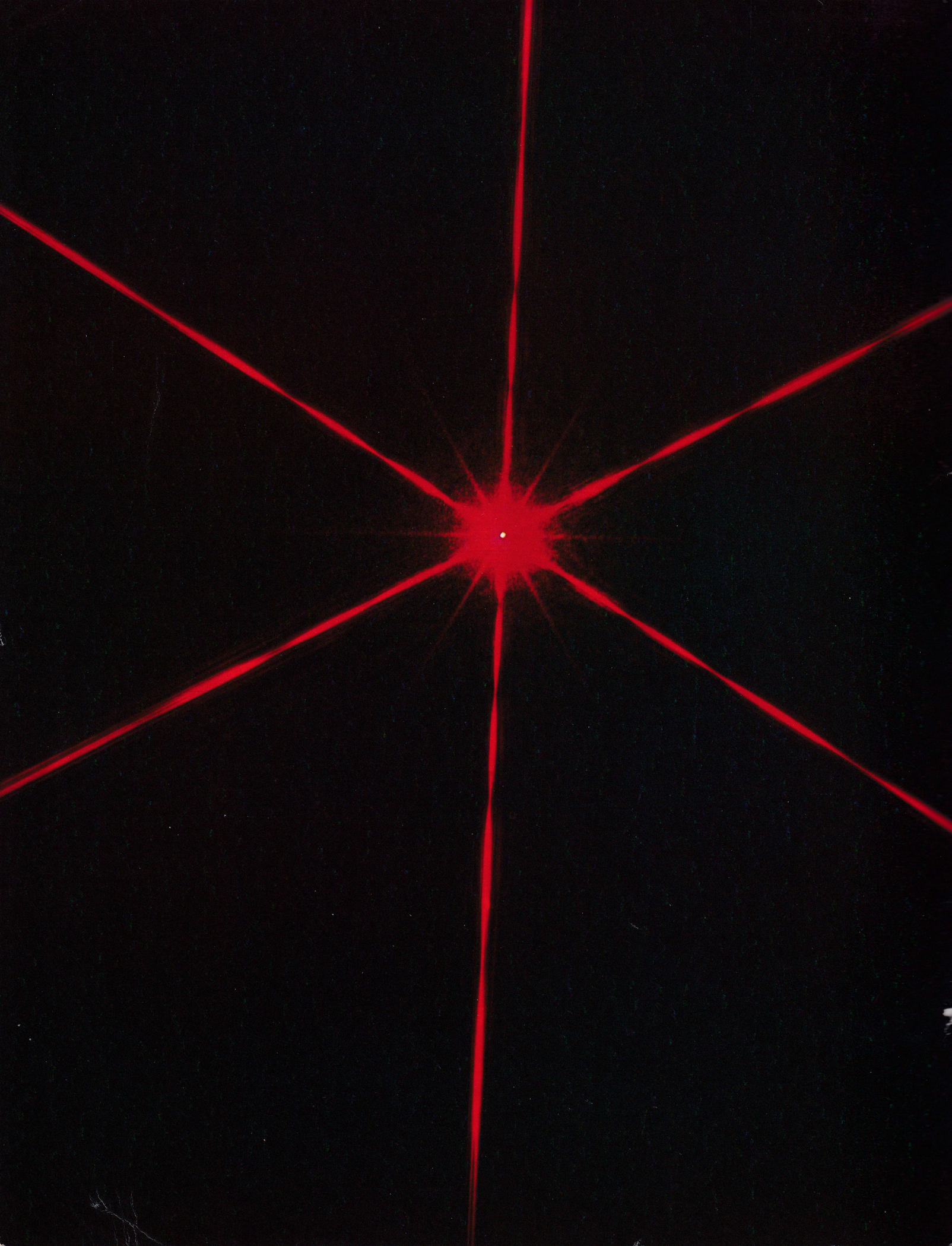
American Telephone and Telegraph Company 1980 Annual Report

AT&T '80

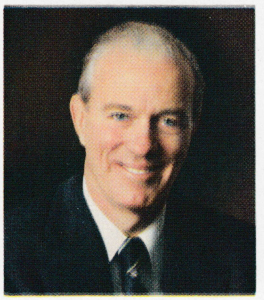


"...1980 was in a number of significant ways Year One of the Bell System's future."

American Telephone & Telegraph Company
1980 Annual Report

Report of the Chairman 2
The Bell System in 1980 4
Photograph Captions 24
Auditor's Report 25
Results in Brief 26
Management's Analysis 26
Financial Statements 30
Officers and Directors 47

Report of the Chairman of the Board



Dear Share Owner:
In the following pages of this report you will find an accounting of the Bell System's performance in the year just past—the service we provided, the improvements in technology and operating methods we introduced, the earnings we achieved.

Here I propose to address what seems to me made the year unique: in the course of it we crossed the threshold of a new era in Bell System history. It is an era that affords us—albeit not without risks—opportunities no less challenging than those our business faced at its founding more than a hundred years ago. In short, I believe that 1980 was in a number of significant ways Year One of the Bell System's future.

It was a year in which the shape of that future—at least in broadest outline—came clear.

It was a year in which—to meet the requirements of that future and to fulfill its opportunities—we took the first steps toward a restructuring of the Bell System that, once it has been accomplished, will make ours an organization vastly different from the one we know today.

And, finally, it was a year in which we redefined the scope of our business and raised our marketing horizons. No longer do we perceive that our business will be limited to telephony or, for that matter, telecommunications. Ours is the business of information handling, the knowledge business. And the market we seek to serve is global.

What spurred these developments was a gathering consensus on national telecommunications policy. Regrettably legislation that would remove many of the remaining uncertainties fell short of enactment. Nonetheless from the bills Congress considered and from the Federal Communications Commission's landmark decision in its Computer Inquiry II, it is possible to discern the main outline of emerging public policy.

First of all, it now seems clear that public policy will look to the marketplace as the most efficient regulator of telecommunications services, to regulation only to the extent that it is necessary to assure the continued universal availability of affordable service and the manageability of the nationwide telecommunications network.

Second, it appears to be widely if not universally agreed that—in an era of intensifying competition—it no longer makes sense to deny the Bell System the opportunity to compete in unregulated markets.

And third, it appears to be agreed as well that—because of its size, because of its presumed market power—there should be a separation between the Bell System's regulated operations and those that serve deregulated markets.

In 1980, then, it became apparent that in the future we shall be operating in two modes. Basic local and long distance service we shall continue to provide under regulation. At the same time, we will be afforded expanding opportunities to compete in unregulated markets. Our aim is to combine the service ethic that inspired the accomplishments of the Bell System's first century with the spirit of venturesomeness which is the key to success in its second. In 1980 we took the first steps toward a restructuring to accomplish this aim.

On August 20, the Board of Directors approved a realignment of AT&T's General Departments that separates those departments whose responsibilities relate mainly to regulated activities from those dealing with prospectively deregulated markets. At the same time, we moved toward establishment of a relatively small corporate staff to provide overall strategic and financial direction to the enterprise as a whole.

What needs to be understood about this realignment is that it does not in itself represent the radical restructuring that is in prospect for our business. Rather does it set the stage for that restructuring. Its aim is to assure two things: first, that we think our way into the future carefully, systematically, comprehensively; and second, that as we do so we mind our current business well.

In short, we are approaching this undertaking with the same care and deliberation that has characterized this enterprise throughout its history. At the same time, we are taking care to see that our service and earnings performance is in no way compromised along the way.

It would be unrealistic, however, to assume that we won't confront problems of transition. We shall be changing our business on a scale unmatched in any industry I know of. Work relationships, proven over generations and by now virtually instinctive, are going to be disrupted and new patterns established. Highly integrated operations systems are going to have to be disaggregated and redesigned to match the dual mode in which the future requires we operate.

More fundamentally, we shall be transforming a business that for more than 60 years has been structured to meet the requirements of a highly regulated environment to one that matches the dictates of a day and age that looks mainly to the marketplace to decide what products and services the public will be

supplied, who will supply them and at what price. That means that not only must we change our business' structure; we must change many cherished policies and practices—ways of doing business—that, while proven over generations of Bell System management, no longer fit today's circumstances.

Traditionally the Bell System has addressed its research and development activities to system optimization, the balanced improvement of our service capabilities in the context of our obligations to the entire public we serve. Competition by contrast spurs innovation at competitive pressure points. One is strategic, the other tactical. Our aim is to combine the best of both.

Traditionally we have depreciated our plant over decades to minimize the cost burden on the general public. Competition and the faster product obsolescence it brings with it will force us to faster depreciation and thus—for a time—higher prices.

Traditionally we have priced our services to support the goal of universal service. No longer is this policy tenable. More and more, we must relate rates to costs—service by service, even customer by customer. That means, among other things, that as they are relieved of the burden of contributing to the support of local service, long distance rates will come down. Deprived of that contribution, local rates will go up. No aspect of the transition we face is more crucial than sound management of this basic change.

But what will most distinguish the management of the future from that of the past is the varying degrees of risk we will confront. Consequently one of our first priorities as we go about reshaping our business is the development of criteria to help guide resource allocation between and within its principal sectors. Certainly as we are permitted to venture in unregulated markets, it will be our aim to seek returns to investors commensurate with the risks involved. In this connection, it appears to be widely recognized that it would not be fair to investors to permit regulators to use profits earned in unregulated markets as an offset to revenue requirements in regulated markets.

Why—in view of the complexities it confronts—has the Bell System chosen to anticipate change rather than await it?

The answer in a word: opportunity.

What creates that opportunity is the scope of the market and the unique resources and skills the Bell System can bring to bear on meeting its needs.

The technology of the Information Age is ours. Indeed it was Bell System technology that very largely brought it into being. And it is Bell System technology that positions us to fulfill its opportunities.

It was the transistor, invented in Bell Laboratories more than 30 years ago, that opened the way to the convergence of communications technology and computer technology and the promise it holds for dramatic increase in the productivity of our economy and in man's ability to manage complex undertakings on a global scale.

Ours, too, is a facility which is unmatched in the world. It is at the core of this country's ability to move information. It is the nationwide switched network.

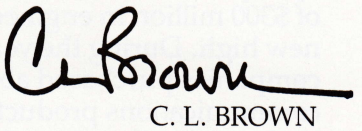
With each passing year we are transforming that network, endowing it with "intelligence." Not so long ago it provided a more or less uniform service to all its customers. Before long it will serve no two of them alike.

But we have even greater strength than our technology: Bell System people. It is not only their skills but their spirit that makes our business great—and will keep it great.

As our business changes, so too does the nature of our share owners' investment. Understandably, along with more opportunity, we confront more risk. However, I have shared these thoughts with you in the hope that in some measure share owners might share in my sense of anticipation of the prospect ahead. Simply put, new markets mean new opportunities to improve earnings— opportunities we do not propose to neglect.

As this is written, discussions are continuing with the Justice Department looking toward a settlement of the antitrust suit that it brought against AT&T in 1974. What the outcome of these discussions will be I can't predict. Clearly, however, we would not be pursuing them were we not hopeful of reaching a sensible conclusion to a proceeding that, so long as it remains pending, casts a cloud of uncertainty over our business. Its removal would be another element contributing to the sense of new beginnings that characterizes these times.

Finally, what further changes the future will bring is beyond knowing. Indeed, how the Bell System will be configured ten years from now I can't predict. But I can say what standard we mean to apply to the decisions we'll be called upon to make on the way to that unknowable destination. It is the standard of excellence. Our purpose is to seek—at every point of decision—the highest and best use of the organizations and resources we call the Bell System. The highest and best. With that as our standard, I have not the least doubt that, unknowable as the future is, it will be a great future.



C. L. BROWN

February 6, 1981

The Bell System in 1980

For the Bell System, 1980 was a year characterized at its beginning by recession and persistent inflation and in the second half of the year by an upturn in volume of business. For the year as a whole Bell companies handled a volume of business (operating revenues adjusted to remove the effect of price changes) 8.3 per cent greater than in 1979. Long distance calling rose 7.8 per cent and international calling increased by 20.8 per cent. Telephone lines for both business and residence customers grew at a rate of 3.1 per cent in 1980 compared to 3.9 per cent in 1979.

Operating revenues in 1980—$50.8 billion—improved 11.9 per cent and net income—$6.1 billion—7.1 per cent. Earnings per share were $8.19 compared to $8.04 in 1979.

Earnings were strengthened through vigorous marketing, firm control of costs, technological innovation and strong growth in productivity. The continued high level of inflation required us to seek rate increases from regulatory authorities in many states and at the federal level as well. During the year, Bell operating companies were awarded $1.5 billion in intrastate rate increases. Pending state rate requests totaled $3.0 billion at year's end. The Federal Communications Commission in June granted AT&T a 5.1 per cent increase in interstate and overseas rates—the first general increase in interstate rates in more than four years. The increase will raise Bell System revenues by $499 million on an annual basis. The Commission, at year's end, was still studying the Bell System's petition for a higher authorized rate of return on its interstate investment.

Of the Bell System's 1980 net income, 89 per cent came from telephone operations, the remainder from Western Electric. While Western Electric shipments of telephone sets, electronic switching equipment and cable were down from 1979 levels, transmission equipment shipped increased by more than 50 per cent and data sets by 18 per cent. Western Electric achieved savings of $300 million in engineering cost reductions—a new high. During the year, the Bell operating companies purchased about $2.4 billion in telecommunications products from the general trade, either directly or through Western Electric.

The Bell System continued to invest significant amounts of capital in order to improve, expand and sustain service. Construction expenditures rose $1.5 billion, from $15.8 billion in 1979 to $17.3 billion in 1980. In constant dollars, however, construction expenditures remained at about the same level as the previous year.

To help finance its construction program the Bell System had to raise some $7 billion in 1980—the highest new money requirement in its history. About $2 billion was raised through the issuance of new equity through the Dividend Reinvestment and Stock Purchase Plan and the Employee Savings and Stock Ownership Plans. The balance was raised through debt issues of Bell System subsidiaries and a $600 million intermediate term debt issue of AT&T. The cost of new Bell System debt in 1980 averaged 12.5 per cent, bringing the System's embedded cost of long and intermediate term debt to 8.0 per cent.

The Bell System's return on average capital rose from 9.8 per cent in 1979 to 9.9 per cent in 1980. Return to common equity was 12.7 per cent in 1980 compared to 12.9 per cent in 1979.

We intensified our efforts during the year to employ our resources as productively as possible. These efforts are being enhanced by new technology, in both long distance and local transmission systems, that dramatically increases the capacity of existing facilities with minimum additional investment. As a result of new technology and better operating methods, Bell System total factor productivity—which has grown at a rate four times that of the economy as a whole over the past five years—continued to grow rapidly.

Highlights	1980	1979
Earnings per share	$ 8.19	$ 8.04
Dividends declared per common share	$ 5.00	$ 5.00
Revenues including other income (millions)	$51,680	$46,183
Expenses including taxes and interest (millions)	$45,600	$40,509
Net income (millions)	$ 6,080	$ 5,674
Rate of return on average total capital	9.9%	9.8%

Overall, service quality remained high in 1980. That we were able to sustain high levels of service and improve earnings—despite a slug-

gish economy and still rampant inflation—is testimony to the rigorous management by the Bell companies. Even more significant for the long term were developments—inside and outside the business—that set the course and established conditions for the Bell System's participation in markets of the Information Age.

The Information Age

The Information Age is here. It is an age in which new capabilities offered by data processing and communications technology are profoundly altering the way individuals and institutions—government, business, education—conduct their affairs. These two powerful technologies mated, and in many cases indistinguishable, are vastly expanding man's capacity to manage complex undertakings on a continental—indeed a global—scale.

The synergistic combination of computers and communications offers the prospect of resumed productivity improvement for an economy whose operations more and more depend on the generation and distribution of information.

At the same time, the Information Age offers a large and growing market for suppliers of information and communications services. Today, just the business sector of the information market—business telecommunications, data processing, business travel, word processing and handling of mail—stands at $200 billion and is expected to triple by the end of the decade.

The Bell System is strategically positioned to meet the needs of that market by virtue of its leadership in the technology of telecommunications. But we are not alone. Regulatory policies of the past decade have opened virtually every sector of telecommunications to competition. Today not only telephone companies but also a wide variety of vendors are offering telecommunications products and services—telephones, office communications systems and long distance services.

The fact of competition—and the prospect of more—by no means signals diminished opportunity. The dimensions of the market are so vast—and its expected growth so rapid—that

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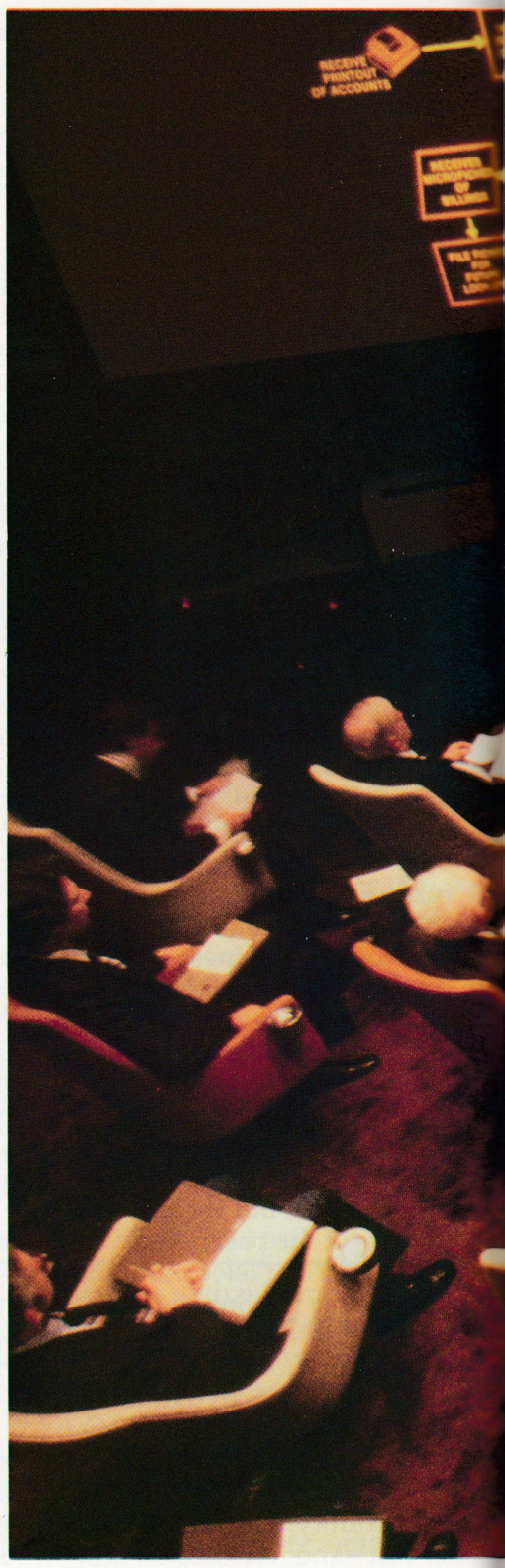

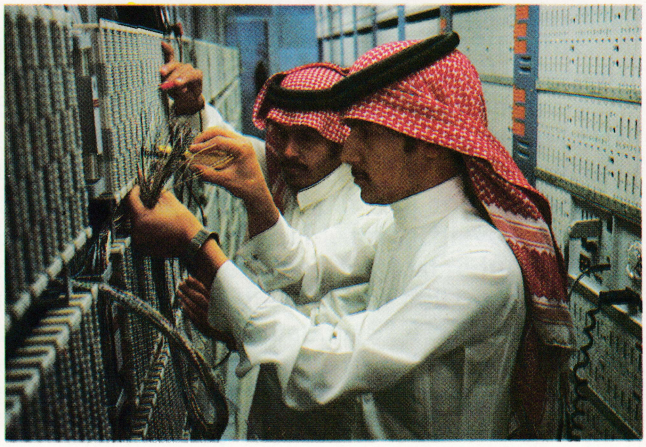

"No longer do we perceive that our business will be limited to telephony or, for that matter, telecommunications. Ours is the business of information handling, the knowledge business. And the market we seek to serve is global."



there certainly will be room for many. More than that, we are confident we have the technical resources to meet the growing demands for new and sophisticated services. We have the marketing skills to match our technology to customers' needs. And we look forward to the opportunity to apply these skills in "detariffed" markets in line with the Federal Communications Commission's Computer Inquiry II decision (see pg. 15).

In 1980 the Bell System moved decisively —in terms of organizational structure, pricing policies, marketing strategies and new products and services—to meet the challenges of the competitive marketplace.

The Network

The nationwide telecommunications network enables customers anywhere, at any time, to communicate with each other and, in addition, provides connection with telephone systems around the world. This network can handle swiftly and accurately communication in any form—voice, data, video, graphics.

Today the network is fast becoming an "intelligent" network with a degree of versatility—adaptability to the unique needs of customers—that was virtually inconceivable just a few years ago.

The network's intelligence stems, in large measure, from the electronic switching systems that we are installing—computerized switching systems that can be programmed to provide specialized services in addition to completing routine telephone calls swiftly and economically. In 1980, we installed more than 300 local and 18 long distance electronic switching centers.

As a result of this intelligence the network will have the ability to furnish a wide variety of new services. For example, one contemplated service, Advance Calling, would enable customers, by dialing a set of numbers, to record a message and direct the network to transmit it to a designated telephone at a designated future time.

The ability to "program" the network offers the possibility of many other services. An auto club, for example, could have a single nationwide telephone number which motorists in trouble could call and be automatically connected—not to some answering center half a continent away but—to the *nearest*, open service station. Another application would enable customers to instruct the network that they want to receive only calls from certain telephone numbers. Yet another capability would let customers direct the network to forward their calls to another location—whether it be a neighbor's home or a hotel in a distant city. They simply would keep a network data base informed of the telephone number where they can be reached.

We have the technical capability to provide these and other such services through the nationwide network. We were concerned, therefore, when the Federal Communications Commission's Computer Inquiry II Decision appeared to require that some of these services would have to be offered through a separate subsidiary and not as regular network service. We expressed to the Commission our concern that such a requirement could prevent the general body of users from enjoying the benefits of advanced technology and, in effect, freeze the network's capabilities at its present level. We are encouraged that the Commission, in response, has indicated that under certain circumstances it might waive the separate subsidiary requirement and permit the enhancement of basic network services.

Other technological advances in the network will keep communications apace with the requirements of the Information Age.

Calls in Smyrna, Georgia are now being speeded on pulses of laser-powered light along hair-thin glass fibers instead of copper wires. The transmission medium of the future—lightwave— is no longer in the trial stage. It is in and working. Some 25 miles away, a Western Electric factory is producing miles of glass fiber that will be used in the first segment of the lightwave system that will link the major cities along the Northeast corridor—a 611-mile route from Boston to Washington.

Lightwave communications not only offers greater call-carrying capacity on cable that takes up far less space, but it also represents another step toward an all-digital network.

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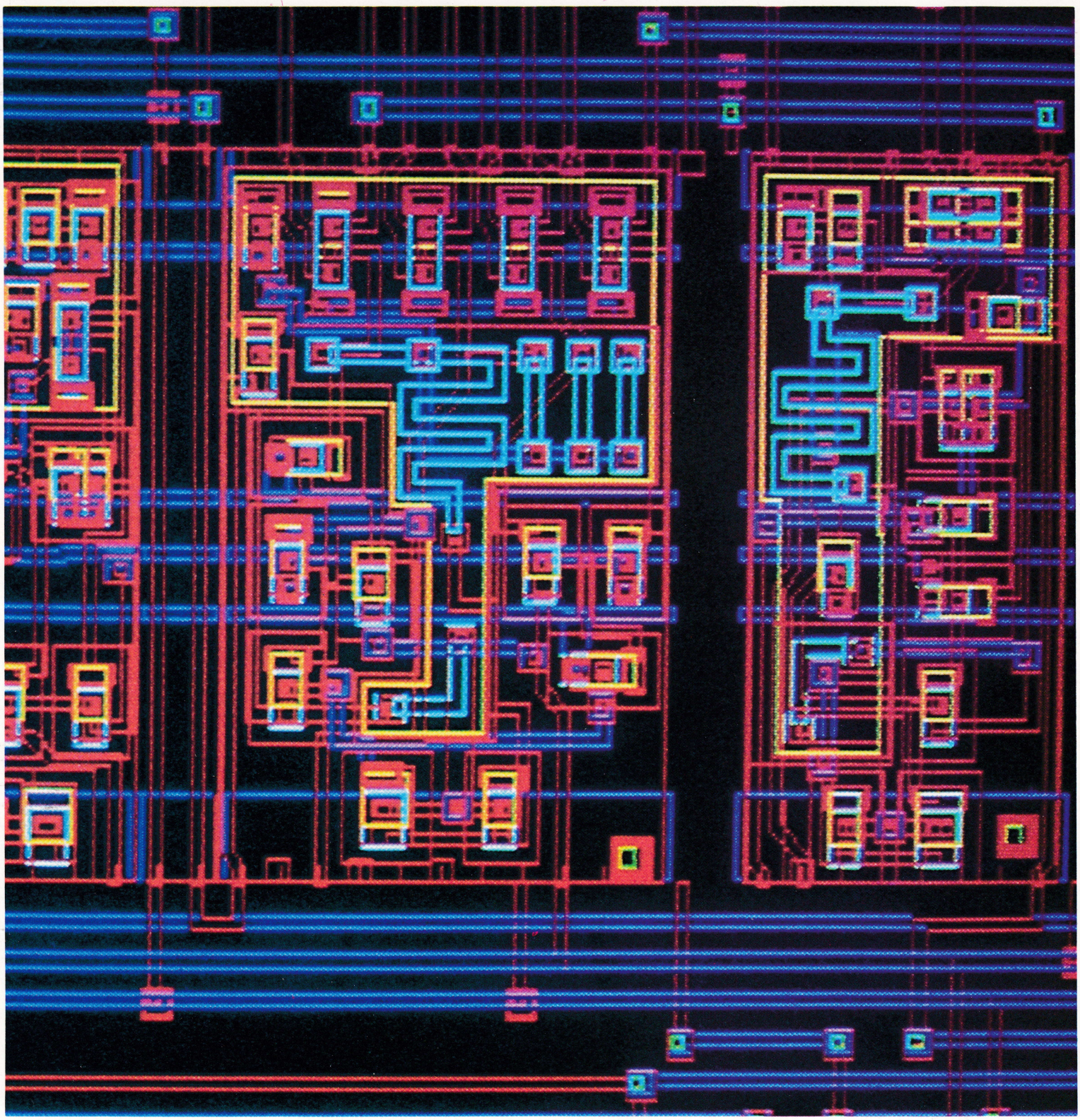


While the telecommunications network today is largely analog—carrying signals in wave form—the language of computers and other data devices is digital: pulses rather than waves. We are moving toward an all-digital network. Our long distance electronic switching systems are digital. Many of our transmission systems are also digital. In recent years, the cost of digital communications systems has become increasingly competitive with those of analog. Digital communications offers the advantage of being able to carry not only voice but also data at much higher speeds and with greater accuracy than analog systems. Ultimately the network will offer end-to-end digital "connectivity", providing voice, image and data communications capability for both residence and business users. Thus the basic switched network will readily be able to handle the voice, data, video and facsimile requirements of the Information Age.

The nationwide network blends a variety of technologies—wire, coaxial cable, microwave, satellite and lightwave. And it is in a continuous state of expansion and improvement. AT&T Long Lines, which manages the nationwide network and our international long distance facilities, awarded a $137 million contract to Hughes Aircraft Company for the construction of three new satellites and related ground station facilities. The first of these satellites will be launched in 1983. The satellites will be owned by the Bell System and will be used for long distance calling as well as data and video services. The new satellites will have 20 per cent more capacity than those currently in use and will offer network managers additional flexibility in routing traffic through the nationwide network.

Technology

The Bell System's leadership in the technology of the Information Age is a matter of history—history that is still being made. The transistor, invented at Bell Laboratories in 1947, sired the solid state electronics industry. Today, Bell Laboratories continues to be at the point of the march—in microelectronics, in photonics (or lightwave) and in the development of software programs that control computerized systems.

Microelectronics: the technique of placing thousands of electronic components on a chip as small as a tenth of an inch square is by no means the sole preserve of Bell Laboratories, though Bell Labs scientists performed much of the pioneering work in the field. But Bell Laboratories is in the forefront in developing new methods that can put even more components—and hence more capability—on these chips. New X-ray lithographic processes, for example, enable Bell scientists to draw experimental circuit elements less than a micron (one thousandth of a millimeter) wide. These processes, and others being explored, yield very large scale integrated circuits that pack on a single chip the capability of several racks of electromechanical switching equipment.

Tiny devices such as these are being used throughout the telecommunications business. Integrated circuits are used in electronic switching systems to store data and help process calls. They are used as the brains for a wide variety of "smart" terminals— from automatic dialers to business switchboard consoles. They are used to eliminate echoes on satellite and other long distance circuits.

Testimony to the increasing importance of microelectronics in our business is the growing amount of production facilities devoted to their fabrication. The Western Electric Company is producing a wide variety of these devices at both its Allentown and Reading Works in Pennsylvania. Gearing for the future, Western Electric announced plans to construct a plant in Orlando, Florida that promises to be one of the most advanced large scale integrated circuit production facilities in the country.

Photonics: Bell Laboratories continued in 1980 to search for ways to enhance the capabilities and reduce the cost of lightwave communications. In Sacramento, California, for example, a new long-wavelength lightwave system—powered by light-emitting diodes rather than lasers—was tested. The longer wavelength of this experimental system minimizes signal loss and reduces the number of signal regenerators needed on long routes.

In New Jersey, Bell Labs scientists tested

lightwave systems in an ocean simulation laboratory. New developments in the production of glass fibers offer the prospect of transoceanic lightwave systems of larger capacity and lower circuit cost than our latest submarine cable systems.

Software: as more and more intelligence is being built into the telecommunications network and in a wide variety of communications terminals, there is a parallel growth in the need for software programs that provide the instructions for these computers and microprocessors.

Today about 30 per cent of the work at Bell Laboratories involves software development. Software specialists design programs for switching centers, for "smart terminals," for data communications systems and—no less important—for the hundreds of computer-based operations systems that the Bell System uses to help manage its operations. These operations systems monitor the performance of the network, track inventories, size and site new switching centers. More and more, these systems are becoming an integral part of the network itself.

One indication of the growing importance of software design and development is Western Electric's five-building software complex under construction in Lisle, Illinois. This complex will house 2,400 computer programmers and others involved in providing software to the Bell System. Another measure is the rapid growth in computer terminals at Bell Laboratories. In 1970, there were only a few hundred computer terminals in use at Bell Labs. Today, there are some 15,000, more than one for each member of its technical staff.

The Bell System continued in 1980 to invest heavily in the technology of the future, spending nearly $1.4 billion for research and development work performed by Bell Laboratories and Western Electric.

Business Services

But technology alone is not sufficient to guarantee success in the marketplace of the future. Technology will have to be matched to the needs and opportunities of the market.

As business grows increasingly complex, as it seeks to offset rising costs and to enhance productivity and as it extends operations both domestically and internationally, managers look more and more to electronic information systems to help assure command of their operations. The Bell System recognizes that success in the marketplace of the future depends on the effectiveness with which it can provide "systems solutions" tailored to particular needs, industry by industry, company by company.

In 1980, for example, we announced a new communications system that not only meets the special voice and data communications needs of hospitals—bed status, medication and diet instructions, emergency communications—but also enables hospitals to cut their energy costs by as much as 20 per cent. At the heart of this system is an electronic Dimension® PBX that is programmed and equipped to monitor and control energy consumption. The Dimension PBX system enables the customer to adjust automatically —or even shut down—heating, lighting and air conditioning systems in various parts of the building as desired.

The first such system was put into service in Savannah, Georgia in September, 1980.

A similar Dimension PBX system—tailored to the requirements of hotels and motels—is at work in many locations around the country. In addition to providing improved communications, it has cut administrative and operating expenses—in one instance reducing energy costs alone by 28 per cent.

Rising energy costs have prompted many businesses to turn increasingly to communications as an alternative to travel. The Bell System provided a variety of teleconferencing arrangements in 1980 that permitted conferees in widely scattered locations to meet by phone and exchange graphic information. The Gemini® electronic blackboard, for example, is used to transmit information written in one location for video display at all points in a conference network.

Business today is spending $18 billion on data communications services and the market is expected to reach more than $90 billion by the end of the decade. Data communications systems that are swift, accurate, reliable, econom-


DENVER
SACRAMENTO



"Ours, too, is a facility which is unmatched in the world… the nationwide switched network. With each passing year we are transforming that network, endowing it with 'intelligence'. Not so long ago it provided a more or less uniform service to all its customers. Before long it will serve no two of them alike."

ical, readily compatible with most computers, easy to use and adaptable to changing needs are crucial to running a modern business.

To that end, we extended Dataphone® Digital Service—which provides private line digital transmission with speeds up to 56 kilobits per second—to 18 additional cities. This network now links 78 cities.

We also tailored data communications systems to the needs of customers using a wide variety of data communications technologies. Our recently introduced Dataphone II service, for example, gained exceptional market response because customers can readily add more "sophistication," expanding their networks to meet individual, specific needs as their data communications requirements grow more complex. Customers also made increased use of our latest and most capable Dataspeed® terminal set—the 4540.

More and more, the Bell System's services for business will take the form of comprehensive systems integrating virtually all aspects of information flow, encompassing voice, video, data storage, retrieval, processing and distribution, word processing and electronic mail. Characteristically, these systems will be custom tailored to meet the individual needs of each business they serve.

Home Communications

Changing lifestyles, economic pressures—such as rising energy costs—and advancing technology are moving the home communications market in much the same direction: toward information-communications *systems*. We expect to equip the home of the future with facilities that meet a wide variety of needs: information, education, entertainment and—as in business—the control of energy consumption.

The Bell System is conducting a number of trials aimed at discerning the needs of the home communications market of the future.

In Coral Gables, Florida 160 homes were equipped to enable customers to access—and to have displayed on a TV screen—information materials in a data base supplied by Knight Ridder Newspapers. The information covered a wide range—restaurant reviews, current events, educational material and shopping guides. Customers were also able to place orders for certain goods and services.

Another trial, scheduled for Austin, Texas in 1981, will equip customers to dial up for video display directory services information and a variety of other computerized data. This is the second trial of electronic information services. The first was held in Albany, New York in 1979.

A third trial will involve two energy companies and 1,000 customers of Southern Bell in Charlotte, North Carolina. A system linking their homes with the utilities will enable consumers to control their energy consumption. The utilities can use the system to read meters remotely, detect tampering and shut off service when customers move. The trial starts in 1981.

As the Bell System's network grows more versatile, so do its telephones. The Bell System's recently introduced Touch-a-matic® "S" telephone is a good example. An all-electronic telephone, it stores up to 12 telephone numbers, each of which can be dialed by pushing a single button.

Customers appear to enjoy increasingly the opportunity to shop for telephones in our PhoneCenter Stores. In 1980 nearly half of the telephones added to our residence lines were sets that customers took home from these stores and installed themselves. In response to growing customer interest, we sought—and received in virtually every jurisdiction—regulatory permission to sell rather than lease our Design Line* telephones.

Almost a decade ago, the Bell System set out to develop a proficiency in marketing to match its accomplishments in technology. That commitment serves us well today. The Bell System's operations and marketing forces are now deployed to match the key segments of the markets they serve: business, residence, public services and directory services. In addition, we have enhanced the professional level of our staff. We have intensified our marketing training program. We have taken significant steps into the general consumer market with our 1,800 PhoneCenter Stores. We have also developed industry specialists who know their industry's particular operating problems and information needs inti-

*Trademark of AT&T Company

mately. Thus, they are equipped, on the one hand, to apply the Bell System's technology to their particular industry's problems and, on the other hand, to acquaint the Bell System's technologists with the needs of the market.

Policy Developments

Nineteen-eighty was marked by a number of significant regulatory actions and legislative proposals that portend fundamental changes in the structure of the telecommunications industry and the way its products and services are supplied. More and more it appears that public policy will look to marketplace forces to regulate our business, while retaining regulation in its traditional form only to the extent it is needed to assure universal service and efficient management of the nationwide network.

To that end, the Federal Communications Commission issued a landmark decision in its Computer Inquiry II. This proceeding initially addressed the degree to which the merging of the technologies of communication and computation might require a redefinition of the role of regulation. The Commission's decision, however, covered a wide range of issues raised by the advent of competition in the telecommunications industry.

While the order requires us to do so through one or more separate subsidiaries, it would permit the Bell System to compete on fair terms in the market for terminal equipment. No longer would we have to seek regulatory approval of our rates, while our competitors price as they please. Significantly, the Commission construes the 1956 Consent Decree that concluded the antitrust case the Justice Department brought against AT&T in 1949 in a way that would permit the Bell System to offer services embodying data processing—what the Commission calls "enhanced services"—and thus be able to compete in the information markets.

Telecommunications legislation, while actively pursued throughout the year, failed at the last to reach the House or Senate floor for a vote. Although the Senate and House bills differed in particulars, they conformed in broad outline. All had three elements in common:

—assurance against cross subsidy of the Bell System's competitive services by its monopoly services,
—fair access to the public switched network for all suppliers of communications services,
—and removal of constraints on the Bell System's freedom to compete in unregulated information markets.

While some have questioned the need for legislation in light of the FCC's Computer In-

A LANDMARK DECISION

In December 1980, the Federal Communications Commission published its Final Decision, in Docket Number 20828, more generally known as Computer Inquiry II. The Decision was recognized as probably the single most important decision in the Commission's 46-year history and one with far-reaching implications with respect to the future of the telecommunications industry. The Commission's action is so significant—and its direction sufficiently clear—to the Bell System that we believe it is important that share owners understand its general provisions.

The Decision distinguishes between "basic" and "enhanced" services. The former are network services that simply transport information without any alteration. "Enhanced" services are those in which some aspect of the original information is changed or where customers interact with stored information.

It requires the Bell System to establish by March 1, 1982 one or more separate subsidiaries in order to provide certain terminal equipment—telephones, PBX switchboards, data sets and so on—and "enhanced" services. While as a general rule enhanced services must be provided through a separate subsidiary, the Commission established a procedure under which it could, in specific instances, waive that requirement and permit the service to be offered by the regulated part of the Bell System.

The Decision detariffs terminal equipment provided after March 1, 1982. Detariffing means that, unlike today, the Bell System will not have to secure regulatory approval of the prices charged for this equipment. But we shall be able to offer such equipment only through a separate subsidiary—not through the local telephone operating companies. (Terminal equipment in place prior to March 1, 1982 would be offered, as it is currently, under state regulatory jurisdiction until a further order of the Commission.)

It limits traditional regulation to the provision of basic local and long distance services. These will continue to be furnished by the telephone companies and Long Lines.

The Decision interprets the 1956 Consent Decree as permitting the Bell System to offer enhanced services and terminal equipment on a detariffed basis through a separate subsidiary.

"Our aim is to combine the service ethic that inspired the accomplishments of the Bell System's first century with the spirit of venturesomeness which is the key to success in its second."







quiry II Decision, the Bell System believes that the authority of Congress is needed to establish the ground rules for a competitive telecommunications industry. National telecommunications policy needs to be set forth unequivocally. That can be done only by Congress.

One thing seems certain about this industry: it will be widely competitive. The fact of competition imposes some new economic requirements on the Bell System, and, in some cases, the general public as well. It requires repricing of products and services—pricing them according to cost and market conditions rather than on "value of service" considerations. And it requires recovering capital more quickly through depreciation rates that reflect the shorter service lives of plant due to rapid changes in technology and market conditions.

As part of its repricing efforts the Bell System moved to extend measured local service—as distinguished from flat rate service—to more residential and business users. Under measured service, customers are charged on the basis of the number of local calls made, their duration, distance, and time placed. Measured service helps keep down basic monthly charges for service, permits customers to pay only for what they use and enables the telephone companies to recover their costs more rapidly and from those who use the service the most.

We also proposed restructuring of Interstate Wide Area Telecommunications Service (WATS) rates to relate prices more closely to costs. This proposal is being studied by the FCC. Should this change go into effect about 90 per cent of WATS users would pay less, while 10 per cent—the heavy users—would pay more. Although overall company earnings would not be affected, the new pricing structure would meet the requirements of the competitive environment.

One of the most critical areas, in making the transition to a competitive environment, has yet to be resolved: that is, the impact of competition in intercity service upon the price of basic service. Telephone company long distance rates today are structured essentially as they have always been. To keep the price for interstate long distance calls affordable even along routes that are very costly to serve, we average the nationwide cost of service. This means that rates along highly trafficked routes are higher than they might otherwise be. Moreover, long distance rates include a substantial contribution—about $12 billion in 1980—to help cover the costs of local service. This structure made sense in the regulated monopoly world in which we used to operate. That world no longer exists. As competition in long distance service grows, such a rate structure becomes increasingly vulnerable, permitting competitors to pinpoint markets where they can undercut our prices even though our costs might be lower. In addition, while our competitors—who bypass our long distance facilities but connect to our network for local distribution—pay a local contribution charge, this charge makes a far smaller contribution to local service than do the rates for our own like services. Again this permits competitors to offer lower rates than ours.

The Bell System believes that fair competition requires that competitors bear an equitable share of the contribution to support local rates. Over the long run, however, this subsidy to local service will only encourage the construction of facilities that by-pass the telephone network altogether. What is needed is a reasonable transition period for the reduction and ultimate elimination of this subsidy and an interim mechanism that is fair to customers and all competitors. In 1980 the FCC proposed an interim access charge plan and initiated a joint board of federal and state regulators to address this problem.

Other Regulatory Actions

The Federal Communications Commission approved changes in the depreciation procedures to be used by Bell operating companies which will enable them to recover capital investment more rapidly. The Commission approved the use of Equal Life Group (ELG) depreciation for new plant and equipment starting, on a phased-in basis, in 1981. ELG permits us to set different depreciation rates for different groups of plant and equipment depending on their expected service lives. In the past, we had been required to use average depreciation rates that

were not as closely geared to the actual service lives of individual categories of plant investment. For existing plant, the Commission authorized Remaining Life depreciation. Remaining Life methods permit us to adjust depreciation rates periodically to assure full capital recovery by the time the plant is retired.

In addition, the Commission ruled that the Bell System should charge to expense the costs associated with new installations of inside wiring and terminal equipment. Heretofore we had been required to capitalize these costs, thus recovering them gradually over time. This change will enhance our ability to recover the costs through installation charges paid by the customers who cause the costs rather than by rate payers in general.

In the short term, these FCC actions will increase expenses and thus initially increase revenue requirements. In the long run, however, they should enable the Company to reduce its reliance on outside sources of capital and reduce the base upon which it must earn and consequently help keep rates down. Provided the Bell associated companies are able to recover through timely rate relief the additional expense incurred, the new depreciation and accounting procedures should strengthen the Company's financial position and share owners' interests as well because the Company's assets and earnings will be more accurately valued.

Pending before the Commission at year's end was the Bell System's petition to be permitted to earn a higher rate of return on its interstate business. The Company is seeking a return on average total capital of 13.0 per cent and a return on common equity of 17.5 per cent. The Company's case is predicated on the surging cost of capital fueled by inflation that has raised investors' demands. In addition to the inflation premium, investors see competition as adding a new element of risk to our business. While the Commission acted in May to raise interstate rates on an interim basis—to produce an interstate rate of return on average capital of 10.5 per cent—a final decision is still awaited. Bell System management is keenly aware that to retain investor confidence it must show earnings comparable to those available from alternative investments of similar risk. We intend to pursue vigorously that objective.

Also pending before the Commission was the adoption of rules that would enable the Bell System to seek authorization of its Advanced Mobile Phone Service (AMPS). Unlike today's mobile service, AMPS could be made available to millions of customers with a quality comparable to regular telephone service.

Judicial Developments

In September, AT&T filed with the United States Court of Appeals an appeal from the $1.8 billion antitrust judgment rendered against AT&T in a suit filed by MCI Telecommunications Corporation. The Company is confident that, after judicial review, the jury's verdict will be reversed.

The Department of Justice suit charging the Bell System with seeking to monopolize the market for telecommunications equipment and services came to trial on January 15, 1981. Judge Harold H. Greene recessed the trial, however, after the attorneys' opening statements because he was informed by both sides that major progress had been made toward reaching a settlement. On January 30, Judge Greene issued an order that set March 2 as the deadline for submission of a consent decree signed by AT&T and the new administration. Failing that, the Judge said that the trial would resume March 4.

Toward a New Structure

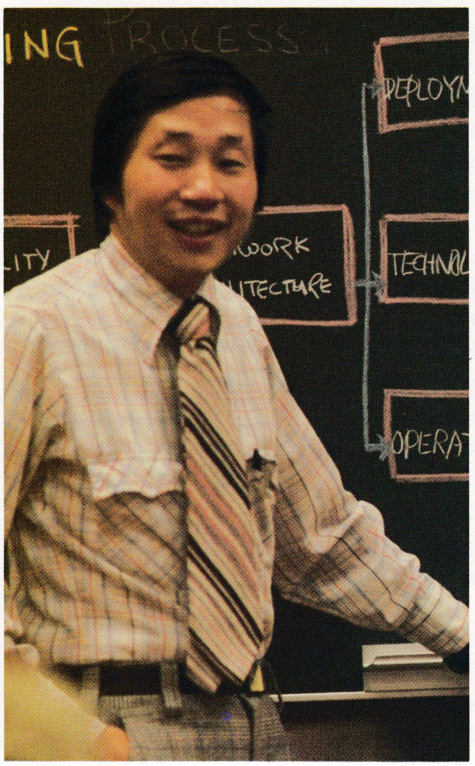
On August 20, 1980, the Board of Directors approved a major realignment of responsibilities at AT&T headquarters. In announcing this realignment, AT&T Chairman Brown said: "The future is fairly clear. We're going to be operating in two modes. One, the long distance business and the local switching business... is clearly going to be under regulation as it has been for so many years.

"The other parts of the business, just as clearly under FCC orders, will be detariffed or deregulated.

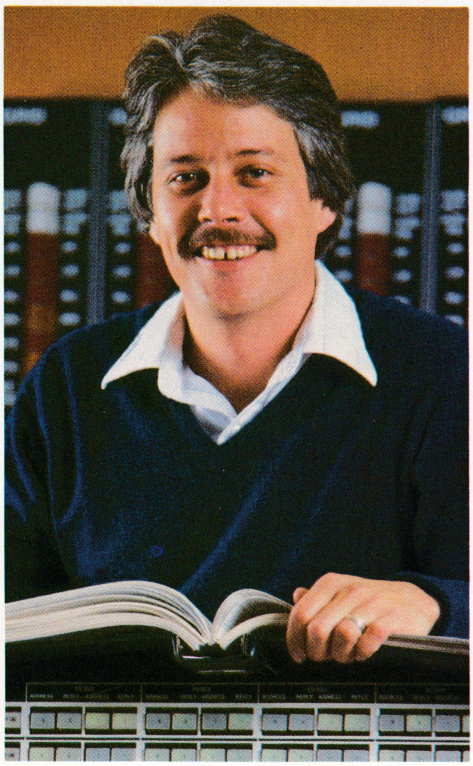
"Those two modes are different but

"...we have even greater strength than our technology: Bell System people. It is not only their skills but their spirit that makes our business great—and will keep it great."

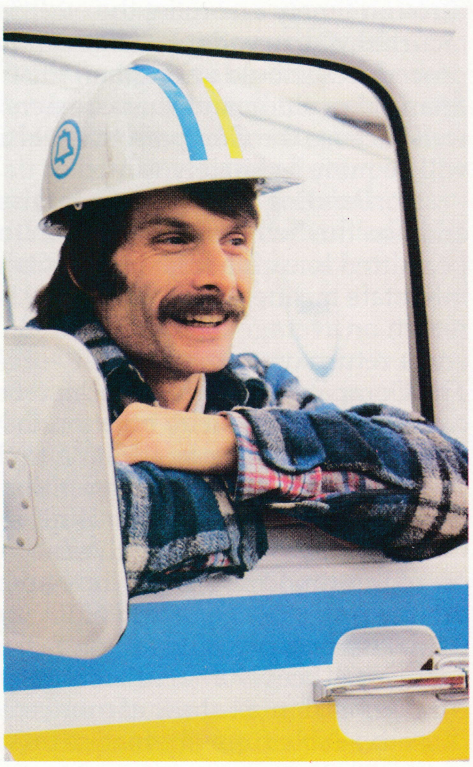












there's no question in our minds that we can successfully operate in them."

The realignment, Mr. Brown said, sets the stage for the kind of fundamental restructuring that is called for by the FCC's Computer Inquiry II Order and the latest Congressional legislative proposals.

The realignment separates responsibility for those activities that we expect to be regulated in the traditional manner from responsibility for those that will be detariffed. The former report to William M. Ellinghaus, president of AT&T. They include basic network services, federal and state regulatory matters, our Long Lines Department and tariffs. Operations that we anticipate will be primarily involved with detariffed markets —residence and business products and services, directory and public telephone services—report to AT&T Vice Chairman James E. Olson. Also reporting to Mr. Olson is a new subsidiary—AT&T International Inc.—which consolidates the activities of Western Electric International and American Bell, Inc. and which will seek new "global" markets for Bell System products and services.

The balance of AT&T corporate activities —finance, legal, public affairs, public relations, labor relations, human resources and planning—continue to serve the entire enterprise.

This realignment of headquarters responsibilities is the first step in what may prove to be the most massive organizational restructuring in American corporate history. The restructuring is intended to equip the Bell System to operate in competitive markets while meeting its basic obligation under regulation: the provision of increasingly efficient telecommunications services available to all.

To facilitate the restructuring and the establishment of one or more separate subsidiaries, the Board of Directors approved plans to acquire the minority shares in Mountain Bell, New England Telephone, Pacific Northwest Bell and Pacific Telephone. In October, as a result of regulatory and legislative uncertainties, AT&T withdrew its offer to purchase minority shares in Pacific Telephone. In late Fall, minority share owners in the three other companies approved the acquisition of their stock, receiving in return a fractional share of AT&T stock for each associated company share surrendered. At the same time, the Board authorized consolidation of the pension plans and funds of Bell associated companies which will simplify and reduce the cost of the administration of pension funds as employees are transferred between companies as a consequence of restructuring.

Unchanged Commitments

In 1980 the Company undertook a number of actions that affirmed its commitment to the individual needs of its customers, the needs of employees, the needs of the community.

While service activities have been detailed elsewhere in this report, the Bell System took special steps in 1980 to meet the service needs of disabled customers. For example, Illinois Bell opened a Telecommunications Center for Disabled Customers in Chicago, one of ten such centers in operation in various parts of the country. At these centers, customers can speak with specially trained staff and examine the range of equipment—both Bell and non-Bell—that is designed to meet their needs. The Bell System also offered a new nationally available, round-the-clock, operator service to provide assistance to hard of hearing and deaf customers who use teletypewriters to communicate. The service went into effect in June.

As part of an intensified effort to improve work relationships in the Bell System, some 50,000 employees—chosen at random—were surveyed with respect to their feelings about their jobs, supervision and compensation. Although 80 per cent of those surveyed were positive about their jobs, there were sufficient expressions of concern about job stress, change and the ability of employees "to be heard" to confirm the importance of efforts to improve the quality of work life in the Bell System.

In August, the Bell System reached agreements on three-year contracts with the unions representing its employees. The contracts will increase wage and benefit costs about 30 per cent over three years, which was within the guidelines of the Council on Wage and Price Stability. In addition to providing an improved

"...what further changes the future will bring is beyond knowing. Indeed, how the Bell System will be configured ten years from now I can't predict. But I can say what standard we mean to apply to the decisions we'll be called upon to make on the way to that unknowable destination. It is the standard of excellence. Our purpose is to seek—at every point of decision—the highest and best use of the organizations and resources we call the Bell System. The highest and best."





pension plan and other benefits, the agreements established joint union-management technology committees, to be formed in each Bell System company, aimed at cushioning the impact on employees of future technological changes. The contract also created joint national committees designed to improve the work life of employees and the operating effectiveness of the Company.

Benefits for management employees were also improved during the year, including a redesigned management pension plan.

The Bell System continued its commitment to Equal Employment Opportunity in 1980. The total number of minority employees increased by more than 8,700 of which some 2,400 were in management. Today minorities represent 19 per cent of the total employee body and 12 per cent of management. Women in management jobs increased by more than 5,000. Women account for 38 per cent of our management. Some 1,400 women entered craft jobs during the year.

While our prime responsibility to the community is the provision of quality communications, we have other obligations as corporate citizens.

The Bell System in 1980, for example, pledged its commitment to the national program to conserve energy and reduce oil imports. This effort included intensified car-pooling by employees, improved maintenance of company vehicles, close control of heating, lighting and air conditioning of company buildings and tests of gasohol and battery-driven vehicles. The Bell System in 1980 consumed five per cent less energy than in 1979. Since 1973, when the Bell System began its intensified energy conservation program, volume of business has increased 73 per cent, while energy consumption has declined 11 per cent.

The Bell System also continued support of worthwhile charitable, health, educational, cultural and civic organizations that provide needed services to the communities in which it operates. In 1980, the Bell System contributed some $40 million to such groups.

Photo Captions:

Inside Front Cover: A single strand of glass fiber or "lightguide," carries a laser-powered lightbeam. Lightwave cable, already in use in some areas of the country, contains up to 144 such lightguides and can carry as many as 50,000 simultaneous conversations.

Page 6: Information in action: (clockwise from top) The trading floor of the New York headquarters of the international investment banking and market making firm, Salomon Brothers; the operations communications center of Mobil Corporation, New York; installation of an Electronic Switching System in Saudi Arabia, and a home information system, currently undergoing trial in Florida.

Page 7: At a Bell System communications seminar, marketing experts keep business customers abreast of ways modern communications can improve their companies' profitability.

Page 9: Computer-generated video displays such as this one enable Bell Laboratories scientists to design very large scale integrated circuits. Computer-aided circuit design is much faster and more efficient than previous methods and lets researchers try a variety of design alternatives before selecting the best configuration.

Page 12-13: The Network Operations Center in Bedminster, New Jersey enables AT&T Long Lines network managers to monitor—minute-by-minute—the movement of traffic through the nationwide telecommunications network, identify potential problems and quickly reroute calls to prevent network congestion.

Page 16: Southwestern Bell outside plant technician, Louis Walkingstick, works on rural telephone lines in a remote area of eastern Oklahoma.

Page 17: Satellite technology complements terrestrial transmission facilities in today's telephone network. These antennas are part of a Bell System satellite ground station complex in Woodbury, Georgia.

Page 20: Bell System employees pictured are, from left to right: (top row) Pat Isom, AT&T Long Lines-Washington, D.C.; Rau C. Chang, Bell Laboratories-West Long Branch, N.J., and Rochelle Deason, Illinois Bell-Chicago; (bottom row) David J. Calvert, Long Lines-Anaheim, Calif.; Garmayonne D. Tyner, Western Electric Company-Atlanta, Georgia, and Robert Butler, Chesapeake & Potomac Telephone-Washington, D.C.

Page 22-23: The "Genius of Electricity" was the name given to Evelyn Beatrice Longman's heroic sculpture when it was first installed atop AT&T headquarters at 195 Broadway in New York in 1916. To generations of telephone people, however, it has been known as "The Spirit of Communications." Last Fall the statue was removed for refurbishing in anticipation of its installation in the lobby of AT&T's new headquarters building at 550 Madison Avenue upon its completion in late 1982.

Financial Review and Consolidated Financial Statements

Report of Management

The financial statements on pages 30 through 43, which consolidate the accounts of American Telephone and Telegraph Company and its subsidiaries, have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission for telephone companies, except for investments, revenue refunds, and a California rate and tax matter as discussed in Notes to Financial Statements.

The integrity and objectivity of data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management as is all other information included in the Annual Report unless indicated otherwise. To this end, management maintains a system of internal accounting controls which, on an ongoing basis, is reviewed and evaluated. Our internal auditors monitor compliance with it in connection with their program of internal audits. However, there are inherent limitations that should be recognized in considering the assurances provided by any system of internal accounting controls. The concept of reasonable assurance recognizes that the costs of a system of internal accounting controls should not exceed, in management's judgment, the benefits to be derived. Management believes that the Company's system does provide reasonable assurance that transactions are executed in accordance with management's general or specific authorizations and are recorded properly to maintain accountability for assets and to permit the preparation of financial statements in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Management also believes that this system provides reasonable assurance that access to assets is permitted only in accordance with management's authorizations, that the recorded accountability for assets is compared with the existing assets at reasonable intervals, and that appropriate action is taken with respect to any differences. Management also seeks to assure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility, and by communications programs aimed at assuring that its policies, standards and managerial authorities are understood throughout the organization.

These financial statements have been examined by Coopers & Lybrand, independent Certified Public Accountants. The other auditors referred to in their report are Arthur Young & Company, auditors of Western Electric Company, Incorporated and Southwestern Bell Telephone Company, and Arthur Andersen & Co., auditors of Illinois Bell Telephone Company.

The Audit Committee of the Board of Directors, which is composed of Directors who are not employees, meets periodically with management, the internal auditors, and the independent auditors to review the manner in which they are performing their responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have free access to the Audit Committee at any time.

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 sheets of American Telephone and Telegraph Company and its subsidiaries as of December 31, 1980, 1979 and 1978, and the related consolidated statements of income and reinvested earnings and sources of funds supporting construction activity for the years then ended. Our examinations were 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. The financial statements of two telephone subsidiaries and of Western Electric Company, Incorporated, the Company's principal unconsolidated subsidiary, were examined by other auditors; such statements reflect net income constituting approximately 28%, 27% and 26% of consolidated net income for 1980, 1979 and 1978, respectively. The reports of the other auditors have been furnished to us and our opinion expressed herein, insofar as it relates to amounts included for subsidiaries examined by them, is based solely upon such reports.

As described in Note (E) to Financial Statements, net income for 1980 includes amounts resulting from intrastate rate increases which were collected subject to refund. In addition, in our previous report dated February 8, 1980, our opinion on the 1979 and 1978 consolidated financial statements was subject to the effects, if any, on the 1979 and 1978 consolidated financial statements of the final outcome of a Federal Communications Commission inquiry. As discussed in Note (F) to Financial Statements, the Company now believes, based on the opinion of its legal counsel, that the eventual outcome of this inquiry will not result in a material refund. Accordingly, our opinion on the 1979 and 1978 consolidated financial statements is no longer subject to the outcome of this matter.

In our opinion, based upon our examinations and the reports of other auditors and subject to the effects, if any, on the 1980 consolidated financial statements of the final outcome of the intrastate rate matters discussed in the preceding paragraph, the financial statements referred to above present fairly the consolidated financial position of American Telephone and Telegraph Company and its subsidiaries at December 31, 1980, 1979 and 1978, and the consolidated results of their operations and consolidated sources of funds supporting their construction activity for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand
1251 Avenue of the Americas, New York, N.Y.
February 6, 1981

Results in Brief

Selected Financial Data

DOLLARS IN MILLIONS (except per share amounts)		1980	1979	1978	1977	1976
Revenues	Local service	$ 22,449	$ 20,208	$ 18,685	$17,007	$15,557
	Toll service	26,133	23,371	20,770	18,094	16,065
	Other (including other income)	3,098	2,604	2,289	1,902	1,492
		51,680	46,183	41,744	37,003	33,114
Expenses	Operating	34,187	30,205	26,505	23,516	21,021
	Income taxes on operations	3,717	3,619	3,837	3,268	2,905
	Other taxes on operations	3,928	3,602	3,439	3,252	2,977
	Interest	3,768	3,083	2,690	2,487	2,426
		45,600	40,509	36,471	32,523	29,329
Net Income		6,080	5,674	5,273	4,480	3,785
Preferred dividend requirements		151	156	164	184	227
Income applicable to common shares		$ 5,929	$ 5,518	$ 5,109	$ 4,296	$ 3,558
Earnings per common share		$ 8.19	$ 8.04	$ 7.74	$ 6.86	$ 5.98
Based on average shares outstanding (in thousands)		723,516	686,109	659,843	625,878	595,184
Total assets		$125,451	$113,402	$102,990	$93,646	$86,502
Long and intermediate term debt		$ 41,255	$ 37,168	$ 34,203	$32,205	$32,341
Preferred shares subject to mandatory redemption		$ 1,575	$ 1,588	$ 1,600	$ 1,625	$ 1,625
Convertible preferred shares subject to redemption		$ 385	$ 433	$ 501	$ 594	$ 1,237
Dividends declared per common share		$ 5.00	$ 5.00	$ 4.60	$ 4.20	$ 3.80
Ratio of pre-tax earnings to fixed charges*		3.33	3.68	4.01	3.77	3.52

Selected Operating Data (In Millions)

For the year ended December 31					
Toll messages	17,457	16,193	14,639	12,844	11,684
WATS messages	4,874	4,244	3,631	3,046	2,451

Charges for toll messages and WATS messages for the year ended December 31, 1980 account for about 38% and 7%, respectively, of total billed operating revenues.

At December 31					
Telephones in service	142	138	133	128	123
Lines in service	82	79	76	73	70

Recurring charges for telephones and lines in service for the year ended December 31, 1980 account for about 21% of total billed operating revenues.

*For the purpose of the ratio: (i) Earnings have been calculated by adding to Income before interest expense the amount of related taxes on income, ownership interest of others in the net income of certain consolidated subsidiaries and the portion of rentals representative of the interest factor, and by deducting therefrom the consolidated subsidiaries' share in the income in excess of dividends of companies accounted for on an equity basis; (ii) Fixed Charges comprise total Interest Expense, dividends on preferred shares of a consolidated subsidiary held by others and such portion of rentals representative of the interest factor. The ratios shown would not change materially if the earnings and fixed charges of companies accounted for on an equity basis were included in the computations.

Management's Discussion and Analysis of Financial Condition and Results of Operations

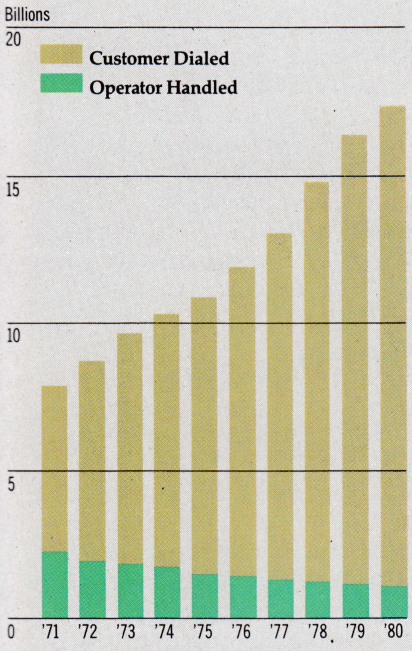
Despite recession and continuing inflation, AT&T's financial results showed modest improvement in 1980.

The Company's marketing efforts, improved operating efficiencies, expense control and productivity gains played significant roles in the year's results. Revenue and earnings gains were bolstered by a resumption of demand in the second half of the year and by increases in telephone rates.

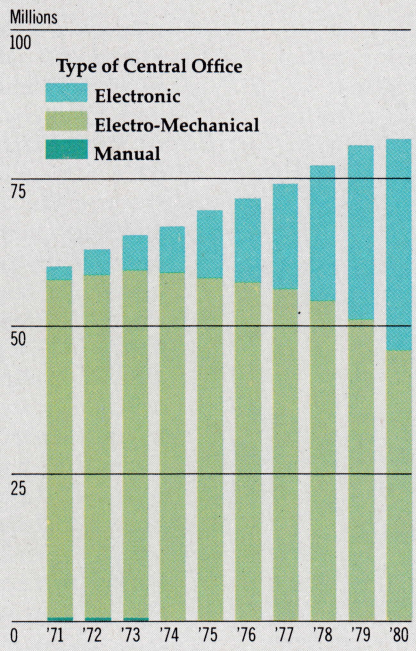
While the Company weathered the effects of recession and inflation, it did not achieve the level of earnings we believe is necessary to meet the expectations of investors. To that point, the Company's stock at year's end was selling some 27 per cent below book value.

Total revenues (including other income) for 1980 showed a year-over-year increase of 11.9 per cent, compared to 10.6 per cent in 1979 and 12.8 per cent in 1978. Total expenses (including operating taxes and interest) increased 12.6 per cent in 1980, versus 11.1 per cent in 1979 and 12.1 per cent in 1978. Net income in 1980 rose 7.1 per cent versus a 7.6 per cent rise in 1979 and 17.7 per cent in 1978.

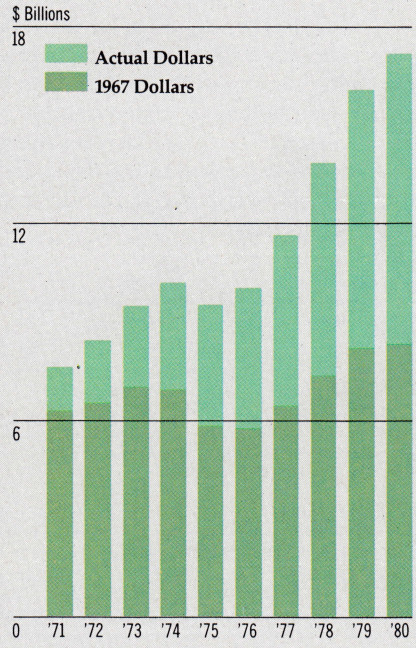
Local and toll service revenues rose 11.5 per cent in 1980, 10.5 per cent in 1979 and 12.4 per cent in 1978 because of continuing growth in calling volumes and telephones and lines in service. Some $285 million of the revenue increase in 1980 was the result of an interstate rate increase authorized by the Federal Communications Commission effective June 6, 1980. (There were no significant interstate rate increases in 1979 and 1978.) Higher intrastate rates contributed $1.2 billion in increased revenues in 1980, compared to $450 million in 1979 and $620 million in 1978. Western Electric's net income, included in "other income," increased principally because of its improved sales to Bell System operating companies.



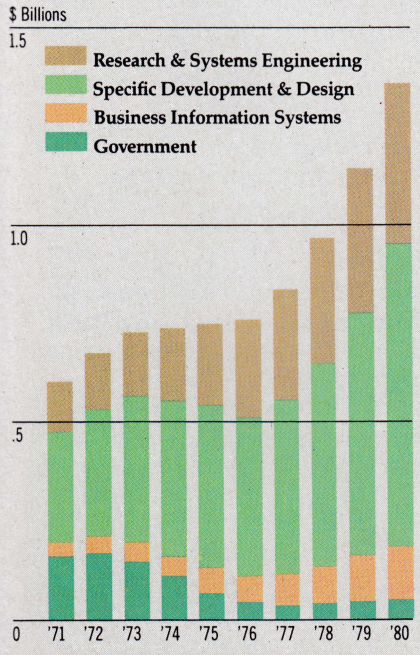
Long distance calling: Customers increasingly dialed their own long distance calls, reflecting the convenience and lower rates customer-dialing offers; long distance calls in 1980 numbered 17.5 billion, an increase of 7.8 per cent over 1979.



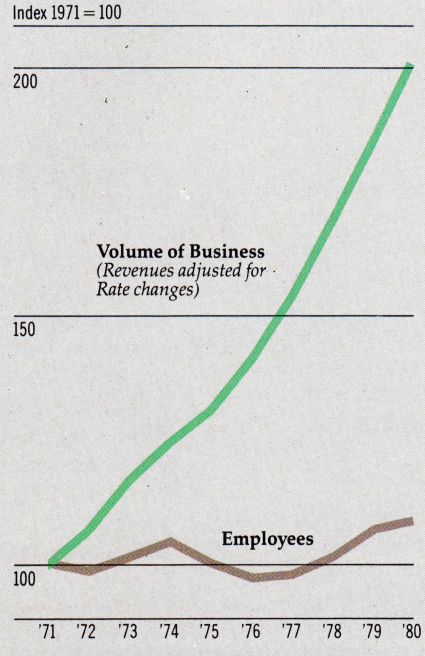
Customer lines: Lines in service increased 3.1 per cent in 1980. By the end of 1980, local electronic central offices served some 43 per cent of customer lines; we are continuing to install electronic switching centers at the rate of about one per day.



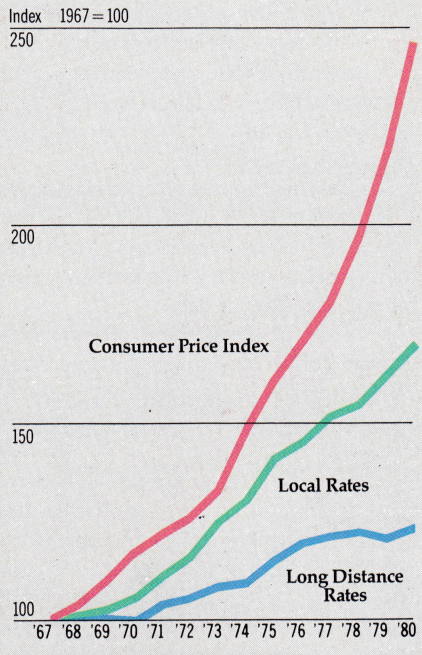
Construction: Expenditures to extend, improve and maintain service totaled $17.3 billion in 1980, $1.5 billion more than in 1979. In constant dollars, 1980 construction expenditures were at about the same level as the previous year.



Research and development: Bell System R & D expenditures, including both Bell Laboratories and Western Electric, grew significantly in 1980. Almost 30 per cent of Bell Laboratories' efforts involved development of computer software.



Productivity: Volume of business grew 8.3 per cent in 1980, while employees increased but 2.1 per cent—one measure of productivity. Bell System total factor productivity also continued its rapid growth during the year.



Prices: Improved operating efficiencies, continuing productivity gains and new technology have helped hold increases in local telephone service rates to 48 per cent of the rise in the Consumer Price Index, long distance rates to 16 per cent.

Inflation continued to have its effect on the Company's expenses. (See also Supplementary Data on Page 43.) Operating expenses increased, in part because of wage increases provided for in new contracts with bargained-for employees. Provision for increased pensions and benefits, depreciation expense and the rising costs of materials and services also contributed to the increase in operating expenses, as follows:

DOLLARS IN MILLIONS	1980 vs 1979	1979 vs 1978	1978 vs 1977
Wages and salaries, including cost-of-living adjustments	$1,678	$1,696	$1,313
Provision for pensions and other employee benefits	354	403	336
Depreciation due to increased:			
Rates	214	111	84
Plant investment	695	479	410
Materials, supplies and other payments	1,041	1,011	846
Total operating expense increase	$3,982	$3,700	$2,989

New contracts, effective on August 10, 1980, with unions representing Bell System employees are expected to increase wage and benefit expenses by about 30 per cent over the next three years.

New Federal Communications Commission rules issued late in 1980, establishing new procedures for depreciating facilities and equipment and for expensing of station connections, are expected to increase expenses in future years. These items of additional expense, however, should be allowable in determining revenue requirements in future rate-making proceedings. (For additional discussion of depreciation and station connection expense, see Notes (A) and (H) to the Financial Statements on pages 35 and 39, respectively.)

On the other hand, pension accruals were reduced, effective October 1, 1980, coincident with the introduction of redesigned pension plans which permitted the Company to improve benefits while reducing pension accruals in the immediate years ahead.

The 1980 and 1978 income tax increases reflect higher income before such taxes. Income taxes on operations decreased in 1979, principally because of a reduction in the corporate federal income tax rate at the beginning of that year.

Interest rates paid by Bell System companies continued to hit record highs in 1980 as they went to the debt market to help finance their construction programs. The Bell System raised 64 per cent of its capital needs through internal sources in 1980, 65 per cent in 1979 and 74 per cent in 1978. In addition, it raised in 1980 $6.8 billion in external capital. This includes a $600 million issue of 10-year notes by AT&T and $4.1 billion in 16 long and intermediate term debt issues by the consolidated subsidiaries compared to $3.4 billion in 1979 and $2.8 billion in 1978. Interest costs on Triple-A long term issues in 1980 ranged from a low of 11.17 per cent to a high of 14.38 per cent. Average interest cost of long and intermediate term debt issued was 12.5 per cent in 1980, 10.3 per cent in 1979 and 9.1 per cent in 1978. The Company's embedded cost of debt was 8.0 per cent at the end of 1980 compared to 7.4 in 1979 and 7.1 in 1978. Additional capital needs in 1980 were met through $1.9 billion in new equity from the Company's Dividend Reinvestment and Stock Purchase Plan and Employee Savings and Stock Ownership Plans. In 1979 and 1978, these plans provided the Company with $1.7 billion and $1.2 billion in new equity, respectively. Average common shares outstanding increased 37 million in 1980, compared to 26 million in 1979 and 34 million in 1978.

The Bell System's debt ratio (debt as a per cent of total debt and equity) rose in 1980 to 46.6 per cent at year's end. It was 46.2 per cent in both 1979 and 1978. If preferred shares subject to mandatory redemption were included with debt, the ratio would be 48.2 per cent for 1980, 48.0 per cent for 1979 and 48.2 per cent for 1978.

The Bell System expects to continue to make large construction expenditures to meet demand for communications services and to further improve such services. It is expected that these large expenditures will be financed by internal sources and, as needed, by external financing from debt and equity sources.

The Company continued to be able to obtain the cash it needed, as reflected in the Statements of Sources of Funds Supporting Construction Activity on page 34. The Company believes that it will continue to be able to do so in the future. Moreover, its needs for external financing will be reduced if regulatory agencies implement changes in depreciation methods and in accounting for station connection costs and reflect such changes in revenue requirements.

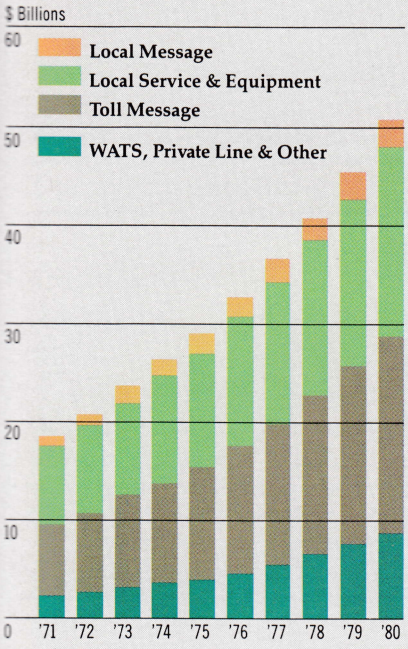
As a result of high interest rates, general inflation and modest growth in earnings, dividends declared remained at $5 during 1980. It was the first year since 1975—and only the third year in the last 10—that dividends were not increased.

Market and Dividend Data

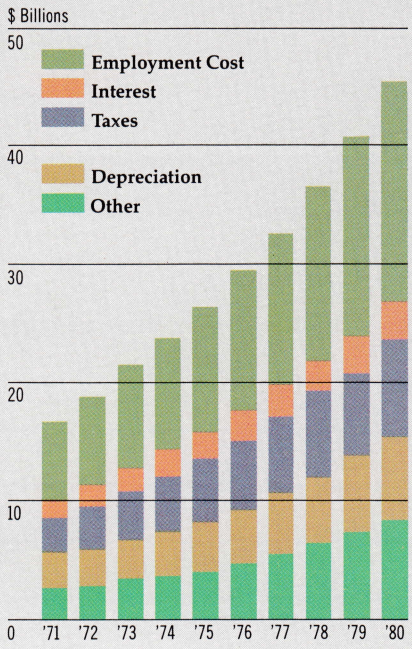
The principal market for trading in AT&T common stock is the New York Stock Exchange. As of December 31, 1980 there were 3,026,080 holders of record of this common stock. Market data as obtained from the Composite Tape* and dividend data for the last two fiscal years are listed below. The preferred shares rank prior to the common shares for dividends. See Note (L).

Calendar Quarter	Market Price High	Market Price Low	Dividend Declared
1979 1st	$64¾	$60⅜	$1.25
2nd	62¼	57	1.25
3rd	59⅛	54⅞	1.25
4th	55⅜	51⅝	1.25
1980 1st	$52⅞	$45	$1.25
2nd	55¾	48¼	1.25
3rd	56⅛	51⅛	1.25
4th	53¼	45	1.25

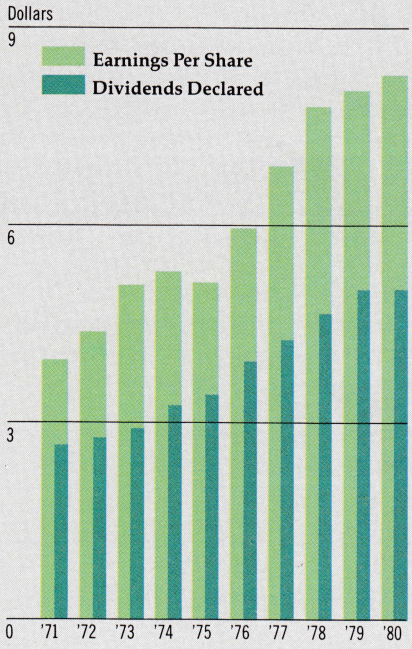
*Encompasses trading on the principal U.S. stock exchanges as well as off-board trading.



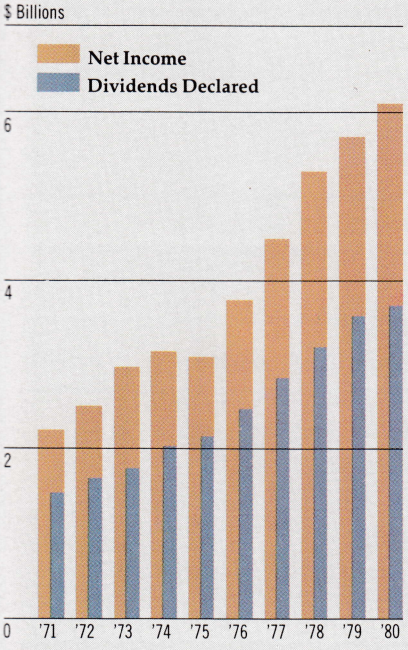
Revenues: Bell System operating revenues grew by $5.4 billion, or 11.9 per cent, in 1980. Growth in volume of business accounted for 73 per cent of the $5.4 billion increase; the remaining 27 per cent was attributable to increased rates.



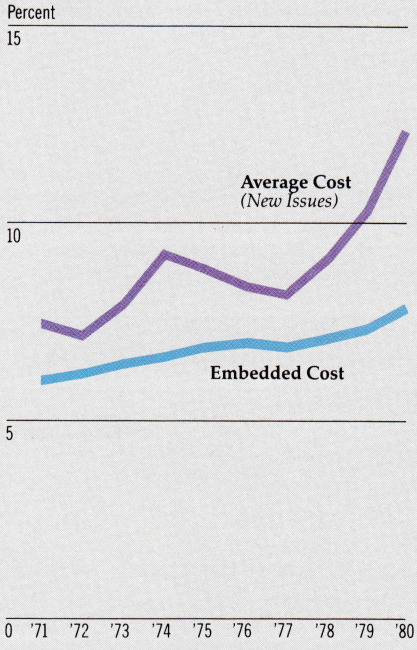
Expenses: Employment costs increased 12 per cent and accounted for about 40 per cent of the Company's total expenses. Operating taxes amounted to $7.6 billion—or 17 per cent—and interest costs $3.8 billion or 8 per cent.



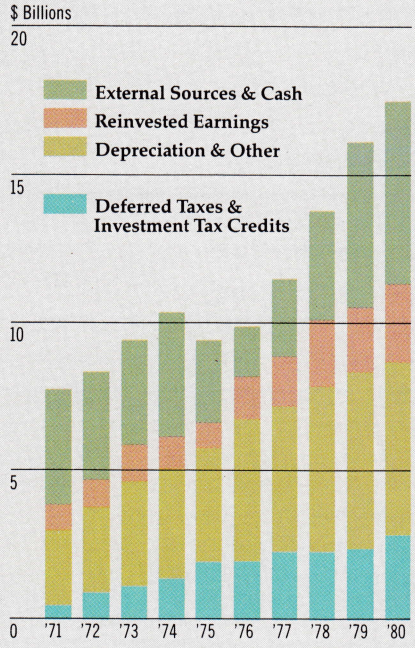
Earnings per share: Despite recession and inflationary pressures, earnings per share continued to improve, rising from $8.04 in 1979 to $8.19 in 1980. The dividend continued at $5 per share.



Net income: The Company's net income increased $406 million from $5.7 billion in 1979 to $6.1 billion in 1980. Some $3.8 billion of 1980's net income was declared in dividends; the remaining $2.3 billion was reinvested in the business.



Cost of debt: The Bell System companies paid record high interest rates in 1980 to help finance their construction programs; as a result, the Company's embedded cost of long and intermediate term debt rose to 8.0 per cent by the end of the year.



Financing: Internal sources provided 64 per cent of the Bell System's capital requirements. Of the $6.8 billion in external capital raised, new equity from dividend reinvestment and employee savings and stock plans accounted for $1.9 billion.

Statements of Income and Reinvested Earnings

American Telephone and Telegraph Company and its Subsidiaries

DOLLARS IN MILLIONS (except per share amounts)	Year 1980	Year 1979	Year 1978
OPERATING REVENUES			
Local service			
Service and equipment charges	**$18,972.4**	$16,872.2	$15,652.6
Message charges	**2,184.7**	2,173.4	1,987.6
Public telephones	**800.4**	778.5	712.4
Private lines and other services	**491.9**	384.1	332.0
Toll service			
Message charges	**20,083.3**	18,231.1	16,325.2
WATS	**3,724.3**	3,175.7	2,745.7
Private lines and other services	**2,325.6**	1,964.6	1,699.4
Directory advertising and miscellaneous	**2,702.6**	2,288.2	1,880.7
Less: Provision for uncollectibles	**494.0**	459.7	342.3
Total operating revenues	**50,791.2**	45,408.1	40,993.3
OPERATING EXPENSES			
Maintenance	**10,916.5**	9,687.4	8,460.4
Depreciation	**7,039.2**	6,130.4	5,539.7
Network and operator services	**3,253.3**	3,156.9	2,920.4
Marketing and customer services	**4,319.5**	3,554.5	2,907.3
Financial operations	**1,547.4**	1,237.2	1,092.0
Directory	**917.5**	854.7	764.8
Research and systems engineering	**418.8**	362.0	319.9
Provision for pensions and other employee benefits (C)	**4,461.2**	4,082.4	3,600.5
Other operating expenses	**1,313.7**	1,139.2	900.2
Total operating expenses	**34,187.1**	30,204.7	26,505.2
Net operating revenues	**16,604.1**	15,203.4	14,488.1
OPERATING TAXES			
Federal income taxes (B)	**3,338.1**	3,260.7	3,494.5
State and local income taxes (B)	**378.9**	358.2	342.9
Property taxes	**1,722.5**	1,626.2	1,678.3
Gross receipts, payroll-related and other taxes (U)	**2,206.1**	1,975.6	1,760.2
Total operating taxes	**7,645.6**	7,220.7	7,275.9
Operating income (carried forward)	**$ 8,958.5**	$ 7,982.7	$ 7,212.2

The accompanying notes are an integral part of the financial statements.

DOLLARS IN MILLIONS (except per share amounts)	Year 1980	Year 1979	Year 1978
Operating income (brought forward)	**$ 8,958.5**	$ 7,982.7	$ 7,212.2
OTHER INCOME			
Western Electric Company, Incorporated net income	**693.2**	635.9	561.2
Interest charged construction	**271.1**	221.9	270.5
Miscellaneous income and deductions-net (D)	**(75.0)**	(82.7)	(80.6)
Total other income	**889.3**	775.1	751.1
Income before interest expense	**9,847.8**	8,757.8	7,963.3
INTEREST EXPENSE (U)	**3,768.1**	3,083.6	2,690.7
NET INCOME	**6,079.7**	**5,674.2**	**5,272.6**
Preferred dividend requirements	**150.7**	156.1	163.4
INCOME APPLICABLE TO COMMON SHARES (E)	**$ 5,929.0**	$ 5,518.1	$ 5,109.2
EARNINGS PER COMMON SHARE based on weighted average number of shares outstanding of 723,516,000, 686,109,000 and 659,843,000 in years 1980, 1979 and 1978, respectively (E)	**$ 8.19**	**$ 8.04**	**$ 7.74**
REINVESTED EARNINGS			
At beginning of year (E)	**$21,856.5**	$19,771.6	$17,699.4
Add—Net income	**6,079.7**	5,674.2	5,272.6
	27,936.2	25,445.8	22,972.0
Deduct—Dividends declared:			
Convertible preferred shares subject to redemption:			
$4 Convertible preferred shares	**32.0**	36.2	42.3
Preferred shares subject to mandatory redemption:			
$3.64 Preferred shares	**36.4**	36.4	36.4
$3.74 Preferred shares	**37.4**	37.4	37.4
$77.50 Preferred shares	**44.6**	45.5	46.5
Common: 1980, $5.00 per share; 1979, $5.00 per share; and 1978, $4.60 per share	**3,619.5**	3,434.3	3,037.5
Miscellaneous—net	**2.8**	(.5)	.3
	3,772.7	3,589.3	3,200.4
At end of year	**$24,163.5**	$21,856.5	$19,771.6

DOLLARS IN MILLIONS (except per share amounts)	December 31 1980	1979	1978
INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS			
COMMON SHARE OWNERS' EQUITY			
Common shares—$16⅔ par value (K)	**$ 12,580.4**	$ 11,689.5	$ 11,159.1
Authorized shares: 1980, 900,000,000; 1979, 750,000,000; and 1978, 750,000,000			
Outstanding shares: 1980, 754,825,000; 1979, 701,367,000; and 1978, 669,549,000			
Proceeds in excess of par value	**12,703.7**	10,942.2	9,687.5
Reinvested earnings—see page 31	**24,163.5**	21,856.5	19,771.6
	49,447.6	44,488.2	40,618.2
CONVERTIBLE PREFERRED SHARES SUBJECT TO REDEMPTION (L)			
$4 cumulative convertible preferred (includes proceeds in excess of stated value)	**384.7**	432.9	501.2
PREFERRED SHARES SUBJECT TO MANDATORY REDEMPTION (L)	**1,575.0**	1,587.5	1,600.0
OWNERSHIP INTEREST OF OTHERS IN CONSOLIDATED SUBSIDIARIES			
Share owners' equity (K)	**393.8**	1,063.1	981.1
Preferred shares subject to mandatory redemption (M)	**553.0**	500.0	416.7
	946.8	1,563.1	1,397.8
LONG AND INTERMEDIATE TERM DEBT (N)	**41,255.0**	37,167.9	34,202.5
CURRENT LIABILITIES			
Accounts payable:			
To unconsolidated subsidiaries	**1,168.8**	1,132.7	973.2
Payrolls	**550.0**	492.8	432.3
Others	**1,463.6**	1,629.5	1,587.0
Taxes accrued	**1,214.9**	1,057.8	1,352.8
Advance billing and customers' deposits	**1,265.9**	1,088.3	955.1
Dividends payable	**984.0**	935.9	831.0
Interest accrued	**994.6**	850.1	735.0
	7,641.8	7,187.1	6,866.4
Debt maturing within one year (P)	**4,342.1**	4,078.2	3,741.8
Taxes relating to California rate order (E)	**1,422.8**	1,304.1	1,005.6
Accumulated deferred income taxes	**506.0**	409.0	310.7
	13,912.7	12,978.4	11,924.5
DEFERRED CREDITS			
Accumulated deferred income taxes (E)	**12,067.3**	10,375.0	8,739.8
Unamortized investment tax credits (E)	**5,574.0**	4,612.6	3,841.4
Other	**287.7**	196.6	164.2
	17,929.0	15,184.2	12,745.4
LEASE COMMITMENTS (R)			
TOTAL INVESTED CAPITAL, LIABILITIES, AND DEFERRED CREDITS	**$125,450.8**	$113,402.2	$102,989.6

Statements of Sources of Funds Supporting Construction Activity

American Telephone and Telegraph Company and its Subsidiaries

DOLLARS IN MILLIONS (except per share amounts)	Year 1980	Year 1979	Year 1978
FUNDS FROM OPERATIONS			
Net Income	**$ 6,079.7**	$ 5,674.2	$ 5,272.6
Add—Expenses not requiring funds currently:			
Depreciation	**7,039.2**	6,130.4	5,539.7
Deferred income taxes—net	**1,789.3**	1,733.5	1,600.0
Investment tax credits—net	**961.4**	771.2	612.8
Deduct—Income not providing funds currently:			
Interest charged construction	**271.1**	221.9	270.5
Share of equity-basis companies' income in excess of dividends	**231.4**	184.4	166.1
Total funds from operations	**15,367.1**	13,903.0	12,588.5
Less—Dividends	**3,769.9**	3,589.8	3,200.1
	11,597.2	10,313.2	9,388.4
FUNDS FROM EXTERNAL FINANCING			
Issuance of shares, net of redemptions (K)	**2,591.7**	1,704.2	1,157.1
Issuance of long and intermediate term debt	**4,728.9**	3,409.8	2,795.3
Increase in short term borrowings—net (P)	**83.9**	706.4	51.1
	7,404.5	5,820.4	4,003.5
Less—Retirement of long and intermediate term debt	**415.0**	785.0	321.5
	6,989.5	5,035.4	3,682.0
CHANGES IN WORKING CAPITAL* (excluding debt maturing within one year and accumulated deferred income taxes)			
Cash and temporary cash investments	**(137.6)**	558.7	(138.2)
Receivables	**(896.7)**	(548.8)	(815.7)
Material and supplies	**(65.2)**	(131.5)	(111.6)
Prepaid expenses	**(25.4)**	(2.4)	(5.8)
Accounts payable	**(72.6)**	262.5	382.8
Taxes accrued	**157.1**	(295.0)	304.6
Advance billing and customers' deposits	**177.6**	133.2	97.5
Dividends payable	**48.1**	104.9	89.6
Interest accrued	**144.5**	115.1	72.0
Taxes relating to California rate order (E)	**118.7**	298.5	260.6
	(551.5)	495.2	135.8
OTHER CHANGES*			
Investments	**(413.5)**	(462.0)	(74.9)
Deferred charges	**(114.3)**	(135.6)	(77.9)
Ownership interest of others in consolidated subsidiaries (K)	**(616.3)**	165.3	153.8
Other—net	**138.7**	203.9	192.5
	(1,005.4)	(228.4)	193.5
FUNDS SUPPORTING CONSTRUCTION ACTIVITY	**17,029.8**	15,615.4	13,399.7
Add—Interest charged construction	**271.1**	221.9	270.5
TOTAL CONSTRUCTION	**$17,300.9**	$15,837.3	$13,670.2

*( ) Denotes a change which results in a decrease in funds supporting construction activity.

The accompanying notes are an integral part of the financial statements.

Notes to Financial Statements

Dollars in Millions (except per share amounts)

(A) Accounting Policies—The consolidated financial statements of American Telephone and Telegraph Company ("Company") and its telephone subsidiaries reflect the application of the accounting policies described in this note. These statements have been prepared in conformity with generally accepted accounting principles applicable to rate-regulated utilities. Such accounting principles are consistent in all material respects with accounting prescribed by the Federal Communications Commission ("FCC") for telephone companies, except for the accounting for investments and revenue refunds described in this note, and a California rate order and related federal tax matter described in Note (E). Other policies and practices are covered in Notes (C), (J) and (R).

Consolidation—The consolidated financial statements include the accounts of the Company and its telephone subsidiaries. The consolidation process eliminates the effects of all significant intercompany transactions except as discussed below under "Purchases from Western Electric." The investment in Western Electric Company, Incorporated ("Western Electric"), 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 included at equity (cost plus proportionate share of reinvested earnings). All other investments are included at cost. See also Note (I).

Revenue Refunds—The FCC's Uniform System of Accounts provides that refunds of prior years' revenues, less related income tax adjustments, be charged against current income. However, in conformity with generally accepted accounting principles applicable to rate-regulated utilities, the Company and its telephone subsidiaries in their financial statements treat material revenue refunds applicable to prior years as adjustments of the respective years' income and, within a year, as adjustments of the applicable interim periods' income. See also Note (E).

Purchases from Western Electric—Most of the telephone equipment, apparatus and materials used by the consolidated companies have been manufactured or procured for them by Western Electric. Contracts with the telephone companies provide that Western Electric's prices 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 Electric at cost to the companies, which cost includes the return realized by Western Electric on its investment devoted to this business (see "Telephone Plant" below).

Telephone Plant—Telephone plant is stated at original cost when first dedicated to the public use. The amounts shown do not purport to represent reproduction cost or current value.

Most of the material purchased for the construction and maintenance of plant, other than buildings, has been obtained from Western Electric (see "Purchases from Western Electric" above). It is impossible to identify the particular purchases from Western Electric over a long period of years which were charged to the plant accounts and now remain therein, but the Company considers that such purchases made by the consolidated companies represent about 50% of the consolidated plant investment. Western Electric advises that its rate of profit (before interest charges) has varied by years and by classes of sales, but that such profit, included in prices for material sold and services furnished to affiliated telephone companies (including items chargeable to other than plant accounts), has been approximately 5¾% of such sales over the twenty year period ended December 31, 1980 and approximately 7¼% of such sales over the three year period then ended. Western Electric considers that its profit ratio on those items which have been charged to the plant accounts is somewhat higher than its profit ratio on total sales to such companies. Appropriate adjustments are made to Telephone Plant to recognize the fact that, while Western Electric's prices for material and services charged to Telephone Plant reflect provision for federal income taxes on Western Electric's profits on such material and services, such taxes are deferred as a result of the filing by the Company and its subsidiaries of consolidated federal income tax returns in which profits on intercompany transactions are excluded in determining consolidated taxable income. Because of these adjustments to Telephone Plant, depreciation expense in the accounts of the consolidated companies is reduced during the life of the related plant. There is no material effect on Net Income, however, because there is a concurrent increase in consolidated current tax expense of substantially the same amount through use of a depreciation base for federal income tax purposes which eliminates the pre-tax amount of Western Electric's profit applicable to the plant.

Material and Supplies—New material and reusable material are carried in inventory at average original cost, except that specific costs are used in the case of large individual items. Nonreusable material is carried at estimated salvage value.

Depreciation—Provision in the accounts for depreciation is based on straight-line composite rates, prescribed by the FCC, determined on the basis of the average expected life of each category of plant acquired in a given year. See Note (U). In November 1980, the FCC allowed computation of depreciation rates effective January 1, 1981 which will recognize that units of a category of plant acquired in a given year can be further categorized into groups of expected equal lives. The FCC also recommended establishment of procedures which would provide for recovery of undepreciated investment over an asset's remaining life. The Company and its telephone subsidiaries also have requested substantially increased depreciation rates effective January 1, 1981 for customer terminal equipment; a decision on this filing is still pending. Increases in depreciation expense resulting from these FCC actions should be allowable in determining revenue requirements in future rate-making proceedings.

When depreciable plant, other than minor items thereof which are replaced, is retired, the amount at which such plant has been carried in telephone plant in service is charged to accumulated depreciation.

Maintenance and Repairs—The cost of maintenance and repairs of plant, including the cost of replacing minor items not effecting substantial betterments, is, with minor exceptions, charged to operating expenses.

Interest Charged Construction—Regulatory authorities allow the Company and its telephone subsidiaries to accrue interest as a cost of construction of certain plant and as an item of income. Such income is not realized in cash currently but will be realized over the service life of plant as the resulting higher depreciation expense is recovered in the form of increased revenues.

Research and Development—The cost of research and systems engineering performed by Bell Telephone Laboratories, Incorporated ("Bell Laboratories") is included as expense in determining Net Income. The cost of specific development and design work related to products to be manufactured by Western Electric is recovered in the price charged for such products (see "Purchases from Western Electric" above).

Income Taxes:

(1) Income tax regulations allow recognition of certain transactions for tax purposes in time periods other than the period during which the transaction will be recognized in the determination of Net Income for financial reporting purposes. Appropriate income charges and their subsequent reversal, reflected as deferred income taxes—net, prevent the tax effect of these timing differences from distorting Net Income. The Company recognizes the tax effect of timing differences on the following transactions:

(a) When vacation pay and certain property taxes are deductible for income tax purposes in the year prior to being accounted for in these financial statements, the tax effects of these timing differences are included in Current Liabilities-Accumulated Deferred Income Taxes in the accompanying balance sheets. For regulatory accounting and rate-making purposes, these payments are accounted for when paid and the deferred income taxes involved are included with those in (b) below by most regulatory jurisdictions.

(b) Depreciation for income tax purposes uses accelerated methods and shortened lives causing such depreciation to be higher during the early years of plant life than the depreciation charges for such plant reflected in these financial statements. The accumulated tax effects of these timing differences are shown in the accompanying balance sheets as Deferred Credits-Accumulated Deferred Income Taxes.

(2) Investment tax credits result from provisions of the federal tax law which allow for reductions in tax liability based on certain construction expenditures. Corresponding reductions in tax expense are deferred and, except for the additional one percent credit available under the Tax Reduction Act of 1975 which must be contributed currently to the Bell System Employee Stock Ownership Plan, are amortized as reductions in tax expense over the life of the plant which gave rise to the credits.

(B) Income Taxes—
The components of operating income tax expense were as follows:

	1980	1979	1978
Federal:			
Current	**$ 565.5**	$ 782.1	$1,309.6
Deferred—net	**1,658.5**	1,599.3	1,478.4
Investment tax credits—net	**1,114.1**	879.3	706.5
	3,338.1	3,260.7	3,494.5
State and local:			
Current	**222.8**	209.4	209.2
Deferred—net	**156.1**	148.8	133.7
	378.9	358.2	342.9
Total	**$3,717.0**	$3,618.9	$3,837.4

Income taxes on non-operating income included in Miscellaneous income and deductions—net were:

	1980	1979	1978
Federal:			
Current	**$57.7**	$49.0	$22.4
Deferred—net	**2.5**	.9	1.3
	60.2	49.9	23.7
State and local:			
Current	**3.1**	5.8	(1.1)
Deferred—net	**.1**	—	—
	3.2	5.8	(1.1)
Total	**$63.4**	$55.7	$22.6

Total deferred income tax expense—net results principally from timing differences involving accelerated depreciation and shorter lives.

The effective consolidated federal income tax rate, as determined

by dividing Federal income taxes (see above) by the sum of Federal income taxes, Net Income (after excluding the net income applicable to investments in unconsolidated companies accounted for on an equity basis), and the ownership interest of others in the net income of certain consolidated subsidiaries, was 38.1%, 38.9% and 42.3% for the years 1980 through 1978, respectively. The differences of 7.9%, 7.1% and 5.7%, respectively, between the effective rate and the federal income tax statutory rate (46% in 1980 and 1979 and 48% in 1978) are attributable to the following factors:

	1980	1979	1978
(1) Certain taxes and payroll-related construction costs capitalized for financial statement purposes, but deducted for income tax purposes, net of applicable depreciation	**3.4%**	3.5%	3.2%
(2) Interest charged construction, which is excluded from taxable income, net of applicable depreciation	**.9**	.7	1.1
(3) Depreciation, not deductible for income tax purposes, on that portion of telephone plant costs which represents profit to Western Electric	**(.8)**	(.7)	(.6)
(4) Amortization of investment tax credits over the life of the plant which gave rise to the credits. Such amortization reduced income tax expense for the years 1980 through 1978 by the amounts shown in Note (U)	**4.5**	3.7	3.0
(5) Other differences	**(.1)**	(.1)	(1.0)
Total	**7.9%**	7.1%	5.7%

(C) Provision for Pensions and Death Benefits—Prior to October 1, 1980 the Company, its consolidated subsidiaries and Western Electric sponsored non-contributory plans which covered all employees for service pensions and certain death benefits. Since October 1, 1980 employees of the Company and these subsidiaries have been covered by national Bell System plans. Contributions to such plans are made to irrevocable trust funds. It has been, and continues to be, the policy of the companies to make contributions which are equal to the current year cost of the plans determined on a going concern basis by actuarial methods specified by the Employee Retirement Income Security Act of 1974 ("ERISA"). The following data relate to plan costs:

	1980	1979	1978
Balance of accumulated costs at beginning of year	**$20,329.0**	$17,202.8	$14,740.5
Current year cost	**2,809.0**	2,614.5	2,354.9
Investment income	**NA**	1,276.5	809.9
Benefits paid	**NA**	(764.8)	(702.5)
Balance of accumulated costs at end of year	**NA**	$20,329.0	$17,202.8
Current year cost as a percent of salaries and wages	**15.0%**	15.6%	16.1%

(NA = Not Available)

The value of pension fund assets used for actuarial purposes equals the balance of accumulated costs shown above.

Changes in actuarial assumptions, an amendment to the plan prior to October 1, 1980 and changes made as a result of the new plans decreased current year cost for 1980 by approximately $85.4.

Effective October 1, 1980 two newly designed national Bell System pension plans were adopted, one for non-management and one for management employees. In addition, the pension funds of existing Bell System pension plans were split into non-management and management segments and then merged into the two new national Bell System pension funds. The newly designed pension plans are subject to approval by the Internal Revenue Service ("IRS") and are expected to reduce 1981's pension costs.

Statement of Financial Accounting Standards No. 36 ("Statement No. 36") requires the following disclosures to be made of the actuarial present value of accumulated plan benefits and the fair value of net assets available for plan benefits ("fair value" essentially is current market value). The following data are based on the latest actuarial valuations and relate to the Company and its consolidated subsidiaries' plans prior to the October 1, 1980 changes referred to in the preceding paragraph:

	December 31 1979	December 31 1978
Actuarial present value of accumulated plan benefits:		
Vested	$14,679.9	$14,252.7
Non-vested	2,217.7	2,224.0
Total	$16,897.6	$16,476.7
Fair value of net assets available for plan benefits	$20,369.4	$16,385.5

The rates of return used in determining the actuarial present value of accumulated plan benefits are the rates used by the Pension Benefit Guaranty Corporation ("PBGC") for determining the value of plan benefits under terminated pension plans and averaged approximately 8.0% and 6.5% annually compounded at December 31, 1979 and 1978, respectively. If the rates used by PBGC had been 1% lower, the actuarial present value of accumulated plan benefits at December 31, 1979 would have been approximately $18,831.2 instead of the $16,897.6 shown above. The actuarial present value of accumulated plan benefits of the newly designed pension plans as determined under Statement No. 36 is expected to be larger than the amounts shown above but less than the fair value of net assets available for plan benefits.

The Company believes that misleading inferences concerning the plans' funding status may result from a comparison of the actuarial present value of accumulated plan benefits with the fair value of net assets available for plan benefits. This is because plan assets have been accumulated by making contributions equal to current year costs determined on a going concern basis as required by ERISA while the determination of the actuarial present value of accumulated plan benefits required by Statement No. 36 is made using methods and assumptions which are not the same as those used to determine current year pension costs. For example, the required method for determining the actuarial present value of accumulated plan benefits fails to take into consideration future wage and salary increases which have been taken into consideration by the Company and its consolidated subsidiaries in determining plan costs. Furthermore, the fair value of net assets available for plan benefits will fluctuate which may create erroneous impressions with respect to long term progress on funding the pension plans.

(D) Miscellaneous Income and Deductions—Net—Miscellaneous income for the years 1980 through 1978 includes the net income applicable to investments in unconsolidated companies, other than Western Electric, accounted for on an equity basis, of $25.1, $(5.8) and $38.5, respectively. Miscellaneous deductions for the years 1980 through 1978 include the ownership interest of others in the net income of certain consolidated subsidiaries of $164.5, $152.7 and $133.5, respectively. See also Note (B).

(E) Rate and Related Matters—On February 13, 1980 the California Public Utilities Commission ("CPUC") directed The Pacific Telephone and Telegraph Company ("Pacific"), a subsidiary, to implement a refund order involving revenues collected since August 1974. The revenue refund amounted to approximately $408.6, including interest, computed as of December 31, 1980, of which approximately $241.6 has been refunded; the remainder will be refunded by June 30, 1981. The IRS has contended that the refund order renders Pacific ineligible for certain federal tax benefits relating to accelerated depreciation and investment tax credits. In the opinion of counsel, Pacific's eligibility for these federal tax benefits probably would be impaired only insofar as it relates to intrastate plant, which represents approximately 80% of Pacific's total plant. After auditing the 1974 federal income tax return, the IRS assessed a tax deficiency for that year based upon its contention of Pacific's ineligibility for the intrastate portion of these federal tax benefits. Pacific paid this tax deficiency of $117.4 in February 1980 and intends to seek a refund of this payment and to litigate the IRS's contention of ineligibility. Pacific's potential unassessed tax deficiencies through December 31, 1980 total approximately $1,422.8 and are continuing to grow; payment of these amounts would substantially increase Pacific's need for cash. These financial statements reflect the effect of the revenue refunds ordered by the CPUC as well as the effects of tax benefit ineligibility on intrastate plant placed in service through February 13, 1980, the date of the CPUC's directive. Recognition of the tax benefit ineligibility reduced Income Applicable to Common Shares for the years 1980 through 1978 by $88.7, $51.8 and $36.2, ($.12, $.08 and $.05 per share), respectively, and Reinvested Earnings as of January 1, 1978 by $51.3. Should Pacific's eligibility for these federal tax benefits be reestablished either by litigation or by passage of pending Congressional legislation, the earnings reduction and balance sheet effects related to their loss would be reversed by restatement of the current and prior years' financial statements. It presently is anticipated that plant placed in service subsequent to February 13, 1980 will be eligible for these federal tax benefits since Pacific's intrastate revenues authorized by the CPUC on February 13, 1980 (which are being collected subject to refund) reflect rate-making methods which previously have been considered to be consistent with eligibility. However, such eligibility could be lost should the CPUC later apply retroactive rate-making methods inconsistent with the requirements of the federal tax law. Should this occur, current tax liabilities related to California rate orders through December 31, 1980 could be increased by an additional amount of approximately $147.5. On February 13, 1980 the CPUC expressed its intent that eligibility for federal tax benefits be preserved. Certain parties have petitioned the California Supreme Court to review the February 13, 1980 CPUC order. Because the ultimate outcome of these matters has not been resolved, Pacific's books of account used for regulatory purposes and its income tax returns do not reflect the loss of eligibility for federal tax benefits.

During the year ended December 31, 1980 approximately $157.0 ($.22 per share) of intrastate revenues (net of taxes) were collected subject to refund resulting from other rate matters in California, from rate matters in other states, and from revenues collected by Pacific subsequent to the CPUC's February 13, 1980 authorization discussed above. Total intrastate revenues (net of taxes) subject to refund as of December 31, 1980 for all years including 1980 are approximately $191.0 ($.26 per share). Refunds of these revenues, if any, may require a restatement of 1980 results.

(F) Interstate Earnings Inquiry—It previously had been reported that the eventual outcome of a September 1979 FCC inquiry on the Bell System's interstate earnings and the effects, if any, on financial results during 1978 and 1979 were uncertain. On May 29, 1980 the FCC authorized the filing of tariffs for increased interstate rates to achieve an interim interstate annual rate of return of 10.5%. Accordingly, the Company now believes, based on the opinion of its legal counsel, that the eventual outcome of the September 1979 interstate earnings inquiry will not result in a material refund.

(G) Interstate Revenues Tax—In August 1979 a County Court in Illinois ruled that interstate telephone revenues earned in Illinois are subject to a messages tax. This Court decision has been appealed. Amounts involved relate to 1967 and subsequent years and will continue to grow. Should it ultimately be determined that these amounts are payable, Income Applicable to Common Shares would be decreased in a future period. If such determination had been made as of December 31, 1980, the decrease in Income Applicable to Common Shares could have been as much as $234.7 ($.32 per share).

(H) Accounting for Station Connection Costs—The FCC has voted to change the accounting treatment provided in its Uniform System of Accounts for the costs of installing telephone service on a customer's premises. These costs are now being capitalized but will be expensed when incurred in the future. This change will result in increased annual operating expenses; however, such increased expenses should be allowable in determining revenue requirements in future rate-making proceedings. These changes are to become effective during 1981.

(I) Investments at Equity—The FCC's Uniform System of Accounts requires that investments be carried on the books of the companies at cost. However, in conformity with generally accepted accounting principles, certain investments are included at equity in the accompanying balance sheets. See also Note (A), "Consolidation."

The following information is provided as of December 31, 1980 for those companies carried at equity:

Western Electric Company, Incorporated and its subsidiaries

Wholly-owned and carried on the Company's books at a cost of $1,963.3. The consolidated assets and liabilities were $8,047.5 and $3,598.2, respectively. See also Note (O).

Other—Includes principally:

Bell Telephone Laboratories, Incorporated—50% owned and carried on the Company's books at a cost of $237.0 which also equals its investment at equity. Western Electric owns the other 50%.

The Southern New England Telephone Company—21.1% owned and carried on the Company's books at a cost of $85.9 plus $7.3 of advances. The Company's investment at equity is $147.6. The market value of the shares owned by the Company based on the closing price as obtained from the Composite Tape was $95.1.

Cincinnati Bell Inc.—29.7% owned and carried on the Company's books at a cost of $42.3 plus $9.9 of advances. The Company's investment at equity is $101.6. The market value of the shares owned by the Company based on the closing price as obtained from the Composite Tape was $61.8.

AT&T International Inc.—Wholly-owned and carried on the Company's books at a cost of $69.9 plus $10.0 of advances. The Company's investment at equity is $75.1.

(J) Cash and Temporary Cash Investments—Cash and temporary cash investments have been reduced by the amount of drafts outstanding with a corresponding reduction in Accounts Payable. It is the practice of the Company and most telephone subsidiaries to make certain payments by draft and to record such drafts as accounts payable until such time as the banks honoring the drafts have presented them for payment. The Company maintains cash and temporary cash investments not only to meet its own obligations but to maintain funds upon which the subsidiary companies may draw on a day-to-day basis to meet their obligations, including coverage for outstanding drafts.

(K) Common Shares—Book value per common share amounted to $65.51, $63.43 and $60.67 at December 31, 1980, 1979 and 1978, respectively.

At December 31, 1980 there were 8,065,184 authorized but unissued common shares reserved for the conversion of the Company's outstanding $4 convertible preferred shares.

Common shares outstanding increased in the periods indicated as follows:

1,008,811, 1,432,764 and 1,939,112 shares issued in the years 1980 through 1978, respectively, upon conversion of the Company's $4 convertible preferred shares. See also Note (L).

16,183,915, 14,923,918 and 10,996,004 shares sold at 95% of market in the years 1980 through 1978, respectively, under the Share Owner Dividend Reinvestment and Stock Purchase Plan. In addition, 6,430,372, 2,362,833 and 2,493,071 shares were sold at market for optional cash payments in the years 1980 through 1978, respectively, under that Plan.

8,087,058, 7,062,500 and 5,098,200 shares sold at market in the years 1980 through 1978, respectively, to the Bell System Savings Plan for Salaried Employees.

5,731,700 and 4,300,100 shares sold at market in the years 1980 and 1979 to the Bell System Savings and Security Plan.

2,427,063, 1,736,580 and 1,389,780 shares issued at market in the years 1980 through 1978, respectively, in connection with the Bell System Employee Stock Ownership Plan through the election of an extra 1% Investment Tax Credit.

Included in the outstanding common shares at December 31, 1980 are 13,589,301 shares that the Company will issue in 1981 in connection with the acquisition, effective December 22, 1980, of the remaining ownership interest of others in three consolidated subsidiaries. Included under "Issuance of shares, net of redemptions" for 1980 in the Statements of Sources of Funds Supporting Construction Activity is $662.5 for these shares.

(L) Preferred Shares—Authorized are 100,000,000 preferred shares at $1 par value. Outstanding are:

Convertible Preferred Shares Subject to Redemption

	December 31 1980	December 31 1979	December 31 1978
$50 stated value:			
$4 cumulative convertible preferred	**7,661,925 shs.**	8,620,292 shs.	9,981,417 shs.
Proceeds in excess of stated value	**$1.7**	$1.9	$2.1

Each $4 preferred share is convertible into approximately 1.05 common shares of the Company. 958,367, 1,361,125 and 1,842,152 shares were converted in the years 1980 through 1978, respectively. See Note (K). Each share may be redeemed by the Company at stated value; however, such redemption is not required.

Preferred Shares Subject to Mandatory Redemption

	December 31 1980	December 31 1979	December 31 1978
$50 stated value:			
$3.64 cumulative preferred	**10,000,000 shs.**	10,000,000 shs.	10,000,000 shs.
$3.74 cumulative preferred	**10,000,000 shs.**	10,000,000 shs.	10,000,000 shs.
$1,000 stated value:			
$77.50 cumulative preferred	**575,000 shs.**	587,500 shs.	600,000 shs.

The $3.64 preferred shares may be redeemed by the Company at a premium of $2.91 per $50 share on or before April 30, 1981 and at a diminishing premium thereafter. On May 1 of each year, commencing in 1984, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may be redeemed each year at the Company's option.

The $3.74 preferred shares may be redeemed by the Company at a premium of $2.99 per $50 share on or before January 31, 1982 and at a diminishing premium thereafter. On February 1 of each year, commencing in 1985, the Company through a sinking fund must redeem without premium 3% of these shares; an additional 3% may be redeemed each year at the Company's option.

The $77.50 preferred shares may be redeemed by the Company at a premium of $57.60 per $1,000 share on or before January 31, 1982 and at a diminishing premium thereafter. On February 1 of each year, the Company through a sinking fund must redeem at stated value 12,500 of these shares through 1992 and 18,750 shares each year thereafter and may redeem an additional equal number each year at the Company's option. Under these sinking fund provisions, which became effective in 1978, the Company redeemed 25,000 shares in 1978 and 12,500 shares in 1979, 1980, and 1981 which reduced stated capital (as defined in the New York Business Corporation Law) by $25.0, $12.5, $12.5 and $12.5, respectively.

The total sinking fund requirement for all series of preferred shares subject to mandatory redemption for each year through 1983 is $12.5, for 1984 is $27.5 and for 1985 is $42.5. These sinking fund requirements are cumulative; that is, should redemption amounts not be set aside in full because the net assets of the Company are insufficient, or for any other reason, such amounts must be set aside, without interest, before any common share dividends are paid or declared, or any common shares are purchased or redeemed.

All preferred shares rank prior to the common shares both as to dividends and on liquidation but have no general voting rights. However, if dividends are in default in an amount equal to six quarterly dividends on any series of preferred shares, the number of directors of the Company will be increased by two, and the holders of all preferred shares will have the exclusive right, voting separately as a class, to elect such two additional directors so long as such default continues.

(M) Ownership Interest of Others in Consolidated Subsidiaries—Preferred Shares Subject to Mandatory Redemption—The only shares authorized are 24,000,000 of $25 par value cumulative non-voting preferred shares of Pacific Telephone.

Outstanding shares amounted to 22,120,000, 20,000,000 and 16,666,000 at December 31, 1980, 1979 and 1978, respectively. The dividend rates on these shares ranged from 7.88% to 11.25%. These shares are subject to mandatory pro rata redemptions without premium through annual sinking fund contributions commencing in 1982. The total sinking fund requirements for the years 1982 through 1985 are $17.3, $24.9, $40.5, and $42.4, respectively.

(N) Long and Intermediate Term Debt—Interest rates and maturities on long and intermediate term debt of the Company and its consolidated subsidiaries outstanding at December 31, 1980 were as follows (see also Note (U)):

Maturities	2⅝% to 6⅞%	7% to 8⅞%	9% to 15½%	Total
1982	$ 365.0	$ 420.0	$ —	$ 785.0
1983	235.0	250.0	—	485.0
1984	355.0	50.0	150.0	555.0
1985	445.0	50.0	—	495.0
1986-1995	3,442.0	300.0	1,100.0	4,842.0
1996-2005	4,732.0	3,783.1	1.5	8,516.6
2006-2015	1,805.0	9,617.0	2,199.5	13,621.5
2016-2020	—	4,320.0	8,005.0	12,325.0
	$11,379.0	$18,790.1	$11,456.0	$41,625.1
Other				43.3
Unamortized discount—net				(413.4)
Total				$41,255.0

Substantially all of the properties of two of the Company's telephone subsidiaries, comprising about $18,639.2 of the total gross consolidated telephone plant, are subject to lien under mortgage bond indentures with outstanding balances of $2,805.0.

(O) Long Term Debt—Western Electric—The long term debentures and notes of Western Electric, an unconsolidated subsidiary, outstanding at December 31, 1980 were as follows (mandatory prepayments are shown in parentheses):

Sinking fund debentures:	
8⅜% due 1995 ($6.0 per year to 1994)	$113.9
7½% due 1996 ($4.0 per year to 1995)	79.7
Promissory notes:	
8.15% due 1983	200.0
5.50% due 1997 ($7.0 per year 1983 to 1996)	150.0
9% due 2000 ($7.5 per year 1986 to 1999)	150.0
7.50% due 2003 ($5.0 per year 1984 to 2002)	125.0
	818.6
Unamortized discount	(2.1)
Total	$816.5

Western Electric also had outstanding $793.6 of commercial paper and $188.1 of unsecured promissory notes payable on demand.

(P) Debt Maturing Within One Year—The Company's telephone subsidiaries follow the practice of financing construction of telephone plant partially through bank loans, commercial paper, commercial notes and other notes, all of which are payable in twelve months or less after issuance, pending long term financing. See also Note (U).

Debt maturing within one year is included as debt in the computation of debt ratios and consists of the following at December 31:

	Amount			Weighted Average Interest Rate		
	1980	1979	1978	**1980**	1979	1978
Notes payable:						
Bank loans	**$ 903.8**	$ 814.5	$1,103.6	**18.5%**	14.1%	10.8%
Commercial paper	**1,930.6**	1,999.2	1,823.1	**18.4%**	13.2%	10.1%
Commercial notes	**754.9**	656.3	—	**18.7%**	13.2%	—
Other notes	**157.8**	193.2	30.1	**19.0%**	12.8%	10.5%
Long and intermediate term debt maturing within one year	**595.0**	415.0	785.0	**—**	—	—
Total	**$4,342.1**	$4,078.2	$3,741.8	**—**	—	—
Average amounts of notes payable outstanding during the year	**$3,918.2**	$3,040.5	$2,846.2	**12.9%***	11.3%*	8.0%*
Maximum amounts of notes payable at any month end during the year	**$4,709.1**	$3,663.2	$3,124.5	**—**	—	—

*Computed by dividing the average daily face amount of notes payable into the aggregate related interest expense.

DOLLARS IN MILLIONS (except per share amounts)

(Q) Financing Subsequent to December 31, 1980—Through February 6, 1981 five telephone subsidiaries have announced their intentions to sell up to $1,065.0 of long and intermediate term debt; Pacific has offered about 23,100,000 common shares to its shareholders (and the Company has purchased its proportionate share of the shares offered). The proceeds of these sales will be applied toward repayment of debt maturing within one year.

(R) Lease Commitments—The Company and its consolidated subsidiaries lease certain facilities and equipment used in their operations and reflect lease payments as rental expense of the periods to which they relate. See Note (U). At December 31, 1980 the aggregate minimum rental commitments under noncancellable leases for the periods shown were approximately as follows:

Years	Amounts
1981	$ 657.8
1982	546.8
1983	450.4
1984	349.1
1985	261.6
Thereafter	2,511.1
Total	$4,776.8

These leases include some which would be classified as "capital leases" under criteria established by the Financial Accounting Standards Board. However, for regulatory accounting and rate-making purposes, such leases are not capitalized. Had such leases been capitalized, the following amounts would have been included on the balance sheets:

	December 31 1980	December 31 1979	December 31 1978
Assets	**$1,619.7**	$1,573.4	$1,449.5
Less: Accumulated amortization	**583.7**	515.6	432.0
Total	**$1,036.0**	$1,057.8	$1,017.5
Lease commitments	**$1,103.0**	$1,139.8	$1,108.0

The effect on Net Income, however, would have been insignificant. Under regulatory rate-making procedures, any such expense effects are not recognized currently but are recognized instead over the life of the respective lease.

(S) MCI Antitrust Litigation—In June 1980 MCI Communications Corporation in a civil antitrust suit against the Company was awarded $1.8 billion in treble damages. The Company is seeking to have this award set aside. In the opinion of its legal counsel, any monetary liability or financial impact to which the Company and the Bell System companies might be subject after final adjudication would not be material in amount.

(T) Department of Justice Antitrust Action—In 1974 the Department of Justice brought a civil antitrust action naming the Company, Western Electric and Bell 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 it is confident that it has not been in violation of the antitrust laws and that the basic structure of the Bell System will not be changed as a result of this antitrust action. In the opinion of the Company, 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 direct effect on net income but would materially increase the need for cash and revenues.

Trial of the action began on January 15, 1981. However, before the taking of testimony, the Court recessed the trial after the attorneys' opening statements because the Court was informed by both sides that major progress had been made toward reaching a settlement. On January 30 the Court issued an order that set March 2 as the deadline for submission of a consent decree signed by AT&T and the new administration. Failing that, the Court said the trial would resume March 4.

(U) Additional Financial Information—

	1980	1979	1978
Depreciation—Average percentage of depreciable telephone plant	**5.86%**	5.63%	5.56%
Amortization of investment tax credits	**$ 401.1**	$ 316.8	$ 255.0
Gross receipts, payroll-related and other taxes:			
Gross receipts	**$1,065.8**	$ 964.9	$ 945.7
Social security	**940.2**	852.5	684.9
Capital stock	**145.3**	106.3	87.0
Miscellaneous	**54.8**	51.9	42.6
Total	**$2,206.1**	$1,975.6	$1,760.2
Interest expense:			
Interest on long and intermediate term debt	**$3,055.5**	$2,610.0	$2,345.9
Interest on notes payable	**505.1**	342.8	226.9
Other interest expense	**207.5**	130.8	117.9
Total	**$3,768.1**	$3,083.6	$2,690.7
Rental expense*	**$1,119.9**	$1,004.7	$ 897.5
*Includes rental expense for satellite rentals based on usage	**$ 116.3**	$ 95.4	$ 126.2

Supplementary Data

Accounting for the Effects of Inflation (Unaudited)

(V) Quarterly Financial Information (Unaudited)—Subject, with respect to all periods of 1980, to the outcome of the matters referred to in Note (E), all adjustments necessary for a fair statement of income for each period have been included.

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Earnings Per Common Share*
1978				
1st	$ 9,838.1	$1,730.8	$1,267.9	$1.88
2nd	10,157.8	1,805.6	1,327.9	1.96
3rd	10,403.6	1,873.4	1,391.5	2.04
4th	10,593.8	1,802.4	1,285.3	1.86
Total	$40,993.3	$7,212.2	$5,272.6	$7.74
1979				
1st	$10,849.6	$1,915.1	$1,361.2	$1.96
2nd	11,251.3	1,994.3	1,448.7	2.07
3rd	11,563.3	2,034.5	1,443.9	2.04
4th	11,743.9	2,038.8	1,420.4	1.98
Total	$45,408.1	$7,982.7	$5,674.2	$8.04
1980				
1st	$12,105.8	$2,104.1	$1,438.9	$1.98
2nd	12,428.0	2,178.6	1,475.3	2.00
3rd	12,990.0	2,274.1	1,555.4	2.09
4th	13,267.4	2,401.7	1,610.1	2.12
Total	$50,791.2	$8,958.5	$6,079.7	$8.19

*Because of increasing numbers of common shares outstanding each quarter, the sum of quarterly earnings per common share may not equal earnings per common share for the year.

Results for the quarters of 1980 include approximately $24.2, $29.4, $41.5 and $61.9 ($.04, $.04, $.06 and $.08 per common share), respectively, of Net Income resulting from intrastate rate increases which are subject to possible refund. See also Note (E).

Net Income for the first quarter of 1980 has been reduced by approximately $22.0 ($.03 per common share) as a result of an agreement with Wyly Corporation and other parties to settle litigation and dismiss antitrust claims. ■

Double-digit inflation has drawn increased attention to the need to assess both the impact of inflation on business and the results of management's efforts in coping with it. Numerous reporting methods have been proposed to provide such an assessment, but no consensus has been reached either on the preferability of any one method or on the practical usefulness of the resulting data. The Financial Accounting Standards Board ("FASB"), believing that additional experience should be gained and experimentation undertaken with respect to reporting the effects of inflation, issued Statement of Financial Accounting Standards No. 33 ("Statement No. 33") which requires disclosure of supplementary data to reflect the effects of general inflation (constant dollar) and the effects of changes in specific prices (current cost). The data in Tables A and B have been prepared to comply with Statement No. 33; however, the Company believes that it should be used with care because the data neither completely nor accurately portray inflation's effects.

Traditionally, financial statements have been prepared on the basis of historical costs, i.e., the actual number of dollars exchanged at the time each transaction took place. However, it is recognized that general inflation has caused the purchasing power of dollars to decline, the result of which is the presentation of financial statement elements in dollars of varying purchasing power. To eliminate this disparity, such elements may be restated in "constant" dollars, each of which then has equal purchasing power. To reflect the effects of inflation and thus express operating results in dollars of comparable purchasing power, Statement No. 33 requires the Company to show what the FASB characterizes as "income from continuing operations" as if depreciation of plant assets had been based on asset amounts expressed in dollars of constant purchasing power. (This is shown in column (b) of Table A, stated in average 1980 dollars.) This adjustment is derived from the application of the Consumer Price Index for All Urban Consumers ("CPI-U"), a measure of inflation based on changes in the costs to consumers of a wide range of commodities and services. (The 1980 average CPI-U has been estimated based on actual statistics through November 1980.)

Technological improvements, changes in supply and demand, and productivity gains cause the specific prices of goods and services purchased by a particular business to fluctuate differently from price changes that would be caused solely by general inflation. To reflect the effects of such specific price changes on operating results, Statement No. 33 requires that the Company also show "income from continuing operations" as if depreciation of plant assets had been based on the "current cost" of these or comparable assets, rather than on historical cost. (This calculation is shown in column (c) of Table A, stated in average 1980 dollars.) Because current cost data are unique to each company, the current cost of telephone plant has been calculated by applying internally-generated indexes to investments in each of the major telephone plant accounts.

In computing "income from continuing operations," only de-

preciation expense has been adjusted to show the effects of inflation. Because most other operating expense items are current year transactions, they already are recorded in dollars of approximately current purchasing power.

In accordance with requirements of Statement No. 33, no adjustments have been made to reflect any effects of inflation on provisions for federal income taxes. The effective federal income tax rate (operating federal income taxes divided by the sum of operating federal income taxes and "income from continuing operations") for the historical data in column (a) of Table A would be 35.4%. The rate reflecting adjustments for inflation would be 77.8% for column (b) and 62.7% for column (c). While the federal income taxes used in these computations include Investment Tax Credits and tax deferrals relating to accelerated depreciation, the effects of inflation on effective tax rates also would be dramatically increased, even though in lower percentages, if these tax benefits were excluded. These tax benefits were intended by Congress to provide funds for investment in other capital assets in order to increase productivity and employment. Inflation's dramatic increase in effective tax rates indicates that there is need for action by Congress to control inflation and further to stimulate investment of more capital in business.

Amounts shown as "net assets at year end" in Table B are the sum of common share owners' equity, convertible preferred shares, and the common share owners' equity portion of the ownership interest of others in consolidated subsidiaries as shown in the historical cost financial statements which, for general inflation, are adjusted by the difference between telephone plant at historical cost and telephone plant in constant dollars and, for changes in specific prices, are adjusted by the difference between telephone plant at historical cost and telephone plant at current cost.

It is essential that regulatory authorities allow telephone services to be priced at levels that will preserve the Company's ability to attract the continuing additional amounts of capital necessary to meet the public's demand for telephone services. Such price levels need to provide rates of return which, giving recognition to the effects of inflation, will adequately compensate purchasers of securities for funds provided for telephone plant construction. This inflation-affected compensation would acknowledge higher interest rates for debt securities in anticipation that such debt will be repaid in dollars having less purchasing power; it would acknowledge that returns on equity securities must be comparable with returns available on alternative equity investment opportunities. Because of this comparable return requirement for equity securities, any reflection of "constant dollar" or "current cost" depreciation in the returns on equity of non-regulated companies should result in regulatory recognition of the need for increased returns on equity for the Bell System and thus give recognition to similar inflation effects on its depreciation. Accordingly, the Company has no reason to expect that increases in operating revenues will not keep pace with the effects of inflation on depreciation; the constant dollar and current cost amounts shown for telephone plant investment in the accompanying schedule reflect this premise. Should regulatory authorities not give recognition to the need for such higher equity returns, then the recoverable amount of the Company's plant, when adjusted for the effects of inflation, could be reduced. The amount of such reductions applicable to constant dollar results in 1980 (Table A column (b)) could have been as much as $7,313.8; the cumulative amount of such reductions at December 31, 1980, could have reduced "net assets," as defined herein, by as much as $74,205.5. The amount of such reductions applicable to current cost results in 1980 (Table A column (c)) could have been as much as $2,652.1; the cumulative amount of such reductions at December 31, 1980, could have reduced net assets by as much as $61,770.6.

The reader should note the item identified in Tables A and B as "benefits from decline in purchasing power of net amounts owed." During inflation lenders of money experience a loss due to the fact that amounts owed to them will be repaid in dollars having less purchasing power than the dollars originally lent; it is in anticipation of such loss that interest rates are so high during inflationary times. Conversely, to the extent that lenders are losing purchasing power, borrowers are benefitting. In assessing the impact of inflation on business, the Company believes that the benefits from inflation's effects on money that is borrowed should be viewed as an offset to interest expense. The benefit, however, does not provide funds to the Company.

The disclosure called for by Statement No. 33 is misleading by its incorrect inference that the Company ought not to have paid out more in dividends than its inflation-adjusted income from continuing operations. Statement No. 33 is based on the incorrect premise that depreciation expense, rather than being a means of allocating asset costs to accounting periods, provides funds to be set aside and used for the replacement of those assets being depreciated. Statement No. 33 also assumes that the cost of new assets acquired to replace retired assets will equal the original cost of the retired assets adjusted for either inflation or specific price increases. Obviously such is not the case in a high technology industry such as ours. Technological advances hold down price increases for new communications equipment and also increase significantly the productive capacity of both new and existing equipment. As shown in the accompanying Analysis of Construction Program and Cash Utilization (Table C), internally-generated funds, after paying dividends, were sufficient not only to provide all of the funds needed for plant replacement, modernization and customer movement, but also to provide $2,890.9, $3,350.9 and $3,193.5 in 1980, 1979 and 1978, respectively, for financing new telephone growth and other corporate investments. That the internally-generated funds available for financ-

Table A—Supplementary Financial Data Adjusted for the Effects of Inflation and Changing Prices—December 31, 1980

DOLLARS IN MILLIONS	As Reported in the Historical Cost Financial Statements (a)	Adjusted for General Inflation (Constant Dollars) (b)	Adjusted for Changes in Specific Prices (Current Costs) (c)
Operating revenues	$50,791.2	$50,791.2	$50,791.2
Depreciation	7,039.2	12,168.4	11,132.5
Other operating expenses	27,147.9	27,147.9	27,147.9
Operating federal income taxes	3,338.1	3,338.1	3,338.1
Other operating taxes	4,307.5	4,307.5	4,307.5
Other income	(889.3)	(889.3)	(889.3)
Interest expense	3,768.1	3,768.1	3,768.1
	44,711.5	49,840.7	48,804.8
Income from continuing operations	$ 6,079.7	$ 950.5	$ 1,986.4
Benefits from decline in purchasing power of net amounts owed		$ 6,968.5	$ 6,968.5
Amount by which current cost of telephone plant would have increased if computed by reference to changes in general price levels			$19,490.8
Increase in current cost of telephone plant			13,793.2
Difference, primarily due to benefits of technological improvements in constructing telephone plant			$ 5,697.6
Telephone plant, net of accumulated depreciation	$110,022.6	$187,804.7*	$174,770.5*

*Year end 1980 dollars.

Table B—Supplementary Five-Year Comparison of Selected Financial Data

DOLLARS IN MILLIONS (except per share amounts)	**1980**	1979	1978	1977	1976
Operating revenues in average 1980 dollars	**$50,791.2**	$51,569.7	$ 51,821.5	$49,581.3	$47,466.1
Historical cost information:					
Income from continuing operations	**$ 6,079.7**	$ 5,674.2			
Income from continuing operations per common share[2]	**8.19**	8.04			
Net assets at year end	**50,226.2**	45,984.2			
Historical cost information adjusted for general inflation (average 1980 dollars):[1]					
Income from continuing operations	**$ 950.5**	$ 2,086.4			
Income from continuing operations per common share[2]	**1.11**	2.78			
Net assets at year end	**122,122.2**	117,766.1			
Historical cost information adjusted for changes in specific prices (average 1980 dollars):[1]					
Income from continuing operations	**$ 1,986.4**	$ 2,567.0			
Income from continuing operations per common share[2]	**2.54**	3.49			
Difference between the amount by which current cost of telephone plant would have increased if computed by reference to changes in general price levels and increase in current cost of telephone plant	**5,697.6**	11,082.2			
Net assets at year end	**109,687.3**	108,082.8			
Other information:[1]					
Benefits from decline in purchasing power of net amounts owed in average 1980 dollars	**$ 6,968.5**	$ 7,785.8			
Cash dividends declared per common share:					
At historical cost	**$5.00**	$5.00	$4.60	$4.20	$3.80
In average 1980 dollars	**$5.00**	$5.68	$5.81	$5.71	$5.51
Market price per common share at year end:					
At historical cost[3]	**$47.88**	$52.13	$60.50	$60.50	$63.50
In average 1980 dollars	**$45.67**	$55.76	$73.65	$80.30	$89.99
Average CPI-U (1980 estimated)	**246.9**	217.4	195.4	181.5	170.5

[1]Certain information for the years prior to 1979 is not disclosed since it is impractical to obtain.
[2]Income from continuing operations per common share is after preferred dividend requirements.
[3]Using Composite Tape closing price.

ing new telephone growth have been diminishing highlights the need for regulatory authorities to expedite and approve larger revenue increases and for Congress to enact legislation to provide for faster depreciation for income tax purposes.

Readers also should note that the increase in the specific prices of telephone plant actually has been less than the general increase in the rate of inflation. This difference primarily is attributable to "benefits of technological improvements in constructing telephone plant." These technological improvements, combined with the resulting improvements in productivity, have been responsible for the Company's success in keeping the rate of growth in the prices of its services below the rate of growth in the general level of prices.

Statement No. 33 also requires that the data shown in Table B be presented in a five-year summary, restated into the average purchasing power of the dollar during 1980. The calculations for these restatements (except market price per common share) have been made by applying the average CPI-U for 1980 to the data for the years 1976 through 1979. The calculations for market price per common share have been made by applying the average CPI-U for 1980 to the data for the years 1976 through 1980. Since the actual market price for 1980 is stated in year end dollars which have a lower purchasing power than the average 1980 dollar, the effect of the calculation for 1980 is to decrease the year end market price per common share from the actual quoted amount. No adjustments have been made to the historical cost information, which is presented for comparison purposes only.

Table C—Analysis of Construction Program and Cash Utilization

Construction program components (approximate):

IN MILLIONS OF HISTORICAL DOLLARS	1980	1979	1978
Plant replacement	**$ 1,032.7**	$ 985.0	$ 787.3
Plant modernization	**3,410.7**	3,294.5	3,021.6
Customer movement	**3,735.8**	3,246.3	2,636.4
Growth	**8,850.6**	8,089.6	6,954.4
	17,029.8	15,615.4	13,399.7
Add—Interest charged construction	**271.1**	221.9	270.5
Total construction program	**$17,300.9**	$15,837.3	$13,670.2
Retirements of telephone plant at historical cost	**$ 6,113.3**	$ 5,279.8	$ 4,288.0

Internally-generated funds available for investments (see page 34):

IN MILLIONS OF HISTORICAL DOLLARS	1980	1979	1978
Funds from operations	**$15,367.1**	$13,903.0	$12,588.5
Decrease (increase) in working capital	**(551.5)**	495.2	135.8
Net decrease in deferred charges and other	**24.4**	68.3	114.6
	14,840.0	14,466.5	12,838.9
Less—Dividends	**3,769.9**	3,589.8	3,200.1
Funds available for investments	**11,070.1**	10,876.7	9,638.8
Less—Amount spent on plant replacement, plant modernization and customer movement	**8,179.2**	7,525.8	6,445.3
Funds available for growth and other investments	**$ 2,890.9**	$ 3,350.9	$ 3,193.5

THE BELL SYSTEM

The principal business of the Bell System is communications. Of the Bell System's 21 principal operating telephone companies, all but one is wholly owned by AT&T: Pacific Telephone (89.9%). In addition, AT&T has a noncontrolling ownership in Cincinnati Bell (29.7%) and Southern New England Telephone (21.1%). Western Electric, a wholly owned subsidiary, manufactures and purchases telecommunications products and supplies for the Bell System; Bell Laboratories, jointly owned by AT&T and Western Electric, provides research and development services. AT&T's Long Lines Department has responsibility for overall management of the nationwide telecommunications network and for connection of the network, via underseas cable and satellite, with telecommunications systems throughout the world. AT&T International Inc. is a newly formed subsidiary which will consolidate the Bell System's marketing of products and services outside the United States.

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THE 96TH ANNUAL MEETING

The 96th Annual Meeting of AT&T shareholders will be held at 2:00 p.m. on Wednesday, April 15, 1981, at the Albert Thomas Convention and Exhibit Center, Houston, Texas.

The consolidated financial results in this report are for American Telephone and Telegraph Company and its subsidiaries.

If you wish further information, the following are available upon request:

- 1980 Statistical Report, with additional data on our operations.
- Form 10-K, AT&T's annual report to the Securities and Exchange Commission.
- Annual reports of the Bell telephone operating companies, the Western Electric Company and Bell Laboratories.
- Information relating to various Bell System benefit plans for employees contained in plan descriptions, annual reports and other materials regularly made available to employees under the Employee Retirement Income Security Act of 1974.

The AT&T Annual Report is also available in braille, talking records and cassettes.

Address requests to the Secretary, AT&T Co., Room 2615, 195 Broadway, New York, NY 10007. The telephone number of the Company is 212-393-9800.

Information on AT&T common and preferred stock, bonds, dividends or interest payments and the Dividend Reinvestment and Stock Purchase Plan can be obtained by calling without charge 800-631-3311 or, from New Jersey, 800-352-4900. Mailed inquiries should be addressed to AT&T Co., P.O. Box 2018, New Brunswick, NJ 08903.

The Company maintains stock transfer offices at 250 Broadway, 15th floor, New York, NY 10007 and at 444 Hoes Lane, Piscataway, NJ 08854, both of which can be reached through the toll-free telephone numbers above.

AT&T

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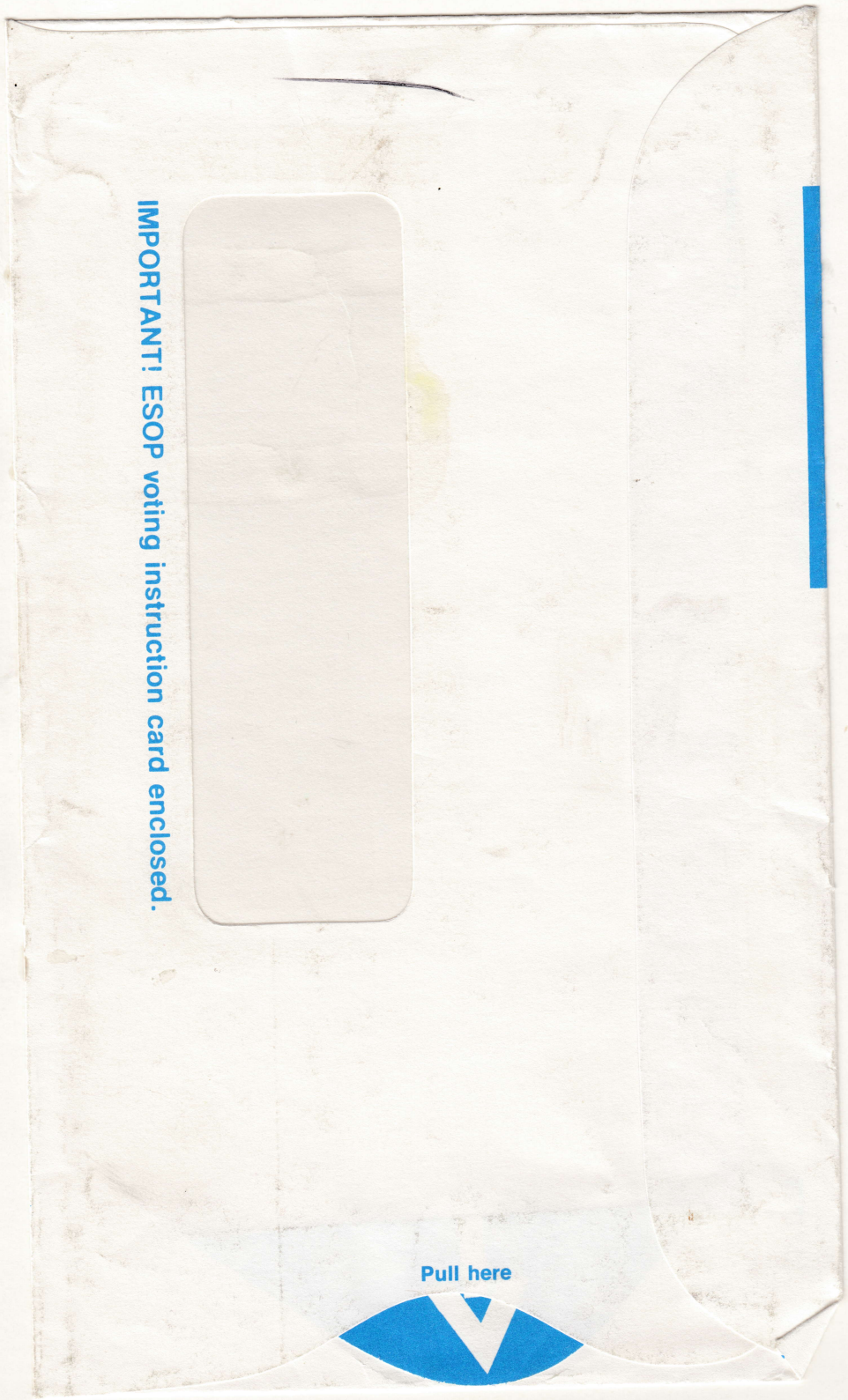

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