

DIVIDER

STATE OF NORTH DAKOTA
INFORMATION TECHNOLOGY DEPARTMENT
SFN 2053 (4-2002)

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DESCRIPTION

PU-05-300
SBC Long Distance, LLC
Local Exchange
Public Convenience & Nece
Filed 5/19/2005 Closed 6/30/2005

05



AT&T Enterprise Services, Inc
 2535 E 40th Ave
 B1200
 Denver, Colorado 80205-3601

Letty Friesen
 Senior Attorney
 303 299 5708
lsfriesen@att.com

March 2, 2007

Ms. Illona A. Jeffcoat-Sacco
 Executive Secretary
 North Dakota Public Service Commission
 State Capitol Building
 600 East Boulevard
 Bismarck, ND 58505



Re: SBC Long Distance, LLC d/b/a SBC Long Distance d/b/a AT&T Long Distance
 Notice of Discontinuance of Local Exchange Service

Dear Ms. Jeffcoat-Sacco:

By this letter, SBC Long Distance, LLC d/b/a AT&T Long Distance ("SBCLD") notifies the Commission of its intention to discontinue provision of local exchange services and its request to withdraw its registration as a local exchange service provider in the state of North Dakota effective April 2, 2007.

The history of SBCLD's registration as a local service provider in North Dakota is as follows:

- On March 17, 2004, in Case No PU-04-84, the Commission granted Southwestern Bell Communications Services, Inc. a Certificate of Registration (No. 960) to provide resold local exchange telecommunications services
- On June 9, 2004, in Case No. PU-04-83, the Commission granted Southwestern Bell Communications Services, Inc. a Certificate of Public Convenience and Necessity (No. 5127) to provide facilities-based local exchange telecommunications services
- On December 30, 2004, in Case No. PU-04-647, the Commission reissued Certificate Nos. 960 and 5127 to reflect the legal name change to SBC Long Distance, Inc.
- On June 8, 2005, in Case No. PU-05-299, the Commission replaced Certificate of Registration No. 960 with new Certificate No. 1011, which was granted to SBC Long Distance, LLC to reflect conversion to a limited liability company, to provide resold local exchange telecommunications services
- On June 29, 2005, in Case No. PU-05-300, the Commission replaced Certificate of Public Convenience and Necessity No. 5127 with new Certificate No. 5251, which was granted to SBC Long Distance, LLC, to



Ms. Illona A. Jeffcoat-Sacco
March 2, 2007
Page 2

reflect conversion to a limited liability company, to provide facilities-based local exchange telecommunications services

- On January 19, 2006, SBCLD notified the Commission of its additional d/b/a of AT&T Long Distance.

This request for withdrawal of SBCLD's local exchange service registration is based on business reasons. At the present time, SBCLD has no local exchange service customers in North Dakota.

SBCLD's request to withdraw is limited to its local service provider registration and its Local Exchange Tariff, NDPSC Tariff No. 3. SBCLD will continue to provide interexchange services and requests that its interexchange carrier registration and tariffs remain in place. SBCLD will modify its online registration to reflect its discontinuance of local exchange service.

Please feel free to contact me directly should you have any questions. I can be reached at (303) 299-5708.

Very truly yours,


Letty S.D. Friesen



Public Service Commission
Receipt of Payment

Receipt# 6432

Received 12/6/2005 Check# 1800082741 for \$172 53
Subject Utility Valuation - Prior Biennium

Docket # PU-05-300

SBC Long Distance, Inc.
5850 W Las Positas Blvd
Pleasanton CA 94588-8522

15 PU-05-300

Pages 1

Receipt# 6,432 \$172 53

by SBC Long Distance, Inc

12/06/2005

APPROVED

MOTION

DATE: 10-18-05
KMF

October 18, 2005

SBC Long Distance, LLC
Local Exchange
Public Convenience & Necessity

Case No. PU-05-300

I move the Commission bill SBC Long Distance, LLC for costs incurred to date in Case No. PU-05-300, SBC Long Distance, LLC, Local Exchange, Public Convenience & Necessity.



Public Service Commission

State of North Dakota

COMMISSIONERS

Tony Clark, President
Susan E Wefald
Kevin Cramer

Executive Secretary
Illona A Jeffcoat-Sacco

600 E Boulevard Ave Dept 408
Bismarck, North Dakota 58505-0480
web www.psc.state.nd.us
e-mail ndpsc@state.nd.us
TDD 800-366-6888
Fax 701-328-2410
Phone 701-328-2400

October 18, 2005

Eric Fishman
Holland & Knight LLP
2099 Pennsylvania Ave NW Ste 100
Washington DC 20006

RE: Case No. PU-05-300
SBC Long Distance, LLC
Local Exchange
Public Convenience & Necessity

Enclosed is a copy of the statement approved at the October 18, 2005 Public Service Commission meeting for the expenses incurred to date in Case No. PU-05-300.

Under N.D.C.C. 49-21-01.7, these expenses are billed through the Valuation Fund and must be paid for by the telecommunications company involved.

Please make your check payable to the *Public Service Commission*

Sincerely,

A handwritten signature in black ink, appearing to read "Gloria Geiger".

Gloria Geiger
Admin Staff Officer
701-328-2401

Enc.

c: Norman W Descoteaux
SBC Long Distance LLC
5850 W Las Positas Blvd
Pleasanton CA 94588

Billing Statement

October 18, 2005

SBC Long Distance, LLC
Local Exchange
Public Convenience & Necessity

Case No. PU-05-300

Bill To:

SBC Long Distance, LLC\$172.53

Expenses Incurred to Date:

Advertising Costs\$172.53

Send Payment and a Copy of this Statement To:

Public Service Commission
600 E Boulevard Ave Dept 408
Bismarck ND 58505-0480

Federal Tax ID 45-0309764

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

AFFIDAVIT OF SERVICE BY CERTIFIED AND ORDINARY MAIL

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

Sharon Helbling deposes and says that

she is over the age of 18 years and not a party to this action and, on the **30th day of June, 2005**, she deposited in the United States Mail, Bismarck, North Dakota, **one** envelope with certified postage, return receipt requested, fully prepaid, securely sealed and each containing a photocopy of

Order

The envelope was addressed as follows

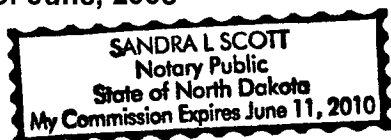
Eric Fishman
Holland & Knight LLP
2099 Pennsylvania Ave NW Ste 100
Washington D C 20006
Cert. No. 7004 2890 0000 5451 4830

Sharon Helbling further deposes and says that on the **30th day of June, 2005**, she deposited in the United States Mail, Bismarck, North Dakota, **one** envelope by regular mail, with postage fully prepaid, securely sealed, each containing a photocopy of the same

Norman W Descoteaux
SBC Long Distance LLC
5850 W Las Positas Blvd
Pleasanton CA 94588

Each address shown is the respective addressee's last reasonably ascertainable post office address

Subscribed and sworn to before me
this **30th day of June, 2005**



SEAL

Sharon Helbling

Sandra L Scott

Notary Public



Public Service Commission

State of North Dakota

COMMISSIONERS

Tony Clark, President
Susan E Wefald
Kevin Cramer

Executive Secretary
Illona A Jeffcoat-Sacco

600 E Boulevard Ave Dept 408
Bismarck, North Dakota 58505-0480
web www.psc.state.nd.us
e-mail ndpsc@state.nd.us
TDD 800-366-6888
Fax 701-328-2410
Phone 701-328-2400

June 29, 2005

Eric Fishman
Holland & Knight LLP
2099 Pennsylvania Ave NW Ste 100
Washington D C 20006

Dear Mr Fishman:

On June 29, 2005, the Commission issued Certificate of Public Convenience and Necessity No. 5251 to SBC Long Distance, LLC to provide local exchange telecommunications services, with facilities, throughout North Dakota, Case No. PU-05-300.

The original certificate is enclosed for your files.

If you have any questions, please call me at 701-328-4076.

Sincerely,

Sharon Helbling
Public Utilities Division

sdh

Enclosures

MOTION

APPROVED

DATE: 6-29-05 June 29, 2005

KOE

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

I move the Commission adopt the Order and issue a Certificate of Public Convenience and Necessity to SBC Long Distance, LLC to provide telecommunication services in North Dakota

AB/sdh

**STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION**

**SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity**

Case No. PU-05-300

ORDER

June 29, 2005

On May 4, 2005 SBC Long Distance LLC, d/b/a SBC Long Distance, (SBC) of Pleasanton, CA filed a letter notifying the Commission that SBC had internally reorganized and asked the Commission to issue revised certificates of public convenience and necessity in the name of SBC Long Distance, LLC d/b/a SBC Long Distance. On May 6, 2005 and in subsequent telephone conference calls, Commission staff advised counsel to SBC that the Commission could not issue new certificates in the name of SBC Long Distance, LLC because it regarded SBC Long Distance, LLC as an entity legally different from SBC Long Distance, Inc. Commission staff directed SBC Long Distance, LLC to apply for a new certificate under the new entity. SBC proposes to provide the same competitive local exchange carrier services previously offered by SBC Long Distance, Inc. d/b/a SBC Long Distance. Upon granting of this application, the certification of SBC Long Distance, Inc. will be relinquished.

On May 19, 2005, SBC filed an application for a certificate of public convenience and necessity to provide facilities-based competitive local exchange telecommunications services throughout North Dakota.

On May 24, 2005 the Commission issued a Notice of Opportunity for Hearing that provided until June 29, 2005 for receiving comments or hearing requests. In accordance with North Dakota Century Code chapter 49-03.1 and North Dakota Administrative Code section 69-09-05-11(3), the Commission's notice identified the following issues to be considered in this matter.

- 1 Fitness and ability of the applicant to provide service.
- 2 Adequacy of the proposed service
- 3 Technical, financial and managerial ability of the applicant to provide service

On June 10, 2005 the Rural Telephone Company Group (RTCG) filed comments requesting limitations to preserve the rural exemption under 47 U.S.C. section 251(f). RTCG stated it did not oppose the application and was not requesting a hearing.

SBC is organized as a limited liability company organized under the laws of Delaware. This Certificate of Public Convenience and Necessity will supersede the Certificate for facilities-based competitive local exchange telecommunications service issued by the Commission to SBC prior to its conversion to a limited liability company, when it operated under the name SBC Long Distance, Inc. d/b/a SBC Long Distance.

when it operated under the name SBC Long Distance, Inc d/b/a SBC Long Distance (formerly Southwestern Bell Communications Services, Inc d/b/a SBC Long Distance) SBC was registered in North Dakota to resell local exchange and long distance services on June 8, 2005 in Case No. PU-05-299

SBC intends to provide the same competitive local exchange carrier services offered by SBC Long Distance, Inc These services include, but are not limited to, basic local service and custom calling features, and data services to commercial and residential subscribers primarily in Qwest Communications exchanges SBC will also provide exchange access services to interconnecting carriers.

The Commission finds SBC is fit, able, and has the technical, financial and managerial ability to provide service

The Commission finds SBC's proposed service adequate.


Exhibit C to the application outlines the managerial qualifications and provides biographical information indicating that SBC has the technical and managerial ability to provide service.

Order

The Commission Orders the application of SBC Long Distance LLC, d/b/a SBC Long Distance for a certificate of public convenience and necessity to provide facilities-based competitive local exchange telecommunications services throughout North Dakota is GRANTED.

PUBLIC SERVICE COMMISSION


Susan E. Wefald
Commissioner


Tony Clark
President


Kevin Cramer
Commissioner

Public Service Commission
STATE OF NORTH DAKOTA

Certificate of Public Convenience and Necessity

Certificate Number 5251

This is to certify that public convenience and necessity require, and permission is granted for SBC Long Distance, LLC, a telecommunications public utility, to provide statewide local exchange telecommunications services, with facilities, in North Dakota.

This certificate is issued in Case No. PU-05-300 and is conditioned upon SBC Long Distance, LLC securing the franchise or other authority of the proper municipal or other authority for the exercise of these rights and privileges.

Bismarck, North Dakota, June 29, 2005.

ATTEST:

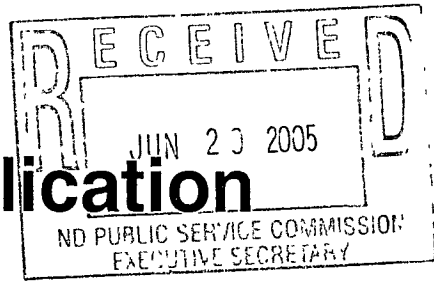
PUBLIC SERVICE COMMISSION



Executive Secretary



Commissioner



Affidavit of Publication

Colleen Park, being duly sworn, state as follows:

1. I am the designated agent, under the provisions and for the purposes of, Section 31-04-06, NDCC, for the newspapers listed on the attached exhibits.
2. The newspapers listed on the exhibits published the advertisement of: PSC, Ernest Communications, 1 time(s) as required by law or ordinance.
3. All of the listed newspapers are legal newspapers in the State of North Dakota and, under the provisions of Section 46-05-01, NDCC, are qualified to publish any public notice or any matter required by law or ordinance to be printed or published in a newspaper in North Dakota.

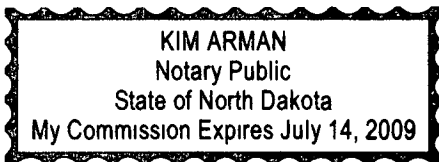
Signed: Colleen Park

State of ND

County of Burleigh

Subscribed and sworn to before me this 27 day of June 20 05.

Kim Hitzendge now known as Kim Arman - formerly





North Dakota Newspaper Association

1435 Interstate Loop
 Bismarck, ND 58503-0567
 Ph (701) 223-6397 • Fax (701) 223-8185

1435 INTERSTATE LOOP
 BISMARCK, ND 58503-0567
 JUN 25 2005
 NORTH DAKOTA SERVICE COM - SC
 P.O. BOX 107 SEBASTIAN

INVOICE

Order **20603-05061PP0** Invoice # **56952**

June 28, 2005

Attn: ILLONAA. JEFFCOAT-SACCO
 PUBLIC SERVICE COMMISSION
 600 E. BOULEVARD AVE.
 STATE CAPITOL
 BISMARCK, ND 58505

Voice 701-328-4076

Advertiser **Public Utilities Division**

P O # **PU-05-229 & 300**

Amount Due **\$345.07**

Amount Paid

Please detach and return this portion with your payment

Public Utilities Division Invoice # 20603-05061PP0-56952 PO# PU-05-229 & 300

Ad Size	Rate Type	Rate	Total	Discount (%)	Caption	Page	Run Date
DAILY							
Bismarck Tribune (Bismarck ND)							
55 00	SPR2	0 63	34 65	0 00	Ernest Corrn & SBC		06/01/05
Devils Lake Daily Journal (Devils Lake ND)							
55 00	SPR2	0 63	34 65	0 00	Ernest Corrn & SBC		06/01/05
Dickinson Press (Dickinson ND)							
59 00	SPR2	0 57	33 63	0 00	Ernest Corrn & SBC		06/01/05
Fargo, The Forum (Fargo ND)							
52 00	SPR2	0 71	36 92	0 00	Ernest Corrn & SBC		06/06/05
Grand Forks Herald (Grand Forks ND)							
50 00	SPR2	0 69	34 50	0 00	Ernest Corrn & SBC		06/02/05
Jamestown Sun (Jamestown ND)							
60 00	SPR2	0 54	32 40	0 00	Ernest Corrn & SBC		06/01/05
Minot Daily News (Minot ND)							
62 00	SPR2	0 54	33.48	0 00	Ernest Corrn & SBC		06/01/05
Valley City Times-Record (Valley City ND)							
55 00	SPR2	0 61	33 55	0 00	Ernest Corrn & SBC		06/01/05
Wahpeton Daily News (Wahpeton ND)							
74 00	SPR2	0 51	37.74	0 00	Ernest Corrn & SBC		06/01/05
Williston Herald (Williston ND)							
55 00	SPR2	0 61	33 55	0 00	Ernest Corrn & SBC		06/01/05

Gross Advertising	345.07	Total Misc	0 00	Amount Paid	0 00
Agency Discount		Tax	0 00	Adjustments	0 00
Other Discount	0.00	Total Billed	345 07	Payment Date	
Service Charge	0.00	Unbilled	0 00	Balance Due	345 07

13 **PU-05-229**

Pages 1

Affidavit of Publication

by North Dakota Advertising Service Inc
 06/29/2005 CC Comm Legal Illona Jerry, Annette, Mike

8 **PU-05-300**

Pages 1

Affidavit of Publication

by North Dakota Advertising Service, Inc
 06/29/2005 CC Comm Legal Illona Annette Mike

State Of North Dakota
Public Service Commission
Notice Of Opportunity For Hearing
PU Case No. PU-05-306
May 24, 2005

Bismarck	6-1
Devils Lake	6-1
Dickinson	6-1
Fargo	6-6
Grand Forks	6-2
Jamestown	6-1
Minot	6-1
Valley City	6-1
Wahpeton	6-1
Williston	6-1

DONALD A. NEGAARD
JAMES E. NOSTDAHL
CAROL K. LARSON
DAVID J. HOGUE
REED A. SODERSTROM
BRENT M. OLSON
DEBRA L. HOFFARTH
SCOTT M. KNUDSVIG
ERIKA L. SLEGER
RYAN D. SANDBERG

PH
LAW OFFICES OF
PRINGLE & HERIGSTAD, P.C.

2525 ELK DRIVE
POST OFFICE BOX 1000
MINOT, NORTH DAKOTA 58702
(701) 852-0381
FAX (701) 857-1361
E-mail pringle@srt.com

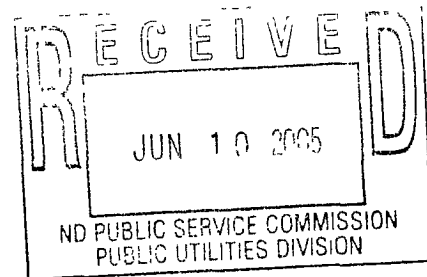
OF COUNSEL
HERBERT L. MESCHKE

RETIRED
THOMAS A. WENTZ
MARK F. PURDY
JAN M. SEBBY

KENNETH G. PRINGLE
(1914-1983)
ROGER O. HERIGSTAD
(1919-2003)

June 9, 2005

Ms. Ilona Jeffcoat-Sacco
Executive Secretary
PUBLIC SERVICE COMMISSION
600 East Boulevard Avenue
Bismarck, ND 58505-0480



**SBC LONG DISTANCE, LLC
LOCAL EXCHANGE
PUBLIC CONVENIENCE AND NECESSITY
CASE NO. PU-05-300**

**ERNEST COMMUNICATIONS, INC.
LOCAL EXCHANGE
PUBLIC CONVENIENCE AND NECESSITY
CASE NO. PU-05-229**

Enclosed herewith for filing in the above matter are an original and seven copies of the Comments of the Rural Telephone Company Group on the Applications for Certificate of Public Convenience and Necessity of Ernest Communications, Inc., Case No. PU-05-229, and SBC Long Distance, LLC, Case No. PU-05-300

A handwritten signature in black ink, appearing to be "Don Negaard".

Don Negaard

jt

Enclosures

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

**COMMENTS OF THE RURAL TELEPHONE COMPANY GROUP (“RTCG”)
ON THE APPLICATION FOR CERTIFICATE OF
PUBLIC CONVENIENCE AND NECESSITY
OF SBC LONG DISTANCE, LLC (SBC)**

The Rural Telephone Company Group (RTCG) is a group of telecommunications carriers, each of which is an “incumbent local exchange carrier” and a “rural telephone company” under the federal Telecommunications Act of 1996 (the Act) and each has legal interests in this case under the Act

The RTCG includes

BEK Communications Cooperative
Consolidated Telcom
Dakota Central Telecommunications Cooperative and Dakota Central Telecom I
Dickey Rural Telephone Cooperative, Dickey Rural Communications, Inc , and
Dickey Rural Access, Inc
Griggs County Telephone Company and Moore & Liberty Telephone Company
Inter-Community Telephone Company, L L C
Midstate Telephone Company and Midstate Communications, Inc
Nemont Telephone Company and Missouri Valley Communications, Inc
North Dakota Telephone Company
Northwest Communications Cooperative
Polar Communications Mutual Aid Corporation and Polar Telecommunications, Inc
Red River Rural Telephone Association and Red River Telecom, Inc
Reservation Telephone Cooperative
SRT Communications, Inc
United Telephone Mutual Aid Corporation and Turtle Mountain Communications
West River Telecommunications Cooperative

The description of service area requested by SBC includes RTCG service areas

In PSC Case No PU-453-96-83, AT&T applied for and was granted a Certificate of Public Convenience and Necessity to provide local telecommunications service throughout the state of North Dakota, subject to limitations in the Commission’s Order

"8 Public convenience and necessity requires the granting of a statewide certificate to AT&T to provide local service. However, the Commission's determination of the public interest with regard to the service territories of rural telephone companies is subject to any future proceedings under §251(f)(1) or (2) of the Act.

9 Granting AT&T's application for a statewide certificate is not a ruling that affects the rights of specific rural telephone company pursuant to 47 U.S.C. §251(f)."

In PSC Case No. PU-987-96-390, Sprint applied for and was granted a Certificate of Public Convenience and Necessity to provide local telecommunications service throughout the state of North Dakota, subject to limitations based on the precedent established in the AT&T case.

"One issue which has been addressed in other Certificate of Public Convenience and Necessity cases was raised by the intervener, NDAATC. This issue concerns rural telephone companies and what effect the grant of a certificate would have on them. NDAATC identified its interest in this proceeding, and the interests of its members, as a concern that the grant of a certificate of public convenience and necessity not defeat the rural protections provided by the Telecommunications Act of 1996.

The Commission agrees with NDAATC that the question is important and must be addressed. This issue will apply to all certificate requests affecting any service area of any rural telephone company in North Dakota. It is the opinion of the Commission that in all such cases, any determination of public interest is subject to future proceedings regarding rural protections or exemptions.

In the instant case the Commission will adhere to the precedent established in the AT&T certificate case, Docket No. PU-453-96-83, on this issue. In AT&T, the Commission held that its determination of the public interest with regard to the service territories of rural telephone companies is subject to any future proceedings under Section 251(f)(1) or (2) of the Telecommunications Act of 1996 (47 U.S.C. §251(f)(1) or (2)). The Commission also held that granting the certificate on a statewide basis is not a ruling that affects the rights of specific rural telephone companies under 47 U.S.C. §251(f). Both Sprint and NDAATC agree that the qualifications expressed in the AT&T case appropriately apply to Sprint's request for a statewide certificate of public convenience and necessity. The inclusion of these conditions satisfies NDAATC's concerns, and is not objectionable to Sprint."

The AT&T precedent has been cited at least one time following the Sprint case, in Case No PU-1693-97-269, where a statewide certificate was granted to Eclipse Communications Corp (a subsidiary of Western Wireless Corporation), subject to the rights of rural telephone companies under 47 U.S C 251(f).

In reliance on the precedent established by the Commission in the AT&T, Sprint, and Eclipse/Western Wireless cases, the RTCG does not request intervention and does not request a hearing on the pending application. The RTCG does request that any order issued to grant the pending application should include limitations substantially the same as those in the AT&T, Sprint, and Eclipse/Western Wireless cases, to preserve the "rural safeguard" rights of rural telephone companies under 47 U S C 251(f)

By the comments contained herein, none of the above-named companies shall be deemed to have waived its rights to claim that SBC Long Distance, LLC, is prohibited from competing with the RTCG or their subsidiaries

Dated at Minot, North Dakota, this 9th day of June, 2005

PRINGLE & HERIGSTAD, P C



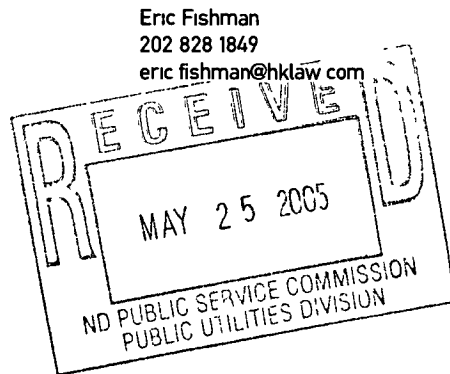
By Don Negaard, ND Bar ID #03598
Attorneys for RTCG
2525 Elk Drive
P O Box 1000
Minot, ND 58702-1000
(701) 852-3081

ORIGINAL

May 24, 2005

Federal Express Delivery

Ilona A. Jeffcoat-Sacco, Executive Secretary
North Dakota Public Service Commission
600 East Boulevard
Department 408
Bismarck, North Dakota 58505-0480



Re: SBC Long Distance, LLC d/b/a SBC Long Distance
Application and Request for Expedited Action

Dear Ms. Jeffcoat-Sacco:

On May 18, 2005, the undersigned counsel filed on behalf of SBC Long Distance, LLC d/b/a SBC Long Distance ("SBC Long Distance") an Application and Request for Expedited Action authority to provide facilities-based local exchange service, and an Application for Certificate of Registration. At the time of these filings, SBC Long Distance had not yet received from the North Dakota Secretary of State a Certificate of Good Standing. Since these filings, SBC Long Distance has received this certificate and submits it herewith for association with its previous filings.

Please acknowledge receipt of this filing by date-stamping and returning the additional copy of this filing in the addressed, self-stamped envelope.

Should you have any questions about this matter, please contact the undersigned counsel.

Respectfully submitted,

HOLLAND & KNIGHT LLP

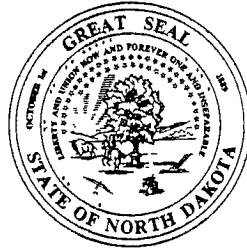
Eric Fishman, Esq.
Counsel to SBC Long Distance, LLC d/b/a SBC Long Distance

Enclosure

2936714_v1

State of North Dakota

SECRETARY OF STATE



CERTIFICATE OF GOOD STANDING OF

SBC LONG DISTANCE, LLC

The undersigned, as Secretary of State of the State of North Dakota, hereby certifies that SBC LONG DISTANCE, LLC, a FOREIGN LIMITED LIABILITY COMPANY, authorized to transact business in the State of North Dakota on May 13, 2005, and according to the records of this office as of this date, has paid all fees due this office as required by North Dakota statutes governing a FOREIGN LIMITED LIABILITY COMPANY.

ACCORDINGLY the undersigned, as such Secretary of State, and by virtue of the authority vested in him by law, hereby issues this Certificate of Good Standing to

SBC LONG DISTANCE, LLC

Issued: May 20, 2005

A handwritten signature in cursive script, reading "Alvin A. Jaeger".

Alvin A. Jaeger
Secretary of State

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Ernest Communications, Inc.
Local Exchange
Public Convenience and Necessity

Case No. PU-05-229

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

AFFIDAVIT OF SERVICE BY CERTIFIED AND ORDINARY MAIL

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

Sharon Helbling deposes and says that:

she is over the age of 18 years and not a party to this action and, on the **25th day of May, 2005**, she deposited in the United States Mail, Bismarck, North Dakota, **one** envelope with certified postage, return receipt requested, fully prepaid, securely sealed and each containing a photocopy of:

Notice of Opportunity for Hearing

The envelope was addressed as follows

Carey Roesel
Technologies Management Inc
P O Box 200
Winter Park FL 32789
Cert. No. 7003 2260 0001 3516 8880

Eric Fishman
Holland & Knight LLP
2099 Pennsylvania Ave NW Ste 100
Washington D C 20006
Cert No. 7003 2260 0001 3516 8897

Sharon Helbling further deposes and says that on the **25th day of May, 2005**, she deposited in the United States Mail, Bismarck, North Dakota, **one** envelope by regular mail, with postage fully prepaid, securely sealed, each containing a photocopy of the same.

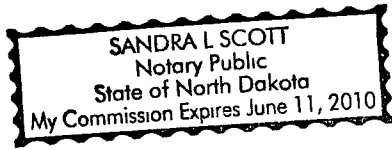
Ernest Communications Inc
5275 Triangle Pkwy Ste 150
Norcross GA 30092

Norman W Descoteaux
SBC Long Distance LLC
5850 W Las Positas Blvd
Pleasanton CA 94588

Each address shown is the respective addressee's last reasonably ascertainable post office address.

Subscribed and sworn to before me
this **25th day of May, 2005**

SEAL



Sharon Hedding

Sandra L Scott

Notary Public

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Ernest Communications, Inc.
Local Exchange
Public Convenience and Necessity

Case No. PU-05-229

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

AFFIDAVIT OF SERVICE BY ORDINARY MAIL OR E-MAIL

STATE OF NORTH DAKOTA
COUNTY OF BURLEIGH

Sharon Helbling deposes and says that:

she is over the age of 18 years and not a party to this action and, on the **25th day of May, 2005**, she deposited in the United States Mail, Bismarck, North Dakota, envelopes by first class mail, fully prepaid, securely sealed, and e-mailed, each containing a photocopy of

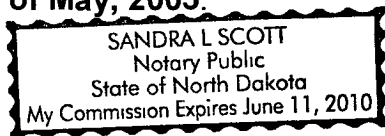
Notice of Opportunity for Hearing

The envelopes were addressed as follows:

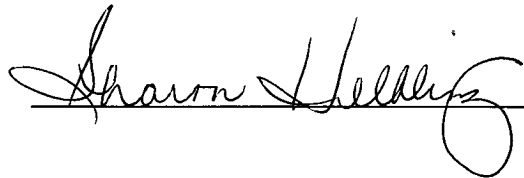
See Attached List

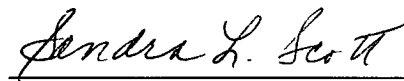
Each address shown is the respective addressee's last reasonably ascertainable post office address.

Subscribed and sworn to before me
this **25th day of May, 2005**.



SEAL





Notary Public

wbrudvik@ohnstadlaw.com
William Brudvik

mariep@telcogroupinc.com
Marie Pierre-Paul

dennis.kelley@reconex.com
Dennis Kelley
1-800-Reconex Inc
2500 Industrial Ave
Hubbard OR 97032

ffarm@wtc-mail.net
Ann Faught
Absaraka Co-op Tele Co
Absaraka ND 58002

jlchapman@acomminc.com
Jerry Chapman
Acomm Inc
510 1st Ave N Ste 203
Minneapolis MN 55403-0343

jcremer@bantzlaw.com
James Cremer
Bantz Gosh & Cremer LLC
305 6th Ave SE
Aberdeen SD 57402-0970

smassey@bepc.com
Sheryl Massey
Basin Electric Power Coop
1717 E Interstate Ave
Bismarck ND 58501-0564

jtmgr@bektel.com
Jerome Tishmack
BEK Communications Cooperative
PO Box 230
Steele ND 58482-0230

dan.meldazis@broadwing.com
Dan Meldazis
Broadwing Communications LLC
200 N LaSalle 10th Fl
Chicago IL 60601

camurray@eschelon.com
Catherine A Murray
Business Productivity Solutions Inc
730 2nd Ave S Ste 900
Minneapolis MN 55402

sbohler@czn.com
Scott Bohler
Citizens Telecomm Co of Minnesota
3 High Ridge Park
Stamford CT 06905

mannawiz@pacbell.net
Larry Manna
Compuwiz
1012 Industrial Blvd
South Lake Tahoe CA 96150

sheba.chacko@btna.com
Sheba Chacko
Concert Communications Sales LLC
11440 Commerce Park Dr
Reston VA 20191

bryan@consolidatedtelcom.com
Bryan W Personne
Consolidated Telcom
PO Box 1077
Dickinson ND 58601-1077

paul@consolidatedtelcom.com
Paul Schuetzler
Consolidated Telcom
PO Box 1077
Dickinson ND 58601-1077

ken@consolidatedtelcom.com
Paul Schuetzler
Consolidated Telcom
PO Box 1077
Dickinson ND 58601-1077

keithl@daktel.com
Keith Larson
Dakota Central Tele Coop
PO Box 299
Carrington ND 58421-0299

mjrasher@msn.com
Mary Jane Rasher
DCI Group

tschilling@drtel.com
Troy Schilling
Dickey Rural Communications Inc
PO Box 69
Ellendale ND 58436-0069

tschilling@drtel.com
Troy Schilling
Dickey Rural Services Inc
P O Box 69
Ellendale ND 58436

tschilling@drtel.com
Troy Schilling
Dickey Rural Telephone Cooperative
PO Box 69
Ellendale ND 58436-0069

lhankins@covad.com
Lynn Hankins
DIECA Communications Inc
7901 Lowry Blvd
Denver CO 80202

kcallen@vartec.net
Kevin Allen
Excel Telecommunications Inc
2440 Marsh Lane
Carrollton TX 75006

glenn.richards@shawpittman.com
Glenn Richards
Glenn Richards
ShawPittman
2300 N St NW

cooperstown@mlgc.com
Ray Brown
Grieggs County Telephone Co
P O Box 506
Cooperstown ND 58425-0506

rlaqua@rrv.net
Ronald Laqua
Halstad Telephone Company
PO Box 55
Halstad MN 56548-0055

rlaqua@rrv.net
HTC Services Inc
P O Box 55
Halstad MN 56548

bjohnson@ideaone.com
Robert K Johnson
IdeaOne Telecom Group LLC
3239 39th St SW
Fargo ND 58104

carl.billek@corp.idt.net
Carl Wolf Billek
IDT America Corp
520 Broad St
Newark NJ 07102-3111

jamie@ignus.com
Jamie Kubik
Ignus Inc
P O Box 9202
Fargo ND 58106-9202

karen.johnson@integratelecom.com
Karen Johnson
Integra Telecom of North Dakota Inc
1201 NE Lloyd Blvd Ste 500
Portland OR 97232

kander@ictc.com
Keith Anderson
Inter-Community Telephone Company LLC
PO Box 8
Nome ND 58062-0008

jamesval@jamesvalley.com

James Valley Coop Telephone Co
235 E 1st Ave
Groton SD 57445

susan.p.green@lmco.com

Susan Green
Lockheed Martin Global Telecomm
12506 Lake Underhill Rd MP 836
Orlando FL 32825

gtaylor@matrixvalue.com

Greg Taylor
Matrix Telecom Inc
300 N Meridian Ste 200-North
Oklahoma City OK 73107

michel.singer_nelson@mci.com

Michel Singer-Nelson
MCI
707 17th St Ste 3600
Denver CO 80202

carols@midstatetel.com

Gordon Wilhelmi
Midstate Communications Inc
PO Box 400
Stanley ND 58784-0400

2kathyg@nemontel.net

Kathy Greenwood
Missouri Valley Communications Inc
P O Box 600
Scobey MT 59263-0600

sbunn@mlgc.com

Shelie Bunn
Moore & Liberty Telephone Co
Enderlin ND 58027

pschaner@ndarec.com

Patti Schaner
ND Assn Rural Electric Coops
PO Box 727
Mandan ND 58554-0727

sales@kmavradio.com

KMAV AM/FM RADIO
PO Box 216
Mayville ND 58257-0216

loretel@loretel.net

Steven Katka
Loretel Systems Inc
13 E 4th Ave
Ada MN 56510

foss@btinet.net

Marilyn Foss
MCI
707 17th St Ste 3600
Denver CO 80202

gerrya@midrivers.com

Gerry Anderson
Mid-Rivers Telephone Coop Inc
PO Box 280
Circle MT 59215-0280

carols@midstatetel.com

Mark Wilhelmi
Midstate Telephone Co
PO Box 400
Stanley ND 58784-0400

karen.collins@mdu.com

Karen Collins
Montana-Dakota Utilities Co
400 N 4th St
Bismarck ND 58501

dhill@ndarec.com

Dennis Hill
ND Assn Rural Electric Coops
PO Box 727
Mandan ND 58554-0727

2kathyg@nemontel.net

Kathy Greenwood
Nemont Telephone Cooperative Inc
Scobey MT 59263

jsilveira@netlojix.com
Janet Medeiros-Silveira
NetLoqix Telecom Inc
501 Bath St
Santa Barbara CA 93101

abussmann@newaccess.cc
Amy Bussmann
New Access Communications LLC
801 Nicollet Ave Ste 350
Minneapolis MN 55402-2519

prieck@newaccess.cc
Pam Rieck
New Access Communications LLC
801 Nicollet Ave Ste 350
Minneapolis MN 55402-2519

lclemens@nft.net
Larry Clemens
Noonan Farmers Tele Co
Noonan ND 58765

rer@norlight.com
Robert E Rogers
NorLight Inc
275 N Corporate Dr
Brookfield WI 53045

laurie.willman@nbne.info
Laurie Willman
North By NortheastCom LLC

stevedl@srttel.com
Steven Lysne
North Dakota Network Co
P O Box 2027
Minot ND 58702-2027

pat@ndta.net
Patricia Gisinger
North Dakota Telephone Assoc
PO Box 2614
Bismarck ND 58502-2614

kathyy@ndtel.com
Dave Dircks
North Dakota Telephone Company
PO Box 180
Devils Lake ND 58301-0180

dwights@nccray.com
Dwight Schmitt
Northwest Communications Coop
PO Box 38
Ray ND 58849-0038

mary.buley@onvoy.com
Mary Buley
Onvoy Inc
300 South Highway 169
Minneapolis MN 55426

ddunning@polarcomm.com
David Dunning
Polar Commun Mut Aid Corp
PO Box 270
Park River ND 58270-0270

ddunning@polarcomm.com
David Dunning
Polar Telcom Inc
PO Box 270
Park River ND 58270-0270

ddunning@polarcomm.com
David Dunning
Polar Telecommunications Inc
PO Box T
Park River ND 58270

donn@srt.com
Don Negaard
Pringle and Heriqstad P C
PO Box 1000
Minot ND 58702-1000

sschwan@qwest.com
Suzy Schwandt
Qwest Corporation

kblicke@qwest.com
Kent Blickensderfer
Qwest Corporation
220 N 5th St
PO Box 5508
Bismarck ND 58502-5508

smacint@qwest.com
Scott Macintosh
Qwest Corporation
220 N 5th St
PO Box 5508
Bismarck ND 58502-5508

areyes@telfile.com
Ayanery Reyes
QX Telecom LLC
230 5th Ave Ste 800
New York NY 10001

jeffolson@rrt.net
Jeff Olson
Red River Rural Tele Assoc
PO Box 136
Abercrombie ND 58001-0136

royce@restel.net
Royce Aslakson
Reservation Telephone Cooperative
Parshall ND 58770

shaneh@restel.net
Shane Hart
Reservation Telephone Cooperative
Parshall ND 58770

ann.c.pongracz@mail.sprint.com
Ann Pongracz
Sprint
330 SValley View Blvd
MAILSTOP: NVLSVB 0207
Las Vegas NV 89107-4357

suelh@srttel.com
Sue Hamilton
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

melvin.kambeitz@qwest.com
Mel Kambeitz
Qwest Corporation
220 N 5th St
PO Box 5508
Bismarck ND 58502-5508

karen.titzer@qwest.com
Karen Titzer
Qwest Corporation
1005 17th St Ste 200
Denver CO 80202

pam@tnics.com
Pamela Harrington
RC Communications Inc
PO Box 197
New Effington SD 57255-0197

jeffolson@rrt.net
Jeff Olson
Red River Telecom Inc
PO Box 136
Abercrombie ND 58001-0136

mbrestel@endak.net
Marcia Burckhard
Reservation Telephone Cooperative
Parshall ND 58770

pam@tnics.com
Pamela Harrington
Roberts County Telephone Coop Assoc
New Effington SD 57255

randyab@srttel.com
Randy Burckhard
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

stevedl@srttel.com
Steve Lysne
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

christm@srttel.com
Chris Morsefield
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

janehp@srttel.com
Jane Petersen
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

johnar@srttel.com
John Reiser
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

kimrw@srttel.com
Kim Weydahl
SRT Communications Inc
P O Box 2027
Minot ND 58702-2027

mdickerson@state.nd.us
Marcy Dickerson
State Tax Department
State Capitol
Bismarck ND 58505

francie@talk.com
Francie McComb
Talk America Inc
12001 Science Dr Ste 130
Orlando FL 32826

lwh@thlglaw.com
Loubna W Haddad
The Helein Law Group LLP
8180 Greensboro Dr Ste 700
McLean VA 22102

kcarlson@utma.com
Kenneth Carlson
Turtle Mountain Communications
PO Box 729
Langdon ND 58249-0729

lahall@usgs.gov
Lenora Hall
U S Geological Survey

kjvannin@usgs.gov
K Vannin
U S Geological Survey

jennifer.arnold@uslink.com
Jennifer Arnold
U S Link Inc dba TDS Metrocom
P O Box 327
Pequot Lakes MN 56472-0327

kimm.partridge@ucn.net
Kimm Partridge
UCN Inc
14870 S Pony Express Rd
Bliffdale UT 84065

kcarlson@utma.com
Kenneth Carlson
United Telephone Mut Aid Corp
P O Box 729
Langdon ND 58249-0729

mspead@universalservice.org
Michael Spead
USAC
2120 L St NW Ste 600
Washington DC 20037

kander@ictc.com
Keith Anderson
Valley Communications Inc
P O Box 8
Nome ND 58062

kcallen@vartec.net
Kevin Allen
VarTec Solutions Inc
2440 Marsh Lane
Carrollton TX 75006

kcallen@vartec.net
Kevin Allen
VarTec Telecom Inc
2440 Marsh Lane
Carrollton TX 75006

rhoudek@venturecomm.net
Randy Houdek
Venture Communications Inc
PO Box 157
Highmore SD 57345-0157

anthony.gillman@verizon.com
Anthony Gillman
Verizon Select Services Inc
P O Box 110
Tampa FL 33601-0110

westriver@sdplains.com
West River Coop Telephone Co
801 Coleman Ave PO Box 39
Bison SD 57620-0039

bonniek@westriv.com
Bonnie Krause
West River Telecomm Coop
PO Box 467
Hazen ND 58545-0467

mickg@westriv.com
Mick Grosz
West River Telecommunications Cooperat
PO Box 467
Hazen ND 58545-0467

windfall_resources@sbcglobal.net
Robert K Lock
Windfall Resources Iternational LLC
7144 BN Harlem Ave Ste 323
Chicago IL 60631

paulihland@wtc-mail.net
Paul Ihland
Wolverton Telephone Company
P O Box 270
Park River ND 58270-0270

Jennifer Sikes
1-800 Reconex
2500 Industrial Ave
Hubbard OR 97032

Patrick Summers
360networks (USA) Inc.
867 Coal Creek Cir Ste 160
Louisville CO 80027-4670

Acceris Communications Corp
9775 Business Park Ave
San Diego CA 92131

ACN Communications Services Inc
32991 Hamilton Ct
Farmington Hills MI 48334

Arch Paging
11437 Valley View Rd
Eden Prairie MN 55344

Kimberly Nielsen
AT&T Wireless
7277 164th Ave NE RTC-1
Redmond WA 98052

Jack Medaris
Atlas Communications LTD
P O Box 807
Conshohocken PA 19428-0807

John Broten
Bell Atlantic Communications Inc
1320 N Court House Rd 9th Fl
Arlington VA 22201

Budget Phone, Inc.
6901 W 70th St
Shreveport IL 71129

BullsEye Telecom, Inc.
25900 Greenfield Rd Ste 330
Oak Park MI 48237

C12 Inc
200 Galleria Pkwy Ste 1200
Atlanta GA 30339

Scott Geston
Cable One of Fargo
P O Box 10757
Fargo ND 58106-0757

Robert Fallan
Coast International
14303 W 95th St
Lenexa KS 66215-5210

Beth Choroser
Comcast Business Communications Inc
1500 Market St
Philadelphia PA 19102

Computer Integrated Communications Inc
8502 Bells Mill Rd
Potomac MD 20854-4071

Consolidated Communications Networks
Inc
507 S Main
Dickinson ND 58601

Consolidated Telcom
PO Box 1077
Dickinson ND 58601-1077

Contact Communications
937 W Main St
Riverton WY 82501

Anthony Barrett
Covista Inc
4803 Hwy 58 N
Chatanooga TN 37416

D D D Calling Inc
6300 Richmond Ave Ste 304
Houston TX 77057

Keith Larson
Dakota Central Telecom I
PO Box 299
Carrington ND 58421-0299

William Jackson
Dakota Justice
38 8th Ave W
Dickinson ND 58601

Dave Dircks
DCN LLC
P O Box 180
Devils Lake ND 58301-0180

DSLnet Communications LLC
545 Long Wharf Dr
New Haven CT 06511

Easton Telecom Services Inc
3046 Brecksville Rd #A
Richfield OH 44286-9399

Evercom Systems Inc
8201 Tristar Dr
Irving TX 75063-2824

Chere Heintzmann
Extend America Inc
1101 E Front Ave
Bismarck ND 58504-5654

Lawrence Freedman
Fleischman & Walsh
1919 Pennsylvania Ave NW Ste 600
Washington DC 20006-3420

France Telecom Corporate Solutions LLC
2300 Corporate Park Dr Mailstop SPO606
Herndon VA 20171

Global Tel*Link Corporation
2609 Cameron St
Mobile AL 36607-3104

GLOBCOM INCORPORATED
2100 Sanders Rd Ste 150
Northbrook IL 60062

Granite Telecommunications LLC
234 Copeland St
Quincy MA 02169

Houlton Enterprises Inc
2201 W Bdwy Ste 1
Council Bluffs IA 51501

Julia Waysdorf
ICG Telecom Group Inc
161 Inverness Dr W
Englewood CO 80112

Ken Hanks
International Telcom Ltd
417 2nd Ave W
Seattle WA 98119

Intrado Communications Inc
1601 Dry Creek Dr
Longmont CO 80503-6493

David A. Huberman
Intrado Communications Inc
1601 Dry Creek Dr
Longmont CO 80503-6493

Nanette Edwards
ITC DELTACOM INC
7037 Old Madison Pike NW #400
Huntsville AL 35806-2107

KMC Telecom V Inc
1545 Rt 206
Bedminster NJ 07921

Myer Shark
Knollwood Place Apts #221
3630 Phillips Pkwy
St Louis Park MN 55426

Thomas K Crowe
Law Offices of Thomas K Crowe PC
1250 24th St NW Ste 300
Washington DC 20037

Level 3 Communications LLC
3555 Farnam St
Omaha NE 68131

Local Telcom Holdings LLC
485 Madison Ave 15th Fl
New York NY 10022-5803

Jan Lowe
Long Dist Consolidated Billing Co
145 S Livernois Rd #199
Rochester MI 48307-1837

Michel Murray
MCI
707 17th St Ste 3600
Denver CO 80202

MCImetro Access Transmission Services
707 17th ST Ste 3600
Denver CO 80202

McKenzie Consolidated Telecom LLC
P O Box 1408
Dickinson ND 58602-1408

McLeodUSA
P O Box 3177
Cedar Rapids IA 52406-3177

Midcontinent Communications
410 South Phillips Ave
Sioux Falls SD 57104

Minnesota Independent Equal Access Co
10300 6th Ave N
Plymouth MN 55441

Mike Strand
MITS
PO Box 5237
Helena MT 59604-5237

Jim Arbury
National Multi Housing Council
1850 M St NW Ste 540
Washington DC 20036

Dave Crothers
NDATC
Box 1144
Mandan ND 58554-1144

New Edge Network Inc
3000 Columbia House Blvd Ste 106
Vancouver WA 98661

Bob Edgerly
Nextel West Corp
2001 Edmund Halley Dr
Reston VA 20191

Carmine Russo
North Dakota Big Sky Telecom
374 Ansin Blvd
Hallandale FL 33009

Dave Dircks
North Dakota Long Distance Inc
P O Box 180
Devils Lake ND 58301-0180

NOW Communications Inc
711 S Tejon St Ste 201
Colorado Springs CO 80903

Brad Van Leur
OrbitCom Inc
1701 N Louise Ave
Sioux Falls SD 57107

Jeff Walker
Preferred Carrier Services Inc
14681 Midway Rd Ste 105
Dallas TX 75001

Premiere Network Services Inc
1510 N Hampton Rd Ste 120
DeSoto TX 75115

Scott Lee
Protel Advantage Inc
1308 Medora Rd
St. Paul MN 55118-1734

QuantumShift Communications Inc
88 Rowland Way Ste 200
Novato CA 94945-5000

Kristin L Smith
Qwest Corporation
1005 17th St Ste 200
Denver CO 80202

Dean Polkow
RCC Network Inc
PO Box 2000
Alexandria MN 56308-2000

Kimberly Nielson
RTC-1
Legal & External Affairs
7277 164th Ave NE
Redmond WA 98052

Arthur H Paquette
SNET America Inc
310 Orange St
North Haven CT 06510-1719

Tel Tech Inc
1300 W 57th St Ste G204
Sioux Falls SD 57108-2885

William Staycoff
Telcom Billing Services Inc
2989 Brookdale Dr
Brooklyn Park MN 55444

Telera Communications Inc
910 E Hamilton Ave Ste 200
Campbell CA 95008

Kathleen Kerr-Lawrence
Primus Telecommunications Inc
1700 Old Meadow Rd 3rd Fl
McLean VA 22102

Public Communications Services Inc
11859 Wilshire Blvd Ste 600
Los Angeles CA 90025

Qwest Corporation
1005 17th St Ste 200
Denver CO 80202

Melissa Thompson
Qwest Corporation
1005 17th St Ste 200
Denver CO 80202

Reliant Communications Inc
801 International Pkwy 5th Fl
Lake Mary FL 32746

ServiSense.com Inc
60 GlP O Box 689acier Dr #3000
Westwood MA 02090-0689

Harris Saele
T P C Inc
PO Box 180
Devils Lake ND 58301-0180

Jack Medaris
Telco Partners Inc
P O Box 807
Conshohocken PA 19428-0807

Al Bosch
Tele-Beep Company
PO Box 7072
Bismarck ND 58502-7072

Jonathan Marashlian
The Helein Law Group P C
8180 Greensboro Dr Ste 700
McLean VA 22102

T-Netix Inc
P O Box 701028
Dallas TX 75370-1028

Trinsic Communications Inc
601 S Harbour Island Blvd Ste 220
Tampa FL 33602-5925

Dennis Houston
Universal Network Services of ND
1572 North Batavia St Ste 1A
Orange CA 92867

VCI Company
3875 Steilacoom Blvd #A
Lakewood WA 98498

Doris Cooper
West River Long Distance Co.
101 W Main PO Box 467
Hazen ND 58545-0467

Carolyn Fodor
Winstar Communications
520 Broad St
Newark NJ 07102

XO Communications Services Inc
11111 Sunset Hills Rd
Reston VA 20190

Trans National Comm Internat'l Inc
2 Charlesgate West
Boston MA 02215

Christina Tygielski
Universal Access Inc
Sears Tower 233 S Wacker Dr Ste 600
Chicago IL 60606-6307

Val-Ed Joint Venture LLP/702
702 Main Ave
Moorhead MN 56560

David Armev
Verizon Communications
750 SH121 Bypass Ste 100
Louisville TX 75067

Western CLEC Corporation
3650 131st Ave SE #400
Bellevue WA 98006

WTC Competitive Services Inc
P O Box 270
Park River ND 58270-0270

Helbling, Sharon D.

From: Helbling, Sharon D.
Sent: Wednesday, May 25, 2005 7:32 AM
To: ndna
Subject: Several Notices attached

Colleen Park
North Dakota Newspaper Association

Colleen,

Would you please have the attached Notice of Hearing (Case No. PU-05-28), and the attached Notices of Opportunity for Hearing (Case Nos. PU-05-229, PU-05-300, and PU-05-272) published as legal publications in the next issue of the ten daily North Dakota newspapers.

Please send the bill to the Public Service Commission along with a tear sheet for billing purposes.

If you have any questions, let me know.

Thank you.

Sharon Helbling
Public Utilities Division



5-24-05 5-24-05 5-24-05
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APPROVED

DATE: 5-24-05
KMF

MOTION

May 24, 2005

**Ernest Communications, Inc.
Local Exchange
Public Convenience and Necessity**

Case No. PU-05-229

**SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity**

Case No. PU-05-300

I move the Commission issue a Notice of Opportunity for Hearing in the captioned applications for certificates of public convenience and necessity to provide telecommunication services in North Dakota.

AB/sdh

STATE OF NORTH DAKOTA
PUBLIC SERVICE COMMISSION

Ernest Communications, Inc.
Local Exchange
Public Convenience and Necessity

Case No. PU-05-229

SBC Long Distance, LLC
Local Exchange
Public Convenience and Necessity

Case No. PU-05-300

NOTICE OF OPPORTUNITY FOR HEARING

May 24, 2005

On March 31, 2005, Ernest Communications, Inc. of Norcross, GA filed an application for a certificate of public convenience and necessity to provide facilities-based competitive local exchange telecommunications services throughout North Dakota.

On May 19, 2005, SBC Long Distance LLC, d/b/a SBC Long Distance, of Pleasanton, CA filed an application for a certificate of public convenience and necessity to provide facilities based competitive local exchange telecommunications services throughout North Dakota.

The issues to be considered in these matters are:

1. Fitness and ability of the applicant to provide service.
2. Adequacy of the proposed service.
3. Technical, financial and managerial ability of the applicant to provide service.

Those interested are invited to comment on the application in writing. Persons desiring a hearing must file a written request identifying their interest in the proceeding and the reasons for requesting a hearing. Comments and requests for hearings must be received by **June 29, 2005**. If deemed appropriate, the Commission can determine the matter without a hearing.

For more information contact the Public Service Commission, State Capitol, Bismarck, North Dakota 58505, 701-328-2400; or Relay North Dakota 1-800-366-6888 TTY. If you require any auxiliary aids or services, such as readers, signers, or Braille materials please notify Illona Jeffcoat-Sacco, Executive Secretary.

PUBLIC SERVICE COMMISSION


Susan E. Wefald
Commissioner


Tony Clark
President


Kevin Cramer
Commissioner

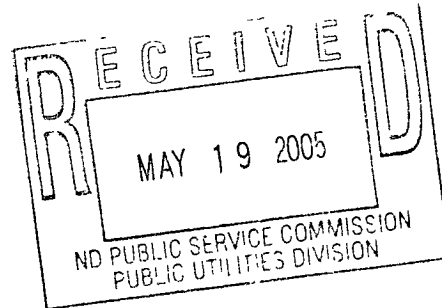
ORIGINAL

Eric Fishman
202 828 1849
eric.fishman@hklaw.com

May 18, 2005

Federal Express Delivery

Ilona A. Jeffcoat-Sacco, Executive Secretary
North Dakota Public Service Commission
600 East Boulevard
Department 408
Bismarck, North Dakota 58505-0480



Re. SBC Long Distance, LLC d/b/a SBC Long Distance
Application and Request for Expedited Action

Dear Ms. Jeffcoat-Sacco:

On behalf of SBC Long Distance, LLC d/b/a SBC Long Distance, please find an original and six (6) copies of an Application and Request for Expedited Action. By this filing, SBC Long Distance seeks authority to provide competitive local-exchange telecommunications service in the State of North Dakota.

Please acknowledge receipt of this filing by date-stamping and returning the additional copy of this filing in the addressed, self-stamped envelope.

Should you have any questions about this matter, please contact the undersigned counsel.

Respectfully submitted,


HOLLAND & KNIGHT LLP

Eric Fishman, Esq.
Counsel to SBC Long Distance, LLC d/b/a SBC Long Distance

Enclosures

2856540_v1

**BEFORE THE
PUBLIC SERVICE COMMISSION
OF NORTH DAKOTA**

In the Matter of)
)
SBC Long Distance, LLC) Case No _____
d/b/a SBC Long Distance)
)
For Certificate of Public Convenience and)
Necessity to Provide Competitive Facilities-Based)
Local Exchange Telecommunications Services)
Within the State of North Dakota)

APPLICATION AND REQUEST FOR EXPEDITED ACTION

SBC Long Distance, LLC d/b/a SBC Long Distance (“Applicant”), pursuant to North Dakota Century Code § §49-03.1-03 and 49-03.1-04, and Chapter 69-09-05-11 of the Public Service Commission of the State of North Dakota (“Commission”) rules, hereby applies to the Commission for a Certificate of Public Convenience and Necessity to provide competitive facilities-based local exchange telecommunications services within and for the State of North Dakota.

This Certificate, when granted, will supersede the Certificate of Public Convenience and Necessity for the provisioning of facilities-based competitive local exchange telecommunications service issued by the Commission to Applicant prior to its conversion to a limited liability company, when it operated under the name SBC Long Distance, Inc. d/b/a SBC Long Distance (formerly known as Southwestern Bell Communications Services Inc. d/b/a SBC Long Distance). See Order dated June 9, 2004 in Case No. PU-04-83.¹ Applicant proposes to provide

¹ In a Petition and Request for Expedited Action filed with the Commission on November 23, 2004, Southwestern Bell Communications Services Inc d/b/a SBC Long Distance requested the Commission’s consent to and approval of an internal corporate reorganization and conversion of Southwestern Bell Communications Services, Inc. d/b/a Long Distance to a limited liability company, to be known as SBC Long Distance, LLC d/b/a SBC Long Distance By letter dated November 23, 2004 and received December 1, 2004, Southwestern Bell Communications Services Inc d/b/a SBC Long Distance withdrew its application, acting on advice by the Commission’s staff that no prior Commission approval for these transactions was required On May 4, 2005, SBC

the same competitive local exchange carrier services offered by SBC Long Distance, Inc. d/b/a SBC Long Distance, as set forth in the Application of SBC Long Distance, Inc. d/b/a SBC Long Distance, filed February 25, 2004, and incorporated herein by reference.

Applicant further requests, in light of the above circumstances, that the Commission process this Application on an expedited basis, and that if no request for hearing of this Application is received within the specified time frame, the Commission exercise its discretionary authority to grant the requested certification without a hearing. In support of this Application, Applicant provides the following information:

I. THE APPLICANT

A. Business Entity Information

1. Applicant is a limited liability company organized under the laws of the State of Delaware on April 28, 2005. Applicant's principal place of business is located at:

SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588
Telephone: (925) 468-6209
Facsimile. (707) 435-6640

Long Distance, LLC d/b/a SBC Long Distance filed with the Commission a letter notifying the Commission that the above-described internal reorganization had occurred, and asking the Commission to issue revised certificates of public convenience in the name of SBC Long Distance, LLC d/b/a SBC Long Distance, to the extent such action is required, to reflect its legal name change. On May 6, 2005, and in subsequent telephone conference calls, the staff of the Commission advised counsel to SBC Long Distance, LLC d/b/a SBC Long Distance that the Commission could not issue new certificates in the name of SBC Long Distance, LLC d/b/a SBC Long Distance since it regarded SBC Long Distance, LLC d/b/a SBC Long Distance as an entity legally different from SBC Long Distance, Inc d/b/a SBC Long Distance. Accordingly, the staff directed SBC Long Distance, LLC d/b/a SBC Long Distance to apply for a new Certificate of Public Convenience for facilities-based local exchange telecommunications service, and to submit a new Application for Certificate of Registration for resold services. The instant application, together with a concurrently filed Application for Certificate of Registration (which will supersede the registrations previously issued to, and currently held by, SBC Long Distance, Inc (formerly known as Southwestern Bell Communications Services, Inc d/b/a SBC Long Distance) on July 30, 1997 (Certificate No. 457) and March 17, 2004 in Case No. PU-04-84 (Certificate No. 960), are submitted herewith in response to these staff instructions.

A true and correct copy of the Certificate of Conversion of SBC Long Distance, Inc. to a Limited Liability Company known as SBC Long Distance, LLC, issued by the Delaware Secretary of State, is attached hereto as **Exhibit A**.

2. The Secretary of the Commission has advised Applicant that it has been granted authority to transact business within the State of North Dakota by the North Dakota Secretary of State. Evidence of such authority to transact business, Certificate of Trade Name Registration, and Applicant's Certificate of Good Standing in the State of North Dakota shall be submitted to the Commission as soon as such documents are issued by the North Dakota Secretary of State, as **Exhibit B**.

3. Applicant's registered agent in the State of North Dakota for service of process is:

CT Corporation System
314 East Thayer Avenue
Bismarck, North Dakota 58501

4. The names, numbers and electronic mailing addresses of the persons designated as contact for the Commission are:

Norman W. Descoteaux
Associate Director – Regulatory
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588
Telephone: (925) 468-6209
Facsimile: (707) 435-6640
E-mail: nd1639@camail.sbc.com

and

Eric Fishman, Esq.

Holland & Knight LLP
2099 Pennsylvania Avenue, NW
Washington, DC 20006
Telephone: (202) 828-1849
Facsimile: (202) 955-5564
E-mail. eric.fishman@hklaw.com

B. Ownership, Officers and Directors

Applicant is a wholly owned subsidiary of SBC Communications, Inc. The names and addresses of Applicant's officers and directors are:

Yno Gonzalez
President and Chairman of the Board
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588

William H. McCracken
Comptroller and Director
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588

John di Bene, Esq.
Vice President, General Counsel and Secretary
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588

Kevin Fix
Treasurer
SBC Long Distance, LLC
d/b/a SBC Long Distance
175 E. Houston St.
San Antonio, Texas 78205

Larry Ruzick
Vice President – Taxes
SBC Long Distance, LLC
d/b/a SBC Long Distance
175 E. Houston St.
San Antonio, Texas 78205

Thomas S. Clemens

Assistant Treasurer
SBC Long Distance, LLC
d/b/a SBC Long Distance
175 E. Houston St.
San Antonio, Texas 78205

Executive profiles of Applicant's officers and directors are attached hereto as

Exhibit C.

II. DESIGNATED CONTACTS

A. Regulatory Contact

Applicant's authorized and designated contact for all issues regarding regulatory compliance is:

Norman W. Descoteaux
Associate Director – Regulatory
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588
Telephone: (925) 468-6209
Facsimile: (707) 435-6640
E-mail: nd1639@camail.sbc.com

B. Consumer Contact

Applicant's authorized and designated contact responsible for consumer inquiries, complaints from the public, and quality of service is:

Marty Hoover
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588
Telephone: (925) 251-7422
E-mail: mh2158@camail.sbc.com

C. Application Contact

Applicant's authorized and designated contacts for all issues regarding this application are:

Norman W. Descoteaux
Associate Director – Regulatory
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Boulevard
Pleasanton, California 94588
Telephone: (925) 468-6209
Facsimile: (707) 435-6640
E-mail: nd1639@camail.sbc.com

and

Eric Fishman, Esq.
Holland & Knight LLP
2099 Pennsylvania Avenue, NW
Washington, DC 20006
Telephone: (202) 828-1849
Facsimile: (202) 955-5564
E-mail: eric.fishman@hklaw.com

III. DESCRIPTION OF BUSINESS AND AUTHORITY REQUESTED

A. Applicant's Business Plan in North Dakota

Applicant proposes to provide the same competitive local exchange carrier services currently offered by SBC Long Distance, Inc d/b/a SBC Long Distance (formerly Southwestern Bell Communications Services, Inc. d/b/a SBC Long Distance), pursuant to Commission authority, as set forth in the Application of SBC Long Distance, Inc. d/b/a SBC Long Distance, dated February 20, 2004, and incorporated herein by reference. Upon the grant of the instant application, the certification of SBC Long Distance, Inc d/b/a SBC Long Distance will be relinquished.

Specifically, Applicant shall provide competitive local exchange carrier services including, but not limited to, basic local service and custom calling features, and data services to commercial and residential subscribers primarily in Qwest Communications exchanges. Applicant will also provide exchange access services to interconnecting carriers. Applicant does not propose to offer alternative operator services to the transient public. Operator assisted calls

are provided under contract by the underlying carrier, whose operators are trained to respond to emergency calls.

Applicant's services will be available to subscribers twenty-four hours per day, seven days per week, at rates, terms and conditions established by Applicant and reflected in Applicant's tariff, attached hereto as **Exhibit D**. Applicant assumes full responsibility for marketing and sales, billing and customer service functions. Services will be offered and provided in accordance with applicable North Dakota laws and Commission rules and regulations.

Applicant does not currently have plans to construct facilities of its own in the State of North Dakota, but does not foreclose the possibility of constructing such facilities in the future.

B. Applicant's Certification Status in Other Jurisdictions

Applicant has been granted authority to provide interexchange telecommunications services in all fifty states.² SBC Long Distance, LLC d/b/a SBC Long Distance currently has authority to provide competitive local exchange services in the following states: Alabama, Alaska, Arizona, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota (under the name SBC Long Distance, Inc.), Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wyoming, and the District of Columbia. No other applications for competitive local exchange authority approval are pending.

² Concurrently with this filing, SBC Long Distance, LLC d/b/a SBC Long Distance is submitting with the Commission an Application for Certificate of Registration. This registration will supersede the registrations previously issued to, and currently held by, SBC Long Distance, Inc. d/b/a SBC Long Distance (formerly known as Southwestern Bell Communications Services, Inc. d/b/a SBC Long Distance) on July 30, 1997 (Certificate No. 457) and March 17, 2004 in Case No. PU-04-84 (Certificate No. 960).

SBC Long Distance, Inc. d/b/a SBC Long Distance (Applicant's name prior to its conversion to a limited liability company) has an interconnection agreement in place with Qwest, which was filed with the Commission by Qwest in Docket No. CDS-040803-0010 on September 2, 2004.

At the time of the execution of this application, Applicant has not been denied a certificate of authority to provide telecommunications services, nor has any regulatory or other legal enforcement action been taken against the Applicant, including revocation of a certificate of authority

C. Applicant's Request for Authority

By this application and its concurrently filed Application for Registration, Applicant seeks authority from the Commission to provide a full range of facilities-based and resold competitive local exchange and exchange access telecommunications services, as described above. Applicant intends to market its services through in-house marketing professionals, although Applicant may in the future avail itself of telemarketing, if economically advantageous. Applicant does not currently plan to maintain or employ any staff within the State of North Dakota.

D. Applicant's Area of Authority

Applicant seeks Commission authority to operate in those areas of the State of North Dakota previously approved by the Commission for provision of competitive local exchange services. Applicant respectfully requests permission to concur in the service area maps of Qwest Communications, already on file and a matter of record with the Commission. SBC Long Distance, Inc. d/b/a SBC Long Distance (Applicant's name prior to its conversion to a limited

liability company) has an interconnection agreement in place with Qwest, which was filed with the Commission by Qwest in Docket No. CDS-040803-0010 on September 2, 2004.

IV. DESCRIPTION AND FITNESS OF COMPANY

Applicant has provided competitive telecommunications services for nearly a decade. Applicant possesses the managerial, technical and financial qualifications to execute its business plan, provide its proposed telecommunications services, and operate and maintain facilities over which its services will be deployed. Applicant's senior managerial and technical capability is demonstrated through the Executive Profiles attached as **Exhibit C**. Applicant's senior management team has extensive business experience in the telecommunications industry, including marketing, network operations, and financial analysis/accounting, in the telecommunications industry. Several of Applicant's executives, managers and employees have held similar positions in Applicant's parent corporation. As the Executive Profiles of Applicant's senior management team reflect, these individuals have substantial experience in managing major telecommunications operations.

Applicant's financial standing is impeccable as demonstrated by the 2004 Annual Report of its parent company, SBC Communications Inc., attached hereto as **Exhibit E**.³ The attached documents demonstrate that Applicant is adequately capitalized to provide reliable, long-term service to subscribers in North Dakota. Applicant does not require construction of its own facilities, nor does it have plans to construct facilities of its own at this time. Applicant is fully funded and requires no additional external capitalization to initiate and sustain its operations. Pursuant to Commission Policy 5-06-98, Applicant has posted a bond in the amount of \$25,000, the minimum amount of financial surety required to indemnify any deposits or advanced

³ Additional financial information is available on the World Wide Web at http://www.sbc.com/investor_relations

payments collected from Applicant's North Dakota subscribers. Evidence of Applicant's bond is attached hereto as **Exhibit E**.

V. PROPOSED TARIFF

All of Applicant's proposed local exchange service in the State of North Dakota will be provided pursuant to the terms and conditions set forth in Applicant's local exchange Tariff No. 2, which Applicant filed with the Commission on May 5, 2005. For the Commission's convenience, a copy of this tariff is attached hereto as **Exhibit D**.

VI. BILLING

Applicant plans to bill all of its customers directly. All invoices for service fees and charges shall bear the name and address of Applicant, as well as bear a toll-free number for customer inquiries and complaints.

VII. CUSTOMER SERVICE

A. Individual Customer Inquiries

Customer service representatives are available twenty-four hours per day, seven days per week, and can be reached at Applicant's toll free number, (877) 366-3200.

B. Individual Customer Complaint Resolution

The customer's first point of contact for billing or service complaints is Applicant's Customer Service Department's trained representatives. If, after contacting Applicant's customer service representative, the customer remains dissatisfied, the customer may be connected with Applicant's assigned Customer Service Manager. Customers will be advised that they may contact the Commission at any time for assistance in the resolution of any issue concerning the Applicant's telecommunications service.

C. Written Complaints

Written inquires and complaints, whether from a regulatory body or other entity or person, will be reviewed by Applicant's assigned customer service management representative. Written complaints will be promptly reviewed, researched and responded to as expeditiously as possible.

VIII. STATEMENT OF COMPLIANCE

Applicant agrees and affirms to abide by all applicable statutes, orders, rules and regulations entered and adopted by the Commission for competitive local carriers in the State of North Dakota. Applicant will allow local exchange subscribers to obtain interLATA and intraLATA interexchange service from other toll carriers as well as local operator and directory services from other providers on a non-discriminatory basis and manner. Where the Applicant offers a service in a particular exchange, the Applicant will offer that same service on a non-discriminatory basis to all subscribers in that exchange. Applicant will provide its local subscribers with a local calling area that is at least as large in scope as the calling area of the incumbent local exchange carrier in the area

IX. PUBLIC INTEREST CONSIDERATION

Commission approval of the instant application will serve the public interest and result in direct benefits to local customers in the State of North Dakota. Applicant will excel in providing the desirable innovative, economic, and high-quality level of service that has been Applicant's hallmark of service for nearly a decade.

X. CONCLUSION

WHEREFORE, based upon the foregoing, Applicant, SBC Long Distance, LLC d/b/a SBC Long Distance, respectfully requests that the Public Service Commission of the State of

North Dakota grant Applicant's request for authority to provide competitive local exchange service in the State of North Dakota.

Respectfully submitted this 17 day of May, 2005.

SBC Long Distance, LLC d/b/a SBC Long Distance

By: 
Joe Carrisalez
Executive Director – Regulatory
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 West Las Positas Boulevard, Suite NE014
Pleasanton, California 94588
Telephone: (925) 468-5128
Facsimile: (707) 435-6623
E-mail: jc2352@camail.sbc.com

Eric Fishman, Esq.
Holland & Knight LLP
2099 Pennsylvania Avenue, NW
Washington, DC 20006
Telephone: (202) 828-1849
Facsimile: (202) 955-5564
E-mail: eric.fishman@hkllaw.com

Counsel to Applicant

VERIFICATION OF APPLICANT

State of California)
) ss.
County of Alameda)

I, Joe Carrisalez, being first duly sworn, do hereby depose, state that I am Executive Director - Regulatory of SBC Long Distance, LLC d/b/a SBC Long Distance ("SBC-LD"), and am authorized to make this verification on behalf of SBC Long Distance, LLC d/b/a SBC Long Distance, an Applicant for Certificate of Public Convenience and Necessity to provide resold and facilities-based competitive local exchange services in the State of North Dakota.

Under the penalties of perjury, I hereby aver that I have read the foregoing application and know the contents thereof, and as to those matters that are therein stated on information or belief, I believe them to be true.

I aver further, that SBC-LD will comply with all applicable statutes, administrative rules and orders of the Public Service Commission of the North Dakota.

SBC Long Distance, LLC d/b/a SBC Long Distance

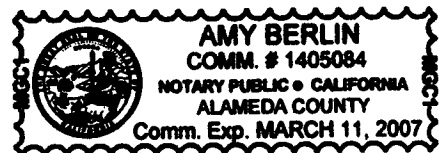
By: Joe Carrisalez

Joe Carrisalez
Executive Director - Regulatory
SBC Long Distance, LLC d/b/a SBC Long Distance
5850 W. Las Positas Blvd., Suite NE014
Pleasanton, CA 94588
Tel: (925) 468-5128
Fax: (707) 435-6623
e-mail: jc2352@camail.sbc.com

Subscribed and sworn to before me this 17th day of May, 2005. Personally known to me.

Amy Berlin
Notary Public in and for the State
of California, residing at
1697 Paseo Laguna, Livermore CA 94551

My Commission Expires: 3/11/07



**BEFORE THE
PUBLIC SERVICE COMMISSION
OF NORTH DAKOTA**

In the Matter of)
)
SBC Long Distance, LLC) Case No. _____
d/b/a SBC Long Distance)
)
For Certificate of Public Convenience and)
Necessity to Provide Competitive Facilities-Based)
Local Exchange Telecommunications Services)
Within the State of North Dakota)

LISTING OF EXHIBITS

<u>Exhibit</u>	<u>Item</u>
A	Certificate of Conversion
B	Authority to Transact Business Certificate of Trade Name Registration Certificate of Good Standing
D	Executive Profiles
E	Illustrative Local Tariff
F	Financial Statements Bond

EXHIBIT A
CERTIFICATION OF CONVERSION

Delaware

PAGE 1

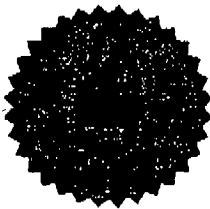
The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF CONVERSION OF A DELAWARE CORPORATION UNDER THE NAME OF "SBC LONG DISTANCE, INC." TO A DELAWARE LIMITED LIABILITY COMPANY, CHANGING ITS NAME FROM "SBC LONG DISTANCE, INC." TO "SBC LONG DISTANCE, LLC", FILED IN THIS OFFICE ON THE TWENTY-EIGHTH DAY OF APRIL, A.D. 2005, AT 9:06 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

2511836 8100V

050342192



Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

AUTHENTICATION: 3842546

DATE: 04-28-05

Delaware

PAGE 2

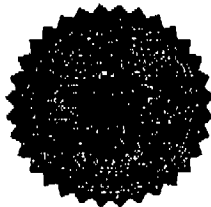
The First State

I, HARRIET SMITH WINDSOR, SECRETARY OF STATE OF THE STATE OF DELAWARE DO HEREBY CERTIFY THAT THE ATTACHED IS A TRUE AND CORRECT COPY OF THE CERTIFICATE OF FORMATION OF "SBC LONG DISTANCE, LLC" FILED IN THIS OFFICE ON THE TWENTY-EIGHTH DAY OF APRIL, A.D. 2005, AT 9:06 O'CLOCK A.M.

A FILED COPY OF THIS CERTIFICATE HAS BEEN FORWARDED TO THE NEW CASTLE COUNTY RECORDER OF DEEDS.

2511836 8100V

050342192



Harriet Smith Windsor

Harriet Smith Windsor, Secretary of State

AUTHENTICATION: 3842546

DATE: 04-28-05

State of Delaware
Secretary of State
Division of Corporations
Delivered 09:17 AM 04/28/2005
FILED 09:06 AM 04/28/2005
SRV 050342192 - 2511836 FILE

STATE OF DELAWARE
CERTIFICATE OF CONVERSION
FROM A CORPORATION TO A LIMITED LIABILITY COMPANY
PURSUANT TO SECTION 266 OF
THE DELAWARE GENERAL CORPORATION LAW AND SECTION 18-214 OF
THE DELAWARE LIMITED LIABILITY COMPANY ACT

- 1) The name of the corporation immediately prior to filing this Certificate is SBC Long Distance, Inc.
- 2) The original Certificate of Incorporation was filed in Delaware on May 31, 1995.
- 3) The original name of the corporation as set forth in the Certificate of Incorporation was Southwestern Bell Communications Services, Inc. and amended to SBC Long Distance, Inc. effective August 9, 2004.
- 4) The name of the limited liability company into which the corporation shall be converted is SBC Long Distance, LLC.
- 5) The conversion has been approved in accordance with the provisions of Section 266 of the Delaware General Corporation Law.

Dated: April 27, 2005.

By: /s/ John di Bene
Authorized Officer
Vice President, General Counsel
and Secretary

Name: John di Bene

State of Delaware
Secretary of State
Division of Corporations
Delivered 09:17 AM 04/28/2005
FILED 09:06 AM 04/28/2005
SRV 050342192 - 2511836 FILE

**CERTIFICATE OF FORMATION
OF
SBC LONG DISTANCE, LLC**

The undersigned authorized person, acting under §18-201 of the Delaware Limited Liability Company Act, certifies as follows:

1. The name of the limited liability company is SBC Long Distance, LLC.
2. The address of its registered office in the State of Delaware is Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.
3. The nature of the business or purposes to be conducted or promoted is to engage in any lawful business or activity for which limited liability companies may be organized under the Delaware Limited Liability Company Act.
4. The company is to be managed by one or more managers as determined by its member pursuant to a Limited Liability Company Operating Agreement to be adopted by the sole member of the company.

IN WITNESS WHEREOF, the undersigned has executed this Certificate on April 27, 2005 and declares that the facts herein stated are true and correct.

AUTHORIZED PERSON:

/s/ John di Bene
John di Bene
Authorized Person
Vice President, General Counsel
and Secretary

EXHIBIT B

**AUTHORITY TO TRANSACT BUSINESS
CERTIFICATE OF TRADE NAME REGISTRATION
CERTIFICATE OF GOOD STANDING**

**(filed applications; certificates to be submitted
once issued by North Dakota Secretary of State)**



**CERTIFICATE OF AUTHORITY
FOREIGN CORPORATION
APPLICATION**
SECRETARY OF STATE
SFN 13100A (13100 + 7974) (7-99)

FOR OFFICE USE ONLY

ID #	
WO #	
Filed	By

SEE REVERSE SIDE FOR FEES, FILING AND MAILING INSTRUCTIONS

- 1 A The application **MUST** be accompanied by ALL of the following:
- Filing fee of \$125 if a Foreign Business or Professional Corporation
 - Filing fee of \$40 if a Foreign Nonprofit Corporation
 - Signed Consent of Registered Agent and fee of \$10
 - Current, ORIGINAL CERTIFICATE OF GOOD STANDING OR CERTIFICATE OF EXISTENCE verifying corporate existence certified by the incorporating officer of the state or country of incorporation.
- B The following **MAY** be required:
- Certification of professional license from the North Dakota licensing board for the profession
 - Signed consent to use of name and fee of \$10
 - Trade Name Registration and fee of \$25

TYPE OR PRINT LEGIBLY For reference, see North Dakota Century Code, Section 10-19.1-135 or 10-33-125.

2 Type of corporation applying for Certificate of Authority (check one)

Foreign Business Foreign Professional Foreign Nonprofit

3 A Name of corporation **EXACTLY** as it appears on Certificate of Good Standing from state of origin
SBC Telecom, Inc

B. Federal ID #
74-2899863

C. If the corporation chooses to use a name other than its corporate name, that name is a trade name and must be registered with the North Dakota Secretary of State. (SEE INSTRUCTION 3.C.) If applicable, provide the trade name below and complete the Trade Name Registration form if the selected trade name is not already registered in North Dakota.

- D. If the corporation has been notified by the North Dakota Secretary of State that its corporate name is the same as, or deceptively similar to a name already registered, this application for Certificate of Authority must be accompanied by one of the following. (check one)
- Consent to use of name from the conflicting name holder(s)
 - An application for registration of a trade name for use in transacting business in North Dakota. The trade name adopted is.

Certified copy of a final decree of a court of competent jurisdiction establishing prior right of this corporation to use of the name in North Dakota

4. Complete mailing address of principal executive office which may not only be a post office box (Street/RR, and PO Box if applicable, city, state, zip + 4) 175 East Houston St., San Antonio, Texas 78205

5.A STATE or country where incorporated Delaware	B. EXACT date incorporated (Month, day, AND year) 11/20/1998	C. Duration of corporation <input checked="" type="checkbox"/> Perpetual <input type="checkbox"/> Other (Specify)	D. Telephone # 210 351 3426
			E Toll-free telephone #

8 A. Name of required registered agent in **NORTH DAKOTA** (SEE INSTRUCTION 6.A.)
C T Corporation System

B. Federal ID/social security # of registered agent
51-0006522

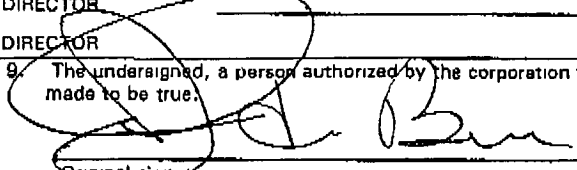
C Address of registered agent in **NORTH DAKOTA** which may not only be a post office box number (Street/RR, and PO Box if applicable, city, state, zip + 4) 314 Thayer Avenue, Bismarck, North Dakota 58501-4018

7 Nature of business or activities the corporation intends to conduct in the State of North Dakota

holding company

		OFFICERS AND DIRECTORS OF THE CORPORATION						
OFFICE	Check box if officer also serves as director	NAME	COMPLETE MAILING ADDRESS					Zip + 4
			Street/RR	PO Box	City	State		
PRESIDENT	<input type="checkbox"/>	please see attached						
VICE PRESIDENT	<input type="checkbox"/>							
SECRETARY	<input type="checkbox"/>							
TREASURER	<input type="checkbox"/>							
DIRECTOR								
DIRECTOR								

9 The undersigned, a person authorized by the corporation to sign this application, knows the contents thereof, and believes the statements made to be true.

 Original signature

15/2/05 Date

10. Name of person to contact about this application
John di Bene, VP, Gen Cnsl and Secretary

Daytime telephone #

SBC TELECOM, INC.**DIRECTORS**

Directors	BUSINESS OFFICE ADDRESS
Yno Gonzalez Chairman and President	5850 West Las Positas Pleasanton, CA 94588
Bill McCracken Director and Comptroller	5850 West Las Positas Pleasanton, CA 94588

OFFICERS

OFFICER / TITLE	BUSINESS OFFICE ADDRESS
Yno Gonzalez President	5850 West Las Positas Pleasanton, CA 94588
John di Bene Vice President, Gen. Counsel and Secretary	5850 West Las Positas Pleasanton, CA 94588
Larry Ruzicka Vice President-Taxes	175 E. Houston St. San Antonio, TX 78205
Bill McCracken Comptroller	5850 West Las Positas Pleasanton, CA 94588
Kevin T. Fix Treasurer	175 E. Houston St. San Antonio, TX 78205
Thomas S. Clemens Assistant Treasurer	175 E. Houston St. San Antonio, TX 78205



**REGISTERED AGENT
 CONSENT TO SERVE**
 SECRETARY OF STATE
 SFN 13100A (7974 + 13100) (7-99)

FOR OFFICE USE ONLY

ID #	
File #	
WO #	
Filed	By

SEE REVERSE SIDE FOR FILING AND MAILING INSTRUCTIONS

1. FILING FEE: \$10.00

TYPE OR PRINT LEGIBLY

2. Name of the organization for which the registered agent is to serve (corporation, limited liability company, limited liability partnership, limited partnership, limited liability limited partnership or real estate investment trust)

3. Name of the registered agent

C T Corporation System

4. Registered agent is (Check one)

- An individual North Dakota resident
- A corporation
- A limited liability company
- A limited liability partnership

5. Federal ID # or social security # of registered agent

51-0006522

6. An individual appointed as registered agent must sign a consent to serve in that capacity. When a corporation, a limited liability company, or limited liability partnership is named as registered agent, an officer or someone authorized by the organization may sign on behalf of the corporation, limited liability company, or limited liability partnership.

"The undersigned, as the newly appointed registered agent, agrees to act as the registered agent for this organization until a change, or resignation, is submitted to the Secretary of State under the provisions of North Dakota law."

C T Corporation System

By. _____

Original signature of registered agent

Date



**TRADE NAME
REGISTRATION**
SECRETARY OF STATE
SFN 13401 (10-03)

FOR OFFICE USE ONLY

ID Number.	
WO Number.	
Filed	By
Expiration Date.	

SEE REVERSE SIDE FOR FEES, FILING AND MAILING INSTRUCTIONS

1. FILING FEE \$25.00
Five Year Registration

TYPE OR PRINT LEGIBLY

For reference, see North Dakota Century Code, Chapter 47-25.

2. Trade Name: SBC Long Distance					
3. Address of the principal place of business. (Street, RR, PO Box) 5850 West Las Positas Blvd.		City: Pleasanton	State: CA	Zip Code + 4. 94588-8522	
4. The nature of the business transacted. (In detail) telecommunications					
5. Trade name is used and owned by. (Select one)					
<input type="radio"/> Individual		<input type="radio"/> Corporation Incorporated in state of _____			
<input type="radio"/> Husband & Wife		<input checked="" type="radio"/> Limited Liability Company organized in state of <u>Delaware</u>			
<input type="radio"/> Other - Define (See instructions) _____					
6. Telephone number of owner.			7. Toll-free telephone number:		
8. The name of the individual(s), corporation, or the limited liability company, using the trade name, their Federal ID/Social Security Number, and the address of their principal place of business.					
NAME		FEDERAL ID/ SOCIAL SECURITY NUMBER	COMPLETE ADDRESS Street/RR PO Box City State Zip Code + 4		
SBC Long Distance, LLC		74-2746907	5850 West Las Positas Blvd., Pleasanton, CA 94588-8522		
9. "I (We), the owner(s), say that I (we) have read the foregoing registration, know the contents thereof, and believe the statements made to be true."					
Signature: John-di Bene, VP, Gen. Cnsl and Secretary			Date:		
Signature:			Date:		
10. Name of person to contact about this form:		E-Mail Address.		Daytime telephone number:	

EXHIBIT C
EXECUTIVE PROFILES

Executive Profiles

Applicant's executive officers have been recruited from the parent company and its affiliates and are among its key managers. Together, Applicant's executive officers have several decades of experience in the telecommunication industry, including operations, interconnection, network, marketing, sales, finance, regulatory and legal issues. The executive officers, consequently, have the managerial ability to operate the company and provide the services that Applicant proposes to provide within North Dakota. The following paragraphs briefly describe the backgrounds of Applicant's executive officers.

A. YNO GONZALEZ, PRESIDENT

Yno Gonzalez is president of SBC Long Distance, LLC ("SBC LD"). In this position, he is responsible for network operations for SBC LD and manages the network operations partnership with WilTel Communications. He was appointed to this position on January 16, 2003.

Mr. Gonzalez, who began his career with Pacific Bell in 1980, has held various leadership positions in human resources, network engineering, network operations, and core process reengineering.

He previously held the title of VP-Network Operations over SBC LD, SWB Video Services and SBC Messaging. He became vice president-core network operations in Pacific Bell's Network Services Group in 1997. In this position, he was responsible for managing the Network Operations Centers in Sacramento and San Diego, the Statewide and Electronic Systems Assistance Center (ESAC), and Radio Operations for Pacific Bell, as well as managing a team of 200 Technical Support Personnel. Mr.

Gonzalez also was responsible for site management for 700 Pacific Bell Central Offices and Radio Sites.

Mr. Gonzalez is a member of the HACEMOS organization and the Mathematics, Engineering, Science Achievement (MESA) program of the University of California. Gonzalez graduated from the University of Southern California with a degree in electrical engineering. He completed the Advanced Technology Innovation program for executives at Carnegie Mellon University.

B. WILLIAM H. MCCRACKEN, COMPTROLLER

Mr. McCracken is the Vice President – Chief Financial Office of SBC LD. Mr. McCracken has 16 years of experience in the telecommunication industry. Specifically, Mr. McCracken has experience relating to finance, accounting, and marketing. Before joining SBC LD, Mr. McCracken held positions within SBC's corporate financial planning, investor relations, regulatory accounting, and billing operations. Mr. McCracken earned a Bachelors degree in Marketing and a Master of Science degree in Business Computer Science from Texas A&M University. Mr. McCracken is licensed by the State of Texas as a certified public accountant.

C. JOHN DI BENE, VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY

Mr. di Bene has more than thirteen years' experience in telecommunications law. As Vice President and General Counsel of SBC LD, his responsibilities include oversight of all state and federal regulatory filings, issuance of all authorized notices for meetings of the stockholders of the Board, and maintenance of corporate records. Before joining the company, Mr. di Bene spent three years as Senior Counsel in SBC's antitrust and regulatory legal group, assisting with SBC's applications before the Federal

Communications Commission (FCC) to provide long distance services. Mr. di Bene also has represented SBC and Pacific Bell in numerous proceedings before the FCC and state commissions. Prior to representing Pacific Bell, he practiced with Blumenfeld & Cohen and Jenner & Block. Mr. di Bene received a Juris Doctor *cum laude* from Georgetown University Law Center in 1988, and a Bachelor of Arts *cum laude* from the University of Alaska, Fairbanks in 1985. He is a member of the California and District of Columbia Bar Associations.

D. KEVIN FIX, TREASURER

Mr. Fix serves as Treasurer of SBC LD. He has held a variety of positions within SBC's finance organization since joining the company in 1996, and is currently Executive Director of Corporate Finance for SBC Communications Inc. Prior to his current position, Mr. Fix was Sr. Vice President and Treasurer at TDC A/S, a Danish communications company and one of SBC's international investments. Before joining SBC, Mr. Fix worked at Arthur Andersen & Co. and CBI Industries Inc., both in Chicago, Illinois. Mr. Fix received a B.S. in Accounting from Miami University (Ohio) and an M.B.A. from the University of Chicago.

E. LARRY RUZICKA, VICE PRESIDENT – TAXES

Larry Ruzicka is the Vice President – Taxes for SBC LD. He is responsible for the direction and coordination of tax policy, research and planning, compliance, accounting and audits for all tax matters at SBC and its subsidiaries. Mr. Ruzicka joined the SBC tax department in 1988 and has been extensively involved with merger and acquisition activity as well as other research and planning projects. Prior to joining SBC, Mr. Ruzicka was with Touche Ross & Co. in St. Louis.

F. THOMAS S. CLEMENS, ASSISTANT TREASURER

Mr. Clemens is Assistant Treasurer of SBC LD. After nine years experience in banking and the construction industry, Mr. Clemens joined SBC Communications Inc. as a Specialist - Cash Management in 1997. Since then, Mr. Clemens has progressed through positions of increasing responsibilities in cash management and benefit plan investment administration. Mr. Clemens was recently appointed Director - Corporate Finance for SBC Communications, Inc. Mr. Clemens has a BBA, Finance from the University of Texas, Austin.

EXHIBIT D
LOCAL TARIFF

SBC LONG DISTANCE, LLC
D/B/A SBC LONG DISTANCE

RATES, RULES AND ADMINISTRATIVE REGULATIONS FOR FURNISHING

LOCAL EXCHANGE SERVICES

WITHIN THE STATE OF NORTH DAKOTA

This Tariff ("Tariff") contains the descriptions, regulations, and rates applicable to the furnishing of competitive, presubscribed resold and facilities-based local exchange telecommunications services provided by SBC Long Distance, LLC d./b/a SBC Long Distance ("Company") within the State of North Dakota. This tariff is on file with the North Dakota Public Service Commission ("Commission"). Copies may be inspected during normal business hours at Company's principal place of business, 1010 N. St. Mary's, San Antonio, Texas 78215.

"All references to SBC Long Distance, LLC, SBC Long Distance, Inc., Southwestern Bell Communications Services, Inc., SBC Long Distance and SBC Telecom, Inc. are to be considered interexchangeable for purposes of these tariff schedules SBC Long Distance, LLC assumes the rates, conditions and obligations of the appropriate tariffs on file with the Public Utilities Commission of the State of North Dakota under the name of SBC Long Distance, Inc. and SBC Telecom, Inc "

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CHECK PAGE

The pages of this Tariff are effective as of the date shown at the bottom of the respective page. Original and revised pages as named below comprise all changes from the original Tariff.

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APPLICATION OF THE TARIFF

- A. This Tariff sets forth the Service offerings, rates, terms and conditions applicable to the furnishing of intrastate communications Services by the Company to Customers within the local exchange Service area defined herein.
- B. The Company operates in some areas as a facilities-based provider of local exchange Service and, in others, as a reseller of the Services of a Local Exchange Carrier.
- C. The rates and regulations contained in this Tariff apply only to the Services furnished by Company and do not apply, unless otherwise specified, to the lines, facilities, or Services provided by a Local Exchange Carrier or other common Carrier for use in accessing the Services of Company.
- D. The Company shall not be deemed to have waived or impaired any right, power, requirement or option reserved by this Tariff (including, but not limited to, the right to demand exact compliance with every term and condition herein), by virtue of any custom or practice of the Company at variance with the terms hereof, or any failure, refusal or neglect of Company to exercise any right under this Tariff or to insist upon exact compliance with its terms, or any waiver, forbearance, delay, failure or omission by Company to exercise any right, power or option hereunder.
- E. The provision of Services are subject to existing regulations and terms and conditions specified in this Tariff and may be revised, added to or supplemented by superseding Tariffs
- F. The Company reserves the right to offer its Customers a variety of Services as deemed appropriate by the Company.
- G. The Company will provide Services requested by Customers, which Services are not included in this Tariff, depending on equipment and facility availability and economic considerations Pricing for these Services will be accomplished on an Individual Case Basis (ICB) Contract.
- H. The Services included in this tariff are intended for purchase by end-use retail Customers. Interexchange Carriers (IXC) should consult the Access Tariff to order Services for resale purposes or enter into an ICB Contract.

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EXPLANATION OF SYMBOLS

The following are the only symbols used for the purposes indicated below:

- (C) To signify changed condition or regulation
- (D) To signify deleted or discontinued rate, regulation or condition
- (E) To signify an error or a correction
- (F) To signify a change in format or numbering
- (I) To signify a change resulting in an increase to a Customer's bill
- (M) To signify that material has been moved from another tariff location
- (N) To signify a new rate, regulation condition or sheet
- (R) To signify a change resulting in a reduction to a Customer's bill
- (T) To signify a change in text but no change to rate or charge

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TARIFF FORMAT

- A. Page Numbering - Page numbers appear in the upper right hand corner of each page. Pages are numbered sequentially. However, new pages are added to the Tariff from time to time. When a new page is added between pages already in effect, a decimal is added. For example, a new page added between pages 14 and 15 would be 14. 1.
- B. Page Revision Numbers - Revision numbers also appear in the upper right hand corner of each page. These numbers are used to determine the most current page version on file with the Commission. For example, the 4th revised page 14 cancels the 3rd revised page 14. Because of various suspension periods, deferrals, *etc.* the Commission follows in its Tariff approval process, the most current page number on file with the Commission is not always the Tariff page in effect.
- C. Paragraph Numbering Sequence - There are six (6) levels of paragraph coding. Each level of coding is subservient to its next higher level:
- 2.1
 - 2.1.1
 - 2.1.1 A.
 - 2.1.1 A.1
 - 2.1.1 A.1.a
 - 2.1.1 A.1.a.1
- D. Check Pages - When a Tariff filing is made with the Commission, an updated check page accompanies the Tariff filing. The check page lists the pages contained in the Tariff with a cross-reference to the current revision number. When new pages are added, the check page is changed to reflect the revision. An asterisk (*) designates all revisions made in a given filing. There will be no other symbols used on this page if these are the only changes made to it. The Tariff user should refer to the latest check page to find out if a particular page is the most current on file with the Commission.

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1. DEFINITIONS

Certain terms used generally throughout this Tariff are defined below.

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

Applicant: Any entity or individual who applies for Service offered under this Tariff.

Authorized User. An end user authorized by the Customer to use the Service.

Business Customer: A Customer that uses a Business Service Offering as set forth in this Tariff.

Carrier: A company authorized by the North Dakota Public Service Commission to provide telecommunications Services.

Central Office: A local exchange switching unit that is used to interconnect Exchange Access Lines within a specified area.

Channel or Circuit: A path for transmission between two (2) or more points having a bandwidth and termination of Customer's own choosing.

Channel Mileage: Distance calculated using the telephone industry standard Rate Centers ("V" & "H") between Company's and Customer's Premises

Collect Call: A billing arrangement where a call is billed to the called station.

Commission: North Dakota Public Service Commission

Company: Southwestern Bell Communications Services, LLC d/b/a SBC Long Distance

Contract: An agreement between Customer and Company in which the two (2) parties agree upon specifications, terms, pricing, and other conditions of Service. The Contract may or may not accompany an associated Service Order.

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1. DEFINITIONS, Continued

Customer: A person, firm, corporation or other entity which orders or uses Service who, by receiving and using the Service, has agreed to honor the terms of the Service herein, and is responsible for the payment of rates and charges for Service to all Customer locations and for compliance with Tariff regulations.

Customer Premises Equipment (“CPE”): Equipment located at the Customer’s Premises for use with the Company’s Services. CPE can include, for example, a station set, facsimile machine, key system, PBX, or other voice and data communication equipment.

Demarcation Point: Denotes the point of interconnection between the Company’s facilities and the wiring at the Customer’s Premises.

Deposit: Refers to a cash or equivalent of cash security held as a guarantee for payment of the charges for Services.

DID Trunk: A form of local switched access that provides the ability for an outside party to call an internal extension directly without the intervention of a Company operator.

Digital: A method of storing, processing and transmitting information through the use of distinct electronic or optical pulses that represent binary digits (bits) 0 and 1. Digital transmission/switching technologies employ a sequence of discrete, individually distinct pulses to represent information, as opposed to the continuously variable signal of analog technologies.

Direct Inward Dial (“DID”): A Service attribute that routes incoming calls directly to stations, by-passing a central answering point.

Directory Assistance Service: A Service whereby Customers may dial a special directory assistance code or telephone number to reach an operator or automatic Interactive Voice System (“IVS”) that will provide available, published directory listings.

DSL: Digital Subscriber Line.

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1. DEFINITIONS, Continued

DS-1: Digital Service, Level 1. A 1 544 Mbps dedicated Digital transmission connection furnished by the Company that may either be a connection between a Customer's Premises and the Company's Premises or a connection between two (2) Customer Premises.

DS-3: Digital Service, Level 3. The equivalent of 28 DS-1 Channels and capable of operating at 44.736 Mbps. (Also called a T-3)

Dual Tone Multi-Frequency ("DTMF"): The signaling type employed by dial tone station sets.

E-911/911: An emergency Service whereby a Customer dials a 911 emergency code or other emergency number and is then connected to an emergency agency responsible for the dispatch of emergency assistance. E911 and 911 are used interchangeably to refer to any emergency dialing arrangement.

Exchange Access Lines: Central Office equipment and related facilities, including the Network interface, which provide access to and from the telecommunications Network

Exchange Area: A geographically defined area described through the use of maps or legal descriptions to specify areas where individual telephone exchange companies hold themselves out to provide local communications Services.

FCC: Federal Communications Commission.

Force Majeure: Causes beyond the Company's control, including but not limited to: acts of God, fire, flood, explosion or other catastrophes; any law, order, regulation, direction, action or request of the United States Government, or of any other government, including state and local governments having or claiming jurisdiction over the Company, or of any department, agency, commission, bureau, corporation, or other instrumentality of any one or more of these federal, state, or local governments, or of any civil or military authority; national emergencies; insurrection; riots; wars; unavailability of rights-of-way or materials; or strikes, lock-outs, work stoppages, fraudulent acts of a third party, or other labor difficulties.

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1. DEFINITIONS, Continued

Holidays: New Year's Day, Memorial Day, Independence Day, Labor Day, Thanksgiving Day, Day After Thanksgiving and Christmas Day.

Individual Case Basis ("ICB"): A Service arrangement in which the regulations, rates and charges are developed based on the specific circumstances of the Customer.

Interexchange Carrier ("IXC"): A long distance telecommunications Services provider.

ISDN: Integrated Services Digital Network. A Digital technology that allows the provision of more than one (1) communication path, called a Channel, over the same copper wire arrangement that provides traditional telephone Service.

Local Exchange Carrier ("LEC"). A provider of local telephone Service.

LERG: Local Exchange Routing Guide. A Telcordia document which lists all North American Class 5 Offices (Central Offices, or end offices) and which describes their relationship to Class 4 Offices (Tandem Offices).

Local Calling Area: The area within which a subscriber for local exchange Service may make telephone calls without incurring a long distance charge.

Mbps: Megabits per second or millions of bits per second.

Non-Recurring Charge ("NRC"): The initial charge, usually assessed on a one-time basis, to initiate and establish Service. NRC includes, but is not limited to, charges for construction, installation, or special fees for which the Customer becomes liable at the time the Service Order is executed.

NPA: Numbering plan area or area code.

NXX: The first three digits of a seven-digit telephone number.

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1. DEFINITIONS, Continued

Operator Services: Assistance by an operator or automated Interactive Voice System (“IVS”) whereby Customers may request, for example, assistance in dialing a number, calling person to person, billing a call to a calling card or to a third number, or calling collect.

PBX: Private Branch Exchange.

Person-to-Person: A call for which the person originating the call specifies to the operator a particular person, department or extension to be reached. Person-to-Person charges only apply when the call is completed to the requested party, department, or extension or when the calling party agrees to talk to another person.

Point of Presence (“POP”): Refers to a location or site containing telecommunications equipment that can include, but is not limited to, switches, multiplexers, modems, leased lines, and routers. A Carrier's Point of Presence usually means a location where the Carrier connects to other Carriers or its Customers.

Premises: Denotes a building, a portion of a building in a multitenant building, or buildings on contiguous property (except railroad rights-of-way, etc) not separated by a public thoroughfare.

Private Line Service: Denotes non-switched point-to-point Service over fully dedicated lines.

Rate Center: Denotes a geographically specified point used to determine distance dependent rates.

Residential Customer: A Customer that uses a Residential Service Offering as set forth in this Tariff.

Recurring Charges: Charges that are assessed for Services included within this Tariff on a recurring, monthly basis.

Service: The telecommunications Services offered by the Company.

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1. DEFINITIONS, Continued

Service Area: The area in which the Company provides Service.

Service Connection Charge: A one-time charge, which applies for Company work associated with activities to set up/change accounts, including, but not limited to, Service Order issuance, programming, billing, etc., for installations, moves, changes, or rearrangements of Services and/or equipment.

Service Order: The request for facilities or Service by an Applicant or Customer. The request may be in writing, or orally, at the Company's discretion. Acceptance by the Company initiates the respective obligations of the parties as set forth therein and pursuant to this Tariff, but the duration of the Service is calculated from the Services Start Date.

Service Start Date: The first day following the date on which the requested Service or facility is available for use.

Station: Telephone equipment from or to which calls are placed.

Station-to-Station: Any operator handled call where the person originating the call does not specify a particular person to be reached, or a particular station, room number, department, or office to be reached through a PBX attendant.

Telcordia: An independent telecommunications research company.

Telecommunications Relay Service ("TRS"): Enables deaf, hard-of-hearing or speech-impaired persons who use a text telephone or similar devices, to communicate freely with the hearing population not using text telephone and visa versa.

Termination of Service: Discontinuance of both incoming and outgoing Service.

Third Number Billing: A billing option that allows a call to be billed to an account different from that of the calling or called party.

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1. DEFINITIONS, Continued

Trunk: A communications path, connecting two (2) switching systems in a network, used in the establishment of an end-to-end connection.

Two-Way: A Service attribute that includes dial capabilities for outbound calls and can also be used to carry inbound calls to a central point for further processing.

V & H: Vertical and Horizontal geographic coordinates.

White Pages Directory Listing: A directory listing found in the local White Pages telephone directory.

2. REGULATIONS

2.1. Undertaking of the Company

2.1.1. Scope

- A. The Company undertakes to provide and is only responsible for the Services offered in this Tariff on the terms and conditions and at the rates and charges specified herein. The Company may offer various unregulated Services in conjunction with or ancillary to its regulated Services. The Company is not responsible to any other entity or its respective customers for any Service provided by the other entity that purchases access to the Company network or uses any of the Company's facilities or Services, in order to originate or terminate its own Services, or to communicate with its own customers.

2.1.2. Shortage of Equipment and Facilities

Service is offered subject to; the availability of facilities, equipment, or systems; the Company's ability to fulfill the request for Service and, the provisions of this Tariff. Service is not offered where operating conditions do not permit. The Company reserves the right, without incurring liability, to refuse to provide or to limit Service to or from any location where the necessary facilities, equipment, systems, interconnection arrangements, billing arrangements, and/or switch software are not available.

2.1.3. Terms and Conditions

A. Minimum Contracts

1. Except as otherwise provided herein, Service is provided and billed on the basis of a minimum period of at least one (1) month, and shall continue to be provided on a monthly basis until canceled by the Customer. Unless otherwise specified herein, for the purpose of computing charges in this Tariff, a month is considered to have thirty (30) calendar days. All calculations of dates set forth in this Tariff will be based on calendar days, unless otherwise specified herein.

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2. REGULATIONS

2.1. Undertaking of the Company, Continued

2 1.3. Terms and Conditions, Continued

A. Minimum Contracts, Continued

2. Except as provided in this Tariff, the length of minimum Contract period for directory listings is the directory period. The directory period is from the day on which the directory is first distributed to the Customers to the day the succeeding directory is first distributed to Customers.
3. The Company may require a minimum Contract period longer than one (1) month at the same location in connection with special (non-standard) types or arrangements of equipment, or for unusual construction or special Service terms, necessary to meet special demands and involving extra cost or expense.

B. Customers may be required to enter into written Service Orders which will contain or reference the name of the Customer, a specific description of the Service ordered, the rates to be charged, and the duration of the Services. Customers will also be required to execute any other documents as may be requested by the Company.

C. Except as otherwise stated in the Tariff or by Contract, at the expiration of the initial term specified in the applicable Service Order, or in any extension thereof, Service shall continue on a month to month basis at the then current Tariff rates until terminated by either party. The Company and Customer may agree that the Service shall automatically renew for the term of the initial Contract. Any termination shall not relieve Customer of its obligation to pay any charges incurred under the Service Order and this Tariff prior to termination. The rights and obligations that by their nature extend beyond the termination of the term of the Service Order shall survive such termination.

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2. REGULATIONS, Continued

2.1. Undertaking of the Company, Continued

2.1.3. Terms and Conditions, Continued

- D. Another telephone company or provider of telecommunications Service must not interfere with the right of any person or entity to obtain Service directly from the Company. The Customer is absolutely prohibited from reselling the Company's Services unless done in compliance with state and federal laws, rules and regulations, and with written permission from the Company.
- E. The Customer has no property right to the telephone number or any other call number designation associated with Services furnished by the Company. Except as provided by state or federal requirements, the Company reserves the right to change such numbers, or the Central Office designation associated with such numbers, or both, assigned to the Customer, whenever the Company deems it necessary to do so in the conduct of its business.

2 1.4. Notification of Service-Affecting Activities

Where possible, the Company may, at its sole discretion, provide the Customer reasonable notification of Service affecting activities that may occur in normal operation of its business. Provided, however, when the Company plans to interrupt Service for more than four hours to perform necessary repairs or maintenance, it will attempt to inform affected Customers at least 24 hours in advance of the scheduled date and estimated duration of the Service interruption.

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2. REGULATIONS, Continued

2.1. Undertaking of the Company, Continued

2.1.5. Taxes, Surcharges, and Fees

- A. The Customer is responsible for the payment of any sales, use, gross receipts, universal service, excise, access, 911/E911, Telephone Relay Service, subscriber line, franchise, occupation, business, license, privilege or other local, state, or federal charges or surcharges, however designated, whether assessed directly on the Company or assessed on another company or Carrier and passed on to the Company (hereinafter individually or collectively referred to as "Fees"), as determined and billed by the Company. The rates for Services provided in this Tariff, unless otherwise specified herein, do not include Fees. Fees imposed by a particular jurisdiction (*e g*, county or municipality) will be billed only to those Customers with lines in the affected jurisdiction. When the Company by virtue of collecting Fees incurs costs that would not otherwise normally be incurred, all such costs shall be determined by the Company and billed, insofar as practical, to the Customers with lines in the affected jurisdiction. The Customer is responsible for any Fees that become applicable retroactively.
- B. Should a local, state or federal jurisdiction assert a right to impose Fees on the Company's operations, the Company may elect to bill the Customer and collect such Fees or it may elect not to do so, pending the conclusion of any challenges to such jurisdiction's right to impose Fees. If it has billed and collected the Fees and the Fees later are found to have been invalid and unenforceable, the Company shall credit or refund such amounts to affected Customers, less a reasonable administrative fee, only if the Fees collected were retained by the Company or the Fees delivered to the jurisdiction in question were later returned to the Company. If the Fees were paid to the jurisdiction in question and not returned to the Company, the Customer agrees that his/her/its recourse is against the jurisdiction in question and not against the Company. The Customer specifically agrees to hold the Company harmless from any and all liability for Fees that were delivered to the jurisdiction in question and not returned to the Company.

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2. REGULATIONS, Continued

2.1. Undertaking of the Company, Continued

2.1.6. Interconnection with Other Carriers

Interconnection with the facilities or service of other Carriers shall be under applicable terms and conditions of an interconnection agreement. Any special interface equipment or facilities necessary to achieve compatibility between facilities of the Company and other participating Carriers will be provided at the Customer's expense.

2.2. Limitations on Liability/Indemnity

2.2.1. The Company shall not be liable to the Customer or Authorized User for, and the Customer and any Authorized User, jointly and severally, shall indemnify, defend and hold harmless the Company from, any allegation, claim, loss, damage, liability, defect, cost or expense resulting from or involving:

- A. Libel, slander, or invasion of privacy from material, data, information or other content transmitted over the Company's facilities; or
- B. Patent or trademark infringement or other infringement of intellectual property rights including, but not limited to, copyrights, trademarks, and trade secrets, arising from (1) combining (or using in connection with) Company-provided Services and equipment with any facilities, services, functions, or products provided by the Customer or Authorized User or (2) use of Services, functions, or products the Company furnished in a manner the Company did not contemplate and over which the Company exercises no control. In the event that any such infringing use is enjoined, the Customer or Authorized User at its expense, shall obtain immediately a dismissal or stay of such injunction, obtain a license or other agreement so as to extinguish the claim of infringement, terminate the claimed infringing use, or modify such combination so as to avoid any such infringement; or

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.1., Continued

- C. A breach in the privacy or security of communications transmitted over its facilities; or
- D. Acts, mistakes, omissions, interruptions, delays, errors or defects in transmission over Company's facilities or equipment; or
- E. Injuries to persons or property from voltages or currents transmitted over Company-provided facilities caused by Customer-provided equipment or Premises wire; or
- F. The disconnection of Service for failure to pay the charges billed to Customer, including but not limited to, any direct, indirect, incidental, special, consequential, exemplary or punitive damages, so long as such disconnection of Service complied with the applicable Commission rules and regulations; or
- G. Violations of the obligations of the Customer section of this Tariff; or
- H. Defacement of or damage to Customer Premises resulting from the furnishing of Services or equipment on such Premises or the installation, maintenance, repair or removal thereof, unless such defacement or damage is caused by willful misconduct of the Company's agents or employees; or
- I. The interruption of a call to any party or any other person in conjunction with use of the Busy Line Verification and Interrupt Service as set forth in this Tariff; or

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.1., Continued

- J Any loss, destruction or damage to property of the Company, the Company's agent, distributors or any third party, or the death of or injury to persons, including, but not limited to, employees or invitees of either the Company or the Customer, to the extent caused by or resulting from the negligent or intentional act or omission of the Customer, its employees, agents, representatives, invitees or Authorized Users; or
- K Any delay or failure of performance or equipment due to a Force Majeure condition; or
- L Misrepresentation of, or the failure to disclose, the lawful rates and charges published in this Tariff, so long as the Company has complied with any applicable Commission rules and regulations related thereto; or
- M Fees the Company delivered to a jurisdiction in question and not returned to the Company as provided in the Taxes, Surcharges, and Fees section of this Tariff; or

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.1., Continued

- N. Any act, mistake, omission, interruption, delay, error, or defect caused by or contributed to by:
1. Another company or Carrier, or their agents or employees, when the facilities or equipment of the other company or Carrier are used for or with the Services the Company offers. This includes the provision of a signaling system or other database by another company; or
 2. The Customer, or any third party acting as its agent, in connection with Company-provided or Customer-provided facilities or equipment, including, but not limited to, the Customer's failure to take all necessary steps to obtain, install and maintain all necessary equipment, materials and supplies for interconnecting the terminal equipment or communications system of the Customer to the Company's network; or
 3. A third party.
- O. Any failures, errors, malfunctions or omissions of Caller ID Blocking as set forth in this Tariff, whether or not arising from or relating to any ordinary negligence or other conduct by the Company.

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.2. The liability of the Company for damages arising out of the furnishing of, or failing to furnish, its Services, including but not limited to mistakes, omissions, disconnection, interruptions, delays, acts of a third party, errors, defects, or representations, whether caused by acts or omissions shall be limited to the extension of allowances for interruption as set forth herein. The extension of such allowances for interruptions shall be the sole remedy of the Customer and the sole liability of the Company. The Company will not be liable for any direct, indirect, incidental, special, consequential, exemplary or punitive damages to Customer as a result of any Company Service, equipment or facilities, acts of a third party, or the acts or omissions, or negligence of the Company, its employees or agents.

2.2.3. The liability of the Company's suppliers and vendors for damages arising out of the furnishing of, or failing to furnish, their Services, including but not limited to mistakes, omissions, disconnection, interruptions, delays, errors, defects, or representations, whether caused by acts or omissions of such suppliers and vendors shall be limited to the extension of allowances for interruption as set forth. The extension of such allowances for interruptions shall be the sole remedy of the Customer and the sole liability of the Company's suppliers and vendors. The Company's suppliers and vendors and their directors, officers or employees, will not be liable for any direct, indirect, incidental, special, consequential, exemplary or punitive damages to Customer as a result of any Service, equipment or facilities, or the acts or omissions, or negligence of the Company's suppliers and vendors, its directors, officers or employees.

2.2.4. The entire liability of the Company for any claim, loss, damage or expense from any cause whatsoever shall in no event exceed sums actually paid to the Company by the Customer for the specific Services giving rise to the claim, and no action or proceeding against the Company shall be commenced more than one (1) year after the Service is rendered.

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.5. THE COMPANY MAKES NO WARRANTIES OR REPRESENTATIONS, EXPRESS OR IMPLIED, INCLUDING BUT NOT LIMITED TO, ANY WARRANTY OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE, WITH RESPECT TO ITS SERVICE, EXCEPT THOSE EXPRESSLY SET FORTH IN THIS TARIFF.

2.2.6. The liability of the Company for errors in billing that result in overpayment by the Customer shall be limited to a credit equal to the dollar amount erroneously billed or, in the event that payment has been made and Service has been discontinued, to a refund of the amount erroneously billed

2.2.7. Emergency 911 Service

A. This Service is offered solely as an aid in handling calls in connection with fire, police, and other emergencies. The Company is not responsible for any losses, claims, demands, suits or any liability whatsoever, whether suffered, made, instituted or asserted by the Customer or by any other party or person for any personal injury to or death of any person or persons and for any loss, damage or destruction of any property, whether caused by mistakes, omissions, interruptions, delays, errors or defects in (1) the provision of this Service or (2) installation, equipment and facilities furnishing emergency 911 Service.

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.7. Emergency 911 Service, Continued

B. Neither is the Company responsible for any infringement or invasion of the right of privacy of any person or persons, caused directly or indirectly, by the installation, operation, failure to operate, maintenance, removal, presence, condition, occasion or use of emergency 911 Service, features and the equipment associated therewith, or by any Services furnished by the Company including, but not limited to, the identification of the telephone number, address or name associated with the telephone used by the party or parties accessing emergency 911 Service, which parties include Customers with a non-published or non-listed telephone number as described in this Tariff, and which infringement or invasion of the right of privacy arises out of the negligence or other wrongful act of the Company, the Customer, its users, agents or municipalities, or the employees or agents of any one of them.

C. When a Customer with a non-published or non-listed telephone number, as described in this Tariff, places a call to the emergency 911 Service, the Company will release the name and address of the calling party, where such information can be determined, to the appropriate local governmental authority responsible for the emergency 911 Service. By subscribing to Service under this Tariff, Customer acknowledges and agrees with the release of information as described above.

2.2.8. Directory Listings

A. The Company's liability arising from errors or omissions in directory listings or in accepting listings presented by Customers or Applicants shall be limited to an abatement or refund of an amount not exceeding the charge for the Service during the period covered by the directory in which the error or omission occurs.

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2. REGULATIONS, Continued

2.2. Limitations on Liability/Indemnity, Continued

2.2.8. Directory Listings, Continued

B. In conjunction with a non-published or non-listed telephone number as described in this Tariff, the Company will not be liable for failure or refusal to complete any call to a telephone with a non-published or non-listed number when the call is not placed by number. The Company will try to prevent the disclosure of the number of such telephone, but will not be liable should such number be divulged.

2.2.9. The Company makes no warranty or representation of any kind whatsoever with respect to installations it provides for use in an explosive atmosphere. The Customer indemnifies and holds the Company harmless from any and all loss, claims, demands, suits, or other action, or any liability whatsoever, whether suffered, made, instituted, or asserted by any entity or person(s), and for any loss, damage, or destruction of any property, whether owned by the Customer or others, caused or claimed to have been caused directly or indirectly by the installation, operation, failure to operate, maintenance, removal, presence, condition, location, or use of any installation so provided. The Company reserves the right to require each Customer to sign an agreement acknowledging acceptance of the provisions of this section as a condition precedent to such installations.

2.3. Provision of Equipment and Facilities

2.3.1. General

A. The Company shall use reasonable efforts to make Services available to a Customer on or before a particular date, subject to the provisions of and compliance by the Customer with the regulations contained in this Tariff. The Company does not guarantee availability by any such date and shall not be liable for any delays in commencing Service to any Customer

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2. REGULATIONS, Continued

2.3. Provision of Equipment and Facilities, Continued

2.3 1. General, Continued

- B. The Company shall use reasonable efforts to maintain facilities that it furnishes to the Customer. The Customer may not, nor may the Customer permit others to, rearrange, disconnect, remove, attempt to repair or otherwise interfere with any of the facilities installed by the Company or an agent designated by the Company, except upon the written consent of the Company. The Company will have control over the installation, rearrangement, repair, maintenance, and disconnection of all network elements owned, headed or otherwise obtained to ensure the required level of Service. The Company may substitute, change or rearrange any equipment or facility at any time and from time to time, but shall not thereby alter the technical parameters of the Service provided to the Customer.
- C. Equipment installed at the Customer's Premises for use in connection with the Services the Company offers will not be used for any purpose other than that for which the Company has provided such equipment.
- D. Unless otherwise set forth in this Tariff, the Company will not be responsible for the installation, operation, or maintenance of any CPE. Where such equipment is connected to the facilities furnished pursuant to this Tariff, the responsibility of the Company shall be limited to the furnishing of facilities offered under this Tariff and to the maintenance and operation of such facilities. Beyond this responsibility, the Company shall not be responsible for:
1. The transmission of signals by Customer-provided equipment or for the quality of, or defects in, such transmission; or
 2. The reception of signals by Customer-provided equipment; or
 3. Network control signaling where such signaling is performed by Customer-provided network control signaling equipment; or

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2. REGULATIONS, Continued

2.3. Provision of Equipment and Facilities, Continued

2.3.1. General, Continued

D., Continued

4. The electric power consumed by CPE which shall be provided by, and maintained at the expense of, the Customer; or
 5. For ensuring that CPE connected to Company equipment and facilities is compatible with such equipment and facilities (the Customer is responsible for ensuring such compatibility).
- E. Any CPE attached to the Company's network shall be in conformance with all FCC requirements, rules and regulations.

2.3.2. Interconnection of Facilities

Any special interface equipment necessary to achieve compatibility between the facilities and equipment of the Company used for furnishing local exchange Service and the Channels, facilities, or equipment of others may be provided at the Customer's expense.

2.3.3. Non-routine Installation

At the Customer's request, non-routine installation and/or maintenance may be performed outside of the Company's regular business hours. Installation and/or maintenance in hazardous locations may be performed at the Company's discretion. In such cases, additional charges may apply. If installation is started during regular business hours but at the Customer's request extends beyond regular business hours into time periods including, but not limited to, weekends, Holidays, and/or night hours, additional charges may apply.

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2. REGULATIONS, Continued
- 2.3. Provision of Equipment and Facilities, Continued
- 2.3.4. Ownership of Facilities

Title to all facilities provided in accordance with this Tariff for provision of Service to the Customer remains with the Company or third party vendor providing facilities on behalf of the Company.

2.3.5. Use of Service

Service is furnished for use by the Customer and may be used by others only as specifically provided elsewhere in this Tariff.

- A. Service shall not be used to transmit a message, to locate a person, or to otherwise give or obtain information, without payment of the charges applicable to such use. A Customer shall use no device with the Service or facilities of the Company for the purpose of avoiding payment of the applicable charge or defrauding the Company.
- B. Service shall not be used in any manner that interferes with other persons in the use of their Service, prevents other persons from using their Service, or otherwise impairs the quality of Service to other Customers. The Company may require a Customer to immediately cease use of Service if such use is causing interference with or impairing the Service of others.
- C. If a Customer's use of Service interferes unreasonably with the Service of other Customers and that interference is believed by the Company to be related to the quantity or grade of Service that the Customer has purchased, the interfering Customer may be required to take Service in sufficient quantity, or of a different class or grade, or to cooperate with the Company to eliminate such interference.

2. REGULATIONS, Continued

2.4. Obligations of the Customer

2.4.1. General

The Customer shall be responsible for:

- A. Payment of all applicable charges pursuant to this Tariff, Contracts and special assembly or special construction; and
- B. Reimbursing the Company for damage to, or loss of, the Company's facilities or equipment caused by the acts or omissions of the Customer; by the noncompliance by the Customer with these regulations, or by fire, theft or other casualty on the Customer's Premises, and
- C. Providing at reasonable charge, as specified from time to time by the Company, any needed personnel, equipment, space and power to operate Company facilities and equipment installed on the Premises of the Customer, and the level of heating and air conditioning necessary to maintain the proper operating environment on such Premises; and

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2. REGULATIONS, Continued

2.4 Obligations of the Customer, Continued

2.4.1. General, Continued

- D. Obtaining, maintaining, and otherwise having full responsibility for all rights-of-way and conduit necessary for installation of all cable and associated equipment used to provide local exchange Service to the Customer from the Premises entrance or property line to the location of the equipment space. Any costs associated with obtaining and maintaining the rights-of-way described herein, including the costs of altering the structure to permit installation of the Company facilities, shall be borne entirely by, or may be charged by the Company to, the Customer. The Company may require the Customer to demonstrate its compliance with this section prior to accepting an order for Service; and ensuring that its equipment and/or system or that of its agent is properly interfaced with the Company's Service; that the signals emitted into the Company's network are of the proper mode, bandwidth, power, data speed, and signal level for the intended use of the Customer and in compliance with the criteria set forth in this Tariff; and that the signals do not damage Company equipment, injure its personnel or degrade Service to other Customers. If the Customer or its agent fails to maintain and operate its equipment and/or system or that of its agent properly, with resulting imminent harm to Company equipment, personnel, or the quality of Service to other Customers, the Company may, upon written notice, require the use of protective equipment at the Customer's expense. If this fails to produce satisfactory quality and safety, the Company may, upon written notice, terminate the Customer's Service without liability; and
- E Providing a safe place to work, complying with all laws and regulations regarding the working conditions on the Premises at which Company employees and agents will be installing or maintaining the Company's facilities and equipment. The Customer may be required to install and maintain Company's facilities and equipment within a hazardous area if, in the Company's opinion, injury or damage to the Company's or third party vendor's employees or property might result from installation or maintenance by the Company or third party vendor. The Customer shall be responsible for identifying, monitoring, removing and disposing of any hazardous material prior to any construction or installation work; and

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.1. General, Continued

- F. Complying with all laws and regulations applicable to, and obtaining all consents, approvals, licenses and permits as may be required with respect to, the location of Company's facilities and equipment in any Customer Premises or the rights-of-way for which Customer is responsible; and
- G. Granting or obtaining permission for Company agents or employees to enter the Premises of the Customer at any time for the purpose of installing, inspecting, maintaining, repairing, or, upon Termination of Service as stated herein, removing the facilities or equipment; and
- H. Preventing liens or other encumbrances from being placed or maintained on the Company's equipment or facilities or CPE leased by the Customer from the Company; and
- I. Making the Company facilities and equipment available periodically for maintenance purposes at a time agreeable to both the Company and the Customer. No allowance for interruptions in Service will be made for the period during which Service is interrupted for such purposes; and
- J. Promptly notifying the Company in writing, of any allegation, claim, loss, damage, liability, defect, fraudulent act of a third party, cost or expense for which the Company may be responsible and cooperating in every reasonable way to facilitate defense or settlement of such allegation, claim, loss, damage, liability, defect, cost or expense.

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.1. General, Continued

K. PBX Information

Customer shall provide Company with detailed information related to multi-location private branch exchanges (“PBX”) and other parties PBXs operating within the Customer’s Premises or otherwise connected to Company’s telecommunication Service through Customer. Such information shall include the end-user addresses corresponding to all telephone lines operating through the PBX and such other information, as requested by Company, which will enable Company to determine, in the event of an emergency 911 call routed through a PBX, the physical location from which the call was made. Customer shall continually update this information and shall immediately notify Company of any changes related to this information. Customer shall indemnify and hold Company harmless from any and all losses, damages, costs, expenses, claims, or liabilities resulting from the Customer’s failure to immediately provide or update this information to Company, including, but not limited to, any and all losses, costs, expenses, claims, liabilities or damages, including third party claims, related to the failure to respond to an emergency 911 telephone call.

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.1. General, Continued

L. Automatic Number Identification

In addition to providing the information requested in 2.4.1(L)(PBX information) above, Customer shall provide and continually update Company with the correct true automatic number identification (“ANI”) for each telephone line operating through a PBX on Customer’s Premises or otherwise connected to Company’s telecommunication Service(s) through Customer. Customer recognizes that it may be necessary to purchase and install additional equipment in order to provide the ANI information and that Customer is solely responsible for all costs and expenses related to this equipment. Customer shall indemnify and hold Company harmless from any and all losses, damages, costs, expenses, claims, or liabilities arising from the Customer’s failure to immediately provide or update this information to Company, including, but not limited to, any and all losses, damages, costs, expenses, liabilities or claims, including third party claims, related to the failure to respond to an emergency 911 phone call.

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.2. Claims

The Customer shall indemnify, defend and hold harmless the Company as set forth in the Limitation of Liability/Indemnity section of this Tariff or as provided elsewhere in this Tariff.

2.4.3. Inspections

A. Upon reasonable notification to the Customer, and at a reasonable time, the Company may make such tests and inspections as may be necessary to determine that the Customer is complying with the requirements set forth in this Tariff for the installation, operation, and maintenance of Customer-provided facilities and equipment connected to Company-owned facilities and equipment. No credit will be allowed for any interruptions occurring during such inspections.

B. The Company will, upon request, provide the Customer with a statement of technical parameters that the Customer's equipment must meet. If the protective requirements for CPE are not being complied with, the Company may take such action as it deems necessary to protect its facilities, equipment, and personnel. The Company will notify the Customer promptly if there is any need for corrective action. Within three (3) days of receiving this notice a Customer must take this corrective action and notify the Company of the action taken. If the Customer fails to do this, the Company may take whatever additional action is deemed necessary, including the suspension of Service, to protect its facilities, equipment and personnel from harm.

2.4.4. The Customer shall not assert any claim against any other Customer or user of the Company's Services for damages resulting in whole or in part from or arising in connection with the furnishing of Service under this Tariff including but not limited to mistakes, omissions, interruptions, delays, errors or other defects or misrepresentations, whether or not such other Customer or user contributed in any way to the occurrence of the damages, unless such damages were caused solely by the negligent or intentional act or omission of the other Customer or user and not by any act or omission of the Company.

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.5. Fraud and Unauthorized Use of the Network.

- A. The Customer is liable for the unauthorized use of the network obtained through the fraudulent use of a Company calling card, if such a card is offered by the Company, or the fraudulent use of an accepted credit card, provided that the unauthorized use occurred as a result of inadequate safe keeping by the Customer.
- B. A Company calling card is a telephone calling card issued by the Company at the Customer's request, which enables the Customer or any Authorized User to place calls over the network and to have the charges for such calls billed to the Customer's account
- C. An accepted credit card is any credit card that a cardholder has requested or applied for and received, or has signed, used or authorized another person to use to obtain credit. Any credit card issued as a renewal or substitute in accordance with this paragraph is an accepted credit card when received by the cardholder
- D. The Customer must give the Company written or oral notice that an unauthorized use of a Company calling card or an accepted credit card has occurred or may occur as a result of loss and/or theft promptly upon Customer's discovery of same.
- E. The Customer is responsible for payment of all charges for calling card Services furnished to the Customer or any Authorized User, unless due to the negligence of the Company. This responsibility is not changed due to any use, misuse or abuse of the Customer's Service by third parties, the Customer's employees or the public.
- F. The liability of the Customer for unauthorized use of the network by credit card fraud is equal to the applicable charges pursuant to this tariff or Contract for the property, labor or Services obtained by the unauthorized user provided that the unauthorized use occurred as a result of inadequate safe keeping by the Customer

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2. REGULATIONS, Continued

2.4. Obligations of the Customer, Continued

2.4.5. Fraud and Unauthorized Use of the Network. , Continued

- G. The Customer is liable for the unauthorized use of the network obtained through the fraudulent access of a telephone system provided that the unauthorized use occurred as a result of inadequate safe keeping by the Customer.

2.5. Establishment of Service

2.5.1. Application for Service/Service Order

- A. An Applicant for Service may be required by the Company in its sole discretion to sign an application form requesting the Company to furnish facilities or Service in accordance with the rates, charges, rules and regulations as set forth in this Tariff. This application for Service, where required by the Company, together with the provisions of this Tariff, establishes the Contract between the Company and the Customer, which may not be assigned or transferred in any manner.
- B. If Customer's Service has been terminated and the Customer wishes to reestablish Service, payment of all unpaid, undisputed charges, as well as a Deposit and Advance Payment for all connection charges, may be required prior to re-establishing Service.

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2. REGULATIONS, Continued

2.5. Establishment of Service, Continued

2.5.1. Application for Service/Service Order, Continued

C. The Company may refuse to establish Service if any of the following conditions exist:

1. The Applicant has an outstanding amount due for similar Services and is unwilling to make acceptable arrangements with the Company for payment; or
2. A condition exists which in the Company's judgment is unsafe or hazardous to the Applicant, the general population, or the Company's personnel or facilities; or
3. Refusal by the Applicant to provide the Company with a Deposit when the Customer has failed to meet the credit criteria for waiver of Deposit requirements; or
4. The Applicant is known to be in violation of the Company's Tariffs filed with the Commission; or
5. Failure of the Applicant to furnish such funds, suitable facilities, and/or rights-of-way necessary to serve the Applicant and which have been specified by the Company as a condition for providing Service; or
6. Applicant falsifies his or her identity for the purpose of obtaining Service.
7. The Company may refuse to provide Service at an address where Service has been discontinued for non-payment of bills for any Service subject to this Tariff if it is determined that the non-payment Customer or real users of the Service still reside at the address.
8. The Service requested is not available under Section 2.1.2 of this tariff.

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2. REGULATIONS, Continued

2.5. Establishment of Service, Continued

2.5.2. Establishment of Credit

- A. The Company may conduct a credit investigation of each new Customer or Applicant prior to accepting a Service Order.
- B. The Company may, in order to assure payment of its charges for Service, require Applicants and existing Customers to establish and maintain credit acceptable to the Company
- C. The establishment and reestablishment of acceptable credit does not relieve the Applicant or Customer from compliance with other provisions in this Tariff as to Deposits, Advance Payments and the payment of charges due, and will in no way modify the provisions regarding disconnection and Termination of Service for failure to pay bills due for Service or facilities furnished.
- D. A Customer may be required to reestablish credit in accordance with this Tariff when the amount of Service furnished or the basis on which credit was formerly established, in the sole discretion of the Company, has significantly changed.

2.5.3. Advance Payments

To safeguard its interests, the Company may require an Applicant or Customer to make an Advance Payment prior to the provision or restoration of Service or facilities. The Advance Payment will not exceed the amount equal to the Non-Recurring Charge(s) and three (3) months Recurring Charges for the Services or facility to be provided. In addition, where special construction is involved, the Advance Payment may also include an amount equal to the estimated Non-Recurring Charges for the special construction and Recurring Charges, if any, for a period to be set by the Company and the Customer. The Advance payment will be credited to the Customer's initial bill. An Advance Payment may be required in addition to a Deposit.

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2. REGULATIONS, Continued

2.5. Establishment of Service, Continued

2 5 4. Deposits

- A. The Company may require each Applicant for Service to make a Deposit as follows, pursuant to ND Commission Rule 69-09-05-03:
1. The Deposit is not to exceed two times the estimated amount of one month's average bill.
 2. The Company may accept in lieu of a cash Deposit a contract signed by a guarantor, satisfactory to the Company, whereby the payment of a specified sum not to exceed the required cash Deposit is guaranteed. The term of such contract must be indeterminate, but it must automatically terminate when the Customer gives notice of Service discontinuance to the Company or a change in location covered by the guarantee agreement or thirty days after written request for termination is made to the Company by the guarantor. However, no agreement may be terminated without the Customer having made satisfactory settlement for any balance which the Customer owes the Company.
 3. Upon termination of a guarantee contract, a new contract or a cash Deposit may be required by the Company.
- B. The Company will not collect a Deposit in order to initiate lifeline service, if the qualifying low-income Customer voluntarily elects toll blocking from the Company, where available. If toll blocking is unavailable, the Company may charge a Deposit.

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2. REGULATIONS, Continued

2.5. Establishment of Service, Continued

2.5.4. Deposits, Continued

C. A Deposit may be required in addition to an Advance Payment

D. Interest on Deposits

Pursuant to ND Commission Rule 69-09-05-03, the Company will each year pay interest on such Deposit at the rate paid by the Bank of North Dakota on a six-month certificate of deposit. Such rate will be determined as of the first business day of each year on a six-month certificate of deposit with the smallest deposit required. The interest may be paid to the depositor or may be deducted from the depositor's indebtedness to the Company for telephone Service. The payment or deduction for interest must be made during each calendar year, or whenever a Deposit is refunded or Service discontinued.

E. Inadequacy of Deposits

If the amount of a Deposit is proven to be less than required to meet the requirements specified herein, the Customer shall be required to pay an additional Deposit upon request.

F. Refund of Deposits

1. Residential Deposits and accrued interest shall be refunded after twelve (12) months of Service if the Customer has not been delinquent in the payment of Company bills.
2. When a Residential or Business Service or facility is discontinued, the amount of a Deposit, if any, will be applied to the Customer's account and any credit balance remaining will be refunded. Before the Service or facility is discontinued, the Company may, at its option, return the Deposit or credit it to the Customer's account

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2. REGULATIONS, Continued

2.6. Billing and Collection of Charges

- 2.6.1. Bills will be rendered monthly to the Customer.
- 2.6.2. All Service, installation, monthly Recurring, and Non-Recurring charges are due and payable upon receipt.
- 2.6.3. The Company shall present invoices for Recurring Charges monthly to the Customer, in advance of the month in which the Service is provided.
- 2.6.4. For new Customers, or existing Customers whose Service is disconnected, the charge for the fraction of the month in which Service was furnished will be calculated on a pro rata basis. For this purpose, every month is considered to have thirty (30) days.
- 2.6.5. Payment of all bills is due twenty five (25) days after the date of invoice unless the Customer has been identified as a candidate for potential fraudulent activity, or the Customer has been under treatment for twenty five (25) days. In those instances, payment is due fifteen (15) days after the date of mailing. Amounts not paid by this date (the "due date") will be considered past due.
- 2.6.6. Essential Service¹ Provider Bills

Pursuant to ND Commission Rule 69-09-05-13, the Company, on any bill issued for the provision of Essential Services, will:

- A. Clearly disclose its name, business address, and a toll-free Customer inquiry telephone number. The Company name and business address must also be made available via the toll-free Customer inquiry number;
- B. Clearly and separately identify the Essential Services for which the bill is issued;
- C. Clearly identify all taxes, fees, and surcharges associated with the Essential Services for which the bill is issued; and
- D. Disclose that the provision of Essential Services may not be discontinued by the Company for nonpayment of charges for Nonessential Services or use other language that complies with federal billing rules.

¹ See definition of Essential Service in Section 4.1.3

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2. REGULATIONS, Continued

2.7. Disputed Bills

2.7.1. The Customer is responsible for notifying the Company in writing, within thirty (30) days of the date of mailing of the bill, of any charges in dispute and the specific basis of such dispute by the due date (Disputed Amounts).

2.7.2. All charges not in dispute will be paid by the Customer by the due date. Telephone Service may be suspended or terminated for nonpayment of the undisputed portion of a disputed bill or Deposit if the Customer does not pay as required in this Tariff.

2.7.3. Upon notification of a dispute, the Company will notify the Customer within five (5) working days of its receipt of the written dispute notice and shall undertake an investigation of the disputed charges. At the conclusion of the investigation, the Company will notify the Customer of any amount determined by the Company to be correctly charged and Customer shall pay such amount to the Company within five (5) working days. The Company may suspend/terminate Service if the Customer fails to pay the amount determined by the Company to be properly charged. Amounts determined by the Company to be correctly charged also will be subject to the late payment charge specified in this Tariff.

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2. REGULATIONS, Continued

2.7. Disputed Bills, Continued

2.7.4. If the Customer and Company are unable to resolve the dispute to their mutual satisfaction, the Company will inform the Customer, prior to termination, of the right to file a complaint with the Commission. The complaint must be filed within five (5) days of the Customer's notification of the Company's determination of the dispute.

The address and telephone number of the Commission is:

North Dakota Public Service Commission
State Capitol, 12th Floor
600 East Boulevard
Bismarck, North Dakota 58505-0480

Telephone number: 701-328-2400

2.8. Late Payment Charges

2.8.1. Customers will be assessed a late fee on past due amounts in the amount of the lesser of 1.5% per month or the maximum lawful rate under applicable state law

2.8.2. Late payment charges do not apply to those portions (and only those portions) of unpaid balances that are bona fide Disputed Amounts. Undisputed amounts on the same bill are subject to late payment charges if unpaid and carried forward to the next bill.

2.8.3. Late payment charges do not apply to final accounts.

2.8.4. Collection procedures and the requirement for a Deposit or Advance Payment are not affected by the application of a late payment charge.

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2. REGULATIONS, Continued

2.9. Cancellation of Service by Customer

Cancellation of Service by the Customer can be made either verbally or in writing.

2.9.1. Cancellation Prior to Start of Design of Work or Installation of Facilities

If, prior to cancellation by the Customer, the Company incurs any expenses in installing Service or preparing to install Service that it would not otherwise have incurred, a charge equal to the cost the Company incurred will apply. In no case will this charge exceed the charge for the minimum period of Services ordered, including installation charges and Non-Recurring Charges, and all amounts others may charge the Company that would have been chargeable to the Customer had Service been initiated.

2.9.2. Cancellation Associated with Special Construction

Where the Company incurs an expense in connection with special construction before it receives a cancellation notice, or where special arrangements of facilities or equipment have begun before the Company receives a cancellation notice, a charge equal to the costs incurred applies. In such cases, the charge applies to allow the Company to recover the otherwise non-recoverable costs of engineering, labor, material, equipment and other related expenses.

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2. REGULATIONS, Continued
- 2.9. Cancellation of Service by Customer, Continued
- 2.9.3. Cancellation During Installation

If cancellation occurs between start and completion of installation, the Customer will be responsible for the estimated cost incurred, not to exceed the charge for the minimum period of Services ordered and the total Non-Recurring Charges, including termination charges, applicable to the entire Service, equipment and facilities ordered.

2.9.4. Cancellation After Installation but Prior to Service Start-up

If cancellation notice is provided after completion of installation but prior to connection for Service, the Customer is responsible for the charges applicable as if the items involved were actually connected for Service and immediately ordered disconnected, including;

- A. All regularly applicable Service Connection Charges and Non-Recurring Charges, and
- B. All regularly applicable basic termination charges in full, and
- C. All regularly applicable minimum Service charges, and
- D. Any other amounts as may be specified in the Tariff covering the items involved, and
- F. Any other amounts that were incurred as a result of expedited orders, or as a result of the cancellation, modification or deferral at the Applicant/Customer's request.

2. REGULATIONS, Continued

2.9. Cancellation of Service by Customer, Continued

2.9.5. Cancellation of Service After Service Start-up

A Customer who wishes to have Service discontinued shall give at least 5 days oral or written notice to the telephone company, specifying the date on which it is desired that Service be discontinued. The Customer shall retain responsibility for Service and equipment charges until the day and time on which Service is requested to be discontinued. If the Customer fails to provide the Company with proper notice or access to the Premises, the Customer shall continue to be responsible for equipment and Service rendered

2.9.6. Subsequent Order Charges Due to Modification

In the case of a Customer-initiated modification of Service, charges for the subsequent order are in addition to the costs incurred before the Customer changed the original order.

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company

The Company will discontinue telecommunications Services as provided in this Section:

2.10.1. Termination of Service for Reasons Other Than Delinquency

- A. Pursuant to ND Commission Rule 69-09-05-02(11)(a), except for discontinuance due to delinquency as provided in Section 2.10.2, the Company may not discontinue Service to a Customer without first providing the Customer with twenty-days (20) written notice of the intent to discontinue Service.

The notice of intent to discontinue Service will inform the Customer of his or her right to choose between local exchange companies, if more than one local exchange company is providing Essential Services.

- B. The Company may disconnect Service, or may withhold the provision of ordered or contracted Service under the following conditions after twenty days written notice to the Customer:

1. The existence of an obvious hazard to the safety or health of the Customer, the general population, or the Company's personnel or facilities; or
2. The Company has evidence of tampering or evidence of fraud
3. Customer violation of this Tariff or any of the Company's tariffs filed with the Commission and/or violation of the Commission's rules and regulations; or
4. Failure to meet or maintain the Company's credit and Deposit requirements; or
5. Failure of the Customer to provide the Company reasonable access to its equipment and property; or

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company

2.10.1. Termination of Service for Reasons Other Than Delinquency, Continued

B., Continued

6. Customer breach of Contract for Service between the Company and the Customer; or
7. When necessary for the Company to comply with an order of any governmental agency having such jurisdiction; or
8. Unauthorized resale of equipment or Service, or
9. use of equipment which interferes with or adversely affects the Service to other Customers, provided the Customer has first been notified and afforded reasonable opportunity to change or disconnect such equipment.

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company

2.10.2. Discontinuation of Services Due to Delinquency

The Company may disconnect Service, if a Customer's account is delinquent, ten (10) calendar days from the date of mailing or personal delivery of notice of the Company's intention to discontinue Service on account of delinquency. The Company's notice will comply with the provisions of ND Commission Rule 69-09-05-02(5) as set forth in Section 2.10.2(E)(5).

A. Determination of Delinquency

Pursuant to ND Commission Rule 69-09-05-02.1, for the purpose of discontinuing or resuming telecommunications Service:

1. If a Customer's partial payment on outstanding charges for telecommunications Services excluding payments on a deferred installment agreement is less than the outstanding charges for Essential Services and federal access charges, the Customer is delinquent in payment for Essential Services.
2. If a Customer's partial payment on outstanding charges for telecommunications Services excluding payments on a deferred installment agreement is equal to or greater than the outstanding charges for Essential Services and federal access charges, the Customer is not delinquent in payment for Essential Services.

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company, Continued

2.10.2. Discontinuation of Services Due to Delinquency, Continued

B. Discontinuance of Essential Services²

Pursuant to ND Commission Rule 69-09-05-02(1), the Company may discontinue the Essential Services it provides.

1. If the Customer is delinquent in payment for Essential Services, then Essential Services may be discontinued even though discontinuing the Services results in the discontinuance of all telecommunications Services.
2. If the Customer is delinquent in payment for long-distance Services rendered by the Company or another company and billed by the Company, but is not delinquent in payment for Essential Services rendered by the Company, the Company may discontinue the Customer's local exchange Services only at central offices lacking the technical ability to discontinue long-distance Services while continuing to provide local exchange Services.

² See definition of Essential Service in Section 4.1.3

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company, Continued

2.10.2. Discontinuation of Services Due to Delinquency, Continued

C. Discontinuance of Nonessential Services³

Pursuant to ND Commission Rule 69-09-05-02(2), the Company may discontinue Nonessential Services:

1. If the Customer is delinquent in payment for Nonessential Services.
2. If the Customer is delinquent in payment for long-distance telecommunications Services rendered by another company and billed by the Company, then the Company may deny the Customer all forms of access to the network of the telecommunications company to which the Customer is delinquent in payment. However, if due to technical limitations, the Company must also deny the Customer all forms of access to the long-distance networks of all telecommunications companies, including its own, in order to deny the Customer access to the network of the company to which the Customer is delinquent, the Company may do so.

³ See definition of Nonessential Service in Section 4.1.4

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company, Continued

2.10 2 Discontinuation of Services Due to Delinquency, Continued

D. Insufficient Reasons for Discontinuance of Service Due to Delinquency

Pursuant to ND Commission Rule 69-09-05-02(4), the Company may not discontinue Service to a Customer

1. for failure of the Customer to pay for merchandise purchased from the Company,
2. to pay for a different class of Service furnished by the Company,
3. to pay for Service rendered to a previous occupant of the premises, or
4. to pay the bill of another Customer as guarantor thereof.

E. Notice of Discontinuance of Service for Delinquency

Pursuant to ND Commission Rule 69-09-05-02(5), the Company will not discontinue Service to a Customer for failure to pay for Service until the Company first gives the Customer notice of its intention to discontinue such Service on account of delinquency. The notice will:

1. Be sent by first-class mail addressed to the billing name and address of the affected account.
2. Show the amount of the delinquency
3. Include the telephone number of the Public Service Commission.
4. Advise the Customer of the Customer's rights and remedies, including the Customer's right to work out a satisfactory deferred installment agreement for delinquent accounts.

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company, Continued

2.10.2. Discontinuation of Services Due to Delinquency, Continued

E. Notice of Discontinuance of Service for Delinquency, Continued

5. Inform the Customer that Service will be discontinued if the delinquent account is not paid within ten (10) calendar days from the date of mailing or personal delivery of the notice, or if a satisfactory installment agreement is not made with the Company for payment of the delinquent bill. The Company may discontinue Service without further notice if the Customer fails to pay the delinquent account by the due date.

F. Deferred Installment Agreements

Pursuant to ND Commission Rule 69-09-05-02(6):

1. A deferred installment agreement for Essential Services may not be combined with a deferred installment agreement for any other Services.
2. The Company will not discontinue Essential Services if the Company and the Customer make a mutually agreed upon deferred installment agreement for Essential Services. The Company may discontinue Essential Services without further notice if the Customer fails to pay the delinquent account in accordance with the deferred installment agreement.
3. The Company will not discontinue Nonessential Services if the Company and the Customer make a mutually agreed upon deferred installment agreement for Nonessential Services. the Company may discontinue Nonessential Services without further notice if the Customer fails to pay the delinquent account in accordance with the deferred installment agreement.

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2. REGULATIONS, Continued

2.10 Cancellation of Service by Company, Continued

2.10.2. Discontinuation of Services Due to Delinquency, Continued

G. Payment of Delinquent Account Prior to Discontinuance

Pursuant to ND Commission Rule 69-09-05-02(7), the Customer may pay the delinquent account at any time prior to the actual discontinuance of Service.

H. Disputed Bills and Discontinuance of Service

Pursuant to ND Commission Rule 69-09-05-02(9), if the Customer disputes the amount of a bill for Service, the Customer may, to prevent discontinuance for nonpayment, pay the disputed bill under protest to the Company. Alternatively, the Customer may request a formal hearing pursuant to ND Commission Rule 69-02-02-02 in which case the Company may not discontinue Service for nonpayment of the disputed bill until a final decision has been issued by the Commission. The Company will immediately give the Commission notice of the dispute and the Commission may investigate the dispute. The Company will refund to the Customer any part of such payment made under protest found by the Commission to be excessive.

2.11. Reconnection of Customer's Service

Pursuant to ND Commission Rule 69-09-05-02(8), whenever Service has been discontinued for nonpayment of a bill, Service will be resumed if the Customer pays the fee for resuming Service, makes a Deposit under Section 2.5 4 (if required by the Company); and makes a satisfactory settlement for the delinquent bill and for the Service rendered to the date the Service was discontinued.

	<u>Residence</u>	<u>Business</u>
Restoral Fee, Per Occurrence	\$25.00	\$40.00

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2. REGULATIONS, Continued

2.12. Miscellaneous

2.12.1. Special Conditions or Requirements

Where special conditions or special requirements of a Customer involve unusual construction or installation cost, the Customer may be required to pay a reasonable proportion of such costs or expense.

2.12.2. Telephone Numbers

Unless otherwise required by state or federal requirements, the Company may change the telephone number of a Customer for engineering, technical, or other reasons. In the event of a dispute between two (2) or more parties regarding use of a number, the decision of the Company will be final and binding on all parties, unless otherwise required by federal or state law.

2.12.3. Ownership and Access to Facilities

Facilities furnished by the Company are the property of the Company or a third-party vendor. The Customer will provide employees, distributors and agents of the Company access to such facilities, at all reasonable times, for the purpose of installing, rearranging, repairing, maintaining, inspecting, disconnecting, removing or otherwise servicing such facilities.

2.12.4. Installation, Rearrangement, Repair, Maintenance, Disconnection and Removal of Facilities

The Company will have control over the installation, rearrangement, repair, maintenance, and disconnection of all network facilities and network elements, owned, leased or otherwise obtained to ensure the required level of Service.

2.12.5. Transfer and Assignments

The Customer may not assign or transfer its rights or duties in connection with the Services and facilities provided by the Company without the written consent of the Company and payment of the applicable charges.

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2. REGULATIONS, Continued

2.12. Miscellaneous, Continued

2.12.6. Notices and Communications

- A. The Customer will designate an address to which the Company will mail or deliver all notices and other communications. The Customer may also designate a separate address to which the Company's bills for Service will be mailed.
- B. The Company will designate on the bills an address to which the Customer will mail or deliver all notices and other communications. Company may designate a separate address on each bill for Service to which the Customer will mail payment on that bill.
- C. All notices or other communications required to be given pursuant to this Tariff will be in writing, unless otherwise provided.
- D. The Company or the Customer will advise the other party of any changes to the addresses designated for notices, other communications or billing, by following the procedures for giving notice set forth herein.

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2. REGULATIONS, Continued

2.13. Interruptions of Service

2.13.1. General

- A. The Company may temporarily interrupt Service when necessary to effect repairs or maintenance; to eliminate an imminent threat to life, health, safety or substantial property damage; or for reasons of local, State or National emergency. Company shall establish procedures to be followed by its employees to prevent or mitigate interruption or impairment and provide prompt oral or written notification to affected Customers.
- B. It is the obligation of the Customer to notify the Company of any interruptions in Service. Before giving such notice, the Customer will ascertain that the trouble is not being caused by any action or omission of the Customer, is not within the Customer's control, and is not in wiring or equipment connected to the terminal of the Company.
- C. A credit allowance will not be given unless otherwise specified in this Tariff. A Service is interrupted when it becomes inoperative to the Customer, *e g.*, the Customer is unable to transmit or receive because of a failure of a component furnished by the Company under this Tariff.
- D. If the Customer reports to the Company that a Service, facility or Circuit is inoperative but declines to release it for testing and repair, or refuses access to Customer Premises for test and repair by the Company or an agent of the Company, the Service, facility or Circuit is considered to be impaired but not interrupted. No credit allowance will be made for a Service, facility or Circuit considered by the Company to be impaired.
- E. The Customer will be responsible for the payment of Service charges as set forth herein when the Service difficulty or trouble report results from the use of equipment or facilities provided by any party other than the Company, including, but not limited, to the Customer.

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2. REGULATIONS, Continued

2.13. Interruptions of Service, Continued

2.13.2. Limitations of Allowances

No credit allowance will be made for any interruption in Service:

- A. Due to the negligence of, willful act of, or noncompliance with the provisions of this Tariff by, the Customer; or
- B. Due to the malfunction of Customer-owned telephone equipment; or
- C. Due to a Force Majeure; or
- D. During any period in which the Company is not given full and free access to Company-provided facilities and equipment for the purposes of investigating and correcting interruptions; or
- E. During any period when the Customer has released Service to the Company for maintenance purposes or for implementation of a Customer order for a change in Service arrangements; or
- F. That occurs or continues due to the Customer's failure to authorize placement of any element of special construction; or
- G. That occurs when the Company, under the terms of the Contract for Service, suspends or terminates Services for nonpayment of charges; or
- H. For the unlawful or improper use of the facilities or Service.

2.13.3. Use of Another Means of Communications

If the Customer elects to use another means of communications during the period of interruption, the Customer must pay the charges for the alternative Service used.

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2. REGULATIONS, Continued

2.13. Interruptions of Service, Continued

2.13.4. Application of Credits for Interruptions in Service

- A. Credits for interruptions in Service that is provided and billed on a flat rate basis for a minimum period of at least one (1) month, beginning on the date that billing becomes effective, will in no event exceed an amount equivalent to the proportionate charge to the Customer for the period of Service during which the event that gave rise to the claim for a credit occurred. A credit allowance is applied on a pro rata basis against the rates specified hereunder and is dependent upon the length of the interruption. Credit will be given only for that portion of the Customer's Service affected by the interruption.
- B. For calculating allowances, every month is considered to have thirty (30) days.

2.13.5. Credit Allowance for Interruptions in Service

If the interruption is for more than twenty four (24) hours, an allowance, at the rate for that portion of the Customer's Service affected by the interruption, will be made upon request for the time such interruption continues after the fact is reported by the Customer or detected by the Company as follows:

- A. If the interruption is for twenty four (24) hours or less, no allowance will be made.
- B. If the interruption continues for more than twenty-four (24) hours, the allowance will be equal to one thirtieth ($1/30^{\text{th}}$) of the monthly rates for the first full twenty four (24) hour period and for each succeeding twenty four (24) hour period or fraction thereof.

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2. REGULATIONS, Continued

2.14. Returned Check Charge

When a check which has been presented to the Company by a Customer in payment for charges, including Deposits and Advance Payments, is returned by a financial institution which refuses to honor it for insufficient funds or a closed or non-existent account, the Customer will be assessed a charge:

	<u>Charge</u>
Per Returned Check	\$20.00

2.15. Customer Service

Correspondence from the Customer to the Company must be addressed to the attention of the Company's Customer Service department and sent to the appropriate office as listed on the Customer bill. The Customer may also contact the Company's Customer Service department by calling a toll free number provided on the Customer bill.

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2. REGULATIONS, Continued

2.16. Termination Liability

2.16.1. Customers who discontinue Services provided under a volume and/or term Contract, prior to the expiration of the Contract, may be subject to a termination charge.

2.16.2. Payment of the termination charge does not release the Customer from other amounts owed to the Company including the balance of any Non-Recurring Charges that have been spread over the term of the Contract.

2.16.3. Early Termination Liability

A. If a Customer discontinues Services provided under a term pricing plan prior to the completion of the term, the Customer will be liable for an early termination charge. The termination charge will be the lesser of:

1. The present value of all monthly charges remaining under the term plan; or
2. The dollar difference, including interest, between (1) the current Monthly Charge(s) for the longest term pricing plan that could have been completed based on the time the Customer actually received the Service and (2) the Monthly Charge(s) under the term pricing plan currently in effect; multiplied by the number of months (any partial month to be represented by a fraction) that the Customer received the Service.

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2. REGULATIONS, Continued

2.16. Termination Liability, Continued

2.16.3. Early Termination Liability, Continued

- B. The Customer will also be responsible for paying any Non-Recurring Charges the Company originally waived that the Customer would have been charged if the Customer had initially obtained Services on a Month-to-Month basis (or, if Service is not available on a month-to-month basis, under the shortest term available for the Service). Such amount will bear interest as set forth below.
- C. The Customer will also be responsible for payment in full of any Non-Recurring Charges that the Company had agreed to spread out over the term of the plan, such amounts to bear interest as set forth below.
- D. For purposes of this section, interest and present value will be calculated using the Prime Rate as reported in the Wall Street Journal on January 1st for the year during which Service is discontinued.
- E. All early termination liability set forth above is due and owing within thirty (30) days of Termination of Service.
- F. For example, suppose the Customer discontinues a thirty-six (36) month Contract during the twentieth (20) month of Service. Suppose, further, the sixty (60) month, thirty-six (36) month, twelve (12) month and month-to-month terms were available. The Customer's termination charge under this section would be the difference between the twelve (12) month rate and the thirty-six (36) month rate, multiplied by the twenty (20) months the Customer received Service, plus (1) any Non-Recurring Charges the Company had waived, with interest, and (2) the remaining balance on any Non-Recurring Charges the Company had agreed to spread out over the term, with interest.

2.16.4. Prior to the completion of the selected Service term plan, the Customer may renew or change to a different term plan without incurring early termination charges, provided the new term plan. (1) is for an equal or greater number of Circuits than the number ordered originally, and (2) is greater in length than the number of months remaining on the original Service term. Monthly Charges for the new term plan will be based on rates in effect at the time the new plan is ordered.

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2. REGULATIONS, Continued

2.17. Service Provider Options

2.17.1. No Primary Interexchange Carrier (PIC) Option

Customers have the option of not selecting a toll provider as primary Carrier for intraLATA and/or interLATA toll traffic, thus requiring the Customer to use an access code to obtain toll providers' Services (i.e., 1010-XXX).

2.17.2. Two PIC Option

Customers will be able to select one toll provider for intraLATA toll calls and, if so desired, the same or another toll provider for interLATA toll calls.

2.17.3. Preferred Carrier Freeze (PCF)

The Company offers a free Service called Preferred Carrier Freeze. This Service is available to all Customers. PCF allows Customers to designate their local long distance (intraLATA) provider, long distance (interLATA) provider, and a local exchange Service provider as permanent choices which may not be changed absent further authorization from the Customer. The Company will send a letter to each Customer upon initiation or transfer of Service, which informs the Customer of the option to freeze his/her intraLATA, interLATA and local Service provider choice(s). At the time a Customer contacts the Company to establish a freeze, a representative will advise him/her on how to facilitate a change of provider(s) on a frozen account.

2.17.4. Carrier Change Charge

After the initial 30-day period, or at any time after an initial Carrier selection has been made, any Carrier selection or change is subject to a Non-Recurring Charge, per change, per line:

Per Change Charge 5.00

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3 APPLICATION OF RATES

3.1. Introduction

The regulations set forth in this section govern the application of rates for Services contained in other sections of this Tariff. The Company will notify the Commission of the rates and charges and the terms and conditions of any promotion.

3.2. Service Trials and Special Promotions

The Company may conduct technical trials of its Service on a limited basis to test and evaluate Service capabilities, implementation procedures, and technical processes. The Company may also offer special offerings for market research, rate experimentation, or promotional purposes. These trial/promotional offerings may include waiving or reducing the applicable charges for the Service. The trial or promotion may also be held for a limited duration for specific locations within the state. The waiver of any charge, other than a Nonrecurring Charge, shall not exceed one (1) year.

3.3. Individual Case Basis Arrangements

When the Company furnishes a facility or Service for which a rate or charge is not specified in the Company's Tariff, or when the Company offers rates or charges which may vary from Tariff arrangements, rates and charges will be determined on an Individual Case Basis (ICB). The rates and charges for ICBs will be specified by Contract between the Company and the Customer.

3.4. Special Arrangements

Where the Company furnishes a facility or Service for which a rate or charge is not specified in the Company's Tariff, charges will be based on the costs incurred by the Company and may include: (1) non-recurring type charges; (2) recurring type charges; (3) termination liabilities; and (4) combinations thereof.

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3. APPLICATION OF RATES, Continued

3.5. Business Rate Application

3.5.1. The term "Business Line" denotes Service provided when any of the following conditions exist:

- A. The line is used primarily or substantially for a paid commercial, professional, governmental, educational or institutional activity; or
- B. The line is situated in a commercial, professional or institutional location, or other location serving primarily or substantially as a site of an activity for pay; or
- C. The line uses a Service number listed as the principal or only number for a business in any telephone directory; or
- D. The line is used to conduct promotions, solicitations, or market research for which compensation or reimbursement is paid or provided. The use of a line without compensation or reimbursement for a charitable or civic purpose will not constitute business use or render such line a "Business Line"; or
- E. The line does not otherwise qualify as a Residential Line (as defined herein)

3.6. Residential Rate Application

3.6.1. The term "Residential Line" denotes Service provided when any of the following conditions exist:

- A. The line does not qualify as a Business Line, or
- B. It is used primarily and substantially for social or domestic purposes; and
- C. The line is located in a residence, or, in the case of a combined business and residence Premises, is located in a bona fide residential quarters of such Premises and a separate Business Line is located in the business quarters of the same Premises.

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3. APPLICATION OF RATES, Continued

3.7. Rates Based Upon Distance

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

3.7.1. “V and H Coordinates”

Distance between two (2) points is measured as airline distance between the Rate Centers of the originating and terminating telephone lines. The Rate Center is a set of geographic “V” and “H” coordinates associated with each NPA-NXX combination (where NPA is the area code and NXX is the first three digits of a seven-digit telephone number). The “V” and “H” coordinates for each Rate Center are found in the Local Exchange Routing Guide (LERG) issued by Telcordia. Where there is no telephone number associated with an access line on the Company’s network (such as a dedicated 800 or WATS access line), the Company will apply the Rate Center of the Customer’s main billing telephone number.

The airline distance between any two (2) Rate Centers is determined as follows:

- A. Obtain the “V” (vertical) and “H” (horizontal) coordinates for each Rate Center from the LERG.
- B. Compute the difference between the “V” coordinates of the two (2) Rate Centers; and the difference between the two (2) “H” coordinates.
- C. Square each difference obtained in step B. above.
- D. Add the square of the “V” difference and the square of the “H” difference obtained in step C. above.
- E. Divide the sum of the squares by 10. Round to the next higher whole number if any fraction is obtained.

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3. APPLICATION OF RATES, Continued

3.7. Rates Based Upon Distance, Continued

3.7.1. “V and H Coordinates”, Continued

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

G. FORMULA

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

3.8. Miscellaneous Charges

3.8.1. Maintenance and Repair Charges

A. Non-Designed Services

The Customer shall be responsible for the installation, operation and maintenance of any terminal equipment, communications systems or Premises cable and wire on the Customer's side of the Demarcation Point. As such, a Trouble Isolation Charge will apply for each repair visit by a technician to the Customer's Premises where the local exchange Service difficulty or trouble is not found to be on the Company's side of the Demarcation Point. In such instances, the Customer may utilize any entity of their choosing to make the necessary repairs to alleviate the problem. This charge will not apply when the trouble is found to be in the Company's facilities.

	<u>Charge</u>
Trouble Isolation	50.00

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges

3.8.1. Maintenance and Repair Charges, Continued

B. Designed Services

The following charges are applicable to designed Services for work performed that is considered above and beyond normal Circuit design, installation and maintenance activities.

1. Additional Engineering

Additional Engineering will be provided by the Company at the request of the Customer only when.

- a. A Customer requests additional technical information after the Company has already provided the technical information normally included on the Design Layout Report;
- b. The Company engineers a Customer's request for a customized Service that is not considered by the Company to be a standard offering

2. Overtime Installation

Overtime installation is that part of the Company installation effort that takes place outside of normally scheduled working hours.

3. Stand-by Time

Stand-by Time includes all time in excess of one-half (1/2) hour during which Company personnel stand by while the Customer or third party makes installation acceptance tests or performs cooperative tests with a Customer to verify facility repair on a given Service.

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges, Continued

3.8.1. Maintenance and Repair Charges, Continued

B. Designed Services, Continued

4. Testing Time

Additional testing, maintenance or repair of facilities which connect to facilities of other Service providers which is in addition to the normal effort required to test, maintain or repair facilities provided solely by the Company.

5. Maintenance of Service

When a Customer reports a trouble on a designed Service to the Company for clearance and the trouble is not found to be on the Company's side of the Demarcation Point, the Customer shall be responsible for the payment of a Maintenance of Service Charge for the period of time Company personnel are dispatched to the Customer's Premises. No charge will be applied if the trouble is found in the Company's facilities.

When the Company dispatches personnel to the Customer's Premises, and the trouble is found to be in equipment or communications systems provided by another Service provider, the Maintenance of Service Charge shall include all time for technicians dispatched, including technicians dispatched to other locations for the purposes of testing with those dispatched to the Customer Premises.

A dispatch of Company personnel at a time period not consecutive with their scheduled work period is subject to Overtime and / or Premium charges. The Maintenance of Service Charge is applied and billed in increments of thirty (30) minutes. No credit allowance will be applicable for the interruption of Service involved if the Maintenance of Service Charge applies.

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges, Continued

3.8.1. Maintenance and Repair Charges, Continued

B. Designed Services, Continued

6. Non-Productive Dispatch

The period of time a technician is dispatched, but is unable to complete the requested work because the technician is denied access to the Premises.

7. Additional Labor

Labor that is requested by the Customer in the provisioning or maintenance of Service that is not classified as any other type mentioned above.

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges, Continued

3.8.1. Maintenance and Repair Charges, Continued

B. Designed Services, Continued

8. Charges

		First Half Hour*	Each Add'l Half Hour*
a.	<u>Additional Engineering</u>		
	- Basic Time	\$ 50.00	\$ 35.00
	- Overtime	77.00	51.00
b.	<u>Overtime Installation</u>		
	- Overtime	225.00	120.00
	- Premium Time	300.00	160.00
c.	<u>Stand-by Time</u>		
	- Basic Time	0.00	85.00
	- Overtime	0.00	120.00
	- Premium Time	0.00	160.00
d.	<u>Testing Time</u>		
	- Basic Time	85.00	55.00
	- Overtime	100.00	80.00
	- Premium Time	110.00	90.00

* or fraction thereof

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges, Continued

3.8.1. Maintenance and Repair Charges, Continued

B. Designed Services, Continued

8. Charges, Continued

	First Half <u>Hour*</u>	Each Add'l <u>Half Hour*</u>
e. <u>Maintenance of Service</u>		
- Basic Time	82.00	50.00
- Overtime	96.00	64.00
- Premium Time	110.00	78.00
f. <u>Non-Productive Dispatch</u>		
- Basic Time	85.00	55.00
- Overtime	100.00	80.00
- Premium Time	110.00	90.00
g. <u>Additional Labor</u>		
- Basic Time	85.00	55.00
- Overtime	100.00	80.00
- Premium Time	110.00	90.00

* or fraction thereof

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3. APPLICATION OF RATES, Continued

3.8. Miscellaneous Charges, Continued

3.8.2. Change Order Charges

The following charges will apply on a per order basis, unless otherwise specified, for the changes / actions specified.

<u>TYPE</u>	<u>CHARGE</u>
Change a Directory Listing	\$ 7.50
Add Directory Listing	7.50
Change To or From Hunting	10.00
Rearrange Hunting, per line	3.00
Change Telephone Number	25.00
Change Class of Service	25.00

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4. LOCAL EXCHANGE SERVICES

4.1. Description

4.1.1. The Company's local exchange Service provides the Customer with the ability to connect to the Company's switching network which enables the Customer to:

- access 911 or E-911 (where available);
- access other telecommunication Carriers;
- place or receive Operator Service calls;
- place calls to Directory Assistance;
- place calls to toll free 8XX telephone numbers;
- access TRS; (using 711, where available)
- access 900/976 numbers;
- obtain a copy of the local White Pages Directory; and
- include a listing in the local White Pages Directory.

4.1.2. The following capabilities are also provided with the Company's local exchange Service.

- Caller ID Blocking, per call (using *67 at no charge)
- Caller ID Blocking, per line (available to qualified Customers where required, e g., abuse hotline)
- 900/976 Blocking, per line (upon Customer request at no charge on initial order)
- Touch-Tone
- Call Trace
- International Call Blocking (upon Customer request at no charge on initial order)

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4. LOCAL EXCHANGE SERVICES

4.1 Description, Continued

4.1.3. Essential Telecommunications Service

Essential Telecommunications Service means the following Services:

- A. Switched access;
- B. The transmission Service line for a coin or pay telephone,
- C. Installation of the Service connection for other Essential Services from the end user's premises to the local exchange network;
- D. Flat rate or measured residence, business and combination business and residence basic telephone Service including the following Service elements:
 - 1. Billing and collecting of the telecommunications company's charges for the Service.
 - 2. Primary directory listing, including nonlisted and nonpublished Service.
 - 3. Access to directory assistance.
 - 4. Access to emergency 911 Service and emergency operator assistance in local exchange areas in which emergency 911 Service is not available.
 - 5. Except as provided in section 49-02-01.1, mandatory, flat-rate extended area Service to designated nearby local exchange areas.
 - 6. Transmission Service necessary for the connection between the end user's premises and the local exchange central office switch including a trunk connection that has inward dialing and necessary signaling Service such as touchtone used by end users for the Service.

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4. LOCAL EXCHANGE SERVICES

4.1. Description, Continued

4.1.4. Nonessential Telecommunications Service

Means any telecommunications Service, other than those essential telecommunications Services listed in Section 4.1.3 above that a customer has the option to purchase either in conjunction with or separate from any Essential Telecommunications Service. Nonessential telecommunications Services include, but are not limited to:

- A. InterLATA and intraLATA message toll Service;
- B. Calling features and information or enhanced Services such as call waiting, call forwarding, three-way calling, intracall, speed calling, call transfer, voice or data store and forward, message delivery, or caller identification,
- C. Centrex Services and features;
- D. Installation of Service connections in addition or supplementary to that described in subdivision c of subsection 4 which also provides transmission Service between the end user's premises and the local exchange central office switch;
- E. Mobile telecommunications Services using radio spectrum or cellular technology; and
- F. Packet-switched Services.

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4. LOCAL EXCHANGE SERVICES, Continued

4.2. General Regulations

4.2.1. Service Area

- A. Exchange access Services are provided in the portions of North Dakota served by Qwest Communications Corporation (“Qwest”)
- B. The Company’s description of Service area in no way compels the Company to provide any Service in an area where facilities or other extenuating factors limit the Company’s ability to provide Service.

4.2.2 Availability

Services are provided subject to technological availability and compatibility with Customer facilities. Services, rates, and Contract conditions may not be available in all areas.

4.2.3. Local Calling Areas

- A. The Company will provide Service in selected Qwest exchanges as defined in subsection C below.
- B. The Company concurs in Qwest’s Exchange Areas listed in its local exchange tariff filed with the Commission. Local Calling Areas, for Customers whose Premises are located in the exchanges listed in subsection C below, will be the same as Qwest’s Local Calling Areas.

C. Exchanges

E. Fairview	Minto	Belfield	Casselton
E. Sidney	Northwood	Bismarck-Mandan	Fargo
Grafton	Valley City	Dickinson	Gardner
Hatton	Wahpeton	Emerado	Kindred
Hilsboro		Grand Forks	Leonard
Jamestown		Manvel	
Larimore		Reynolds	
Mayville		Thompson	

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4. LOCAL EXCHANGE SERVICES, Continued

4.3. Emergency Services (911/Enhanced 911)

4.3.1. Emergency Service (911/Enhanced 911) allows Customers to reach appropriate emergency agencies including police, fire and ambulance Services.

4.3.2. Emergency Service (911/E911 Service) is an arrangement of Company Central Office and trunking facilities whereby any telephone user who dials the number 911 will reach the emergency report center for the telephone from which the number is dialed or will be routed to an operator if all lines to an emergency report center are busy. If no emergency report center exists for a Central Office entity, a telephone user who dials the number 911 will be routed to an operator. The telephone user who dials the 911 number will not be charged for the call.

4.4. Telecommunications Relay Service

4.4.1. Telecommunications Relay Service enables deaf, hard-of-hearing or speech-impaired persons who use a Text Telephone ("TT") or similar devices to communicate freely with the hearing population not using TT and visa versa

A Customer will be able to access the state provider to complete such calls by either dialing the applicable telephone number directly or by dialing the number 711, where available

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4. LOCAL EXCHANGE SERVICES, Continued

4.5 Business Service Offerings¹

4.5.1 Basic Business Line: Provides the Customer with a single, voice-grade, DTMF communications Channel. Each local Channel will include a telephone number and unlimited usage. This line has the capabilities listed in 4.1, preceding. Any of the available optional features offered may be ordered and associated with this line at rates and charges stated in 4.8.2.

4.5.2 Local Usage (Business): Provides the ability to place and receive locally dialed calls over the public switched network. It is provided on an unlimited, flat rate basis.

4.6. Residence Service Offerings

4.6.1 Basic Residence Line: Provides the Customer with a single, voice-grade, DTMF communications Channel. Each local exchange Channel will include a telephone number and the following features:

4.6.2 Local Usage (Residence): Provides the ability to place and receive locally dialed calls over the public switched network. It is provided on an unlimited, flat rate basis. Any of the available optional features offered may be ordered and associated with this line at rates and charges stated in 4.8.4.

May not be available in all areas¹

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4. LOCAL EXCHANGE SERVICES, CONTINUED

4.7. Features – Description¹

Call Trace – initiates a trace on the last call received. The number from which threatening or obscene calls are made will be provided to the local law enforcement authorities should the user wish to file a complaint. Call Trace is available on a pay per use basis.

Caller ID Blocking – blocks the Customer's name and number from being transmitted on all outgoing calls from a particular line. Per call blocking is achieved by pressing *67 prior to each call, while per line blocking blocks the name and number of every outgoing call. Dialing a special code prior to dialing the number of the person being called can unblock the number and name. Caller ID Blocking is provided at no charge

International Call Blocking - blocks the Customer from being able to place an outgoing call from a particular line to an international number.

Toll Restriction - is a Central Office feature that blocks all calls preceded by a 0 or 1 and denies access to Operator Services. However, calls to Inward WATS Services and 1+ calls to the Company business offices, repair Services and 911 are not blocked.

900/976 Blocking -blocks the Customer from being able to place an outgoing call from a particular line to a number with a 900/976 prefix.

¹ May not be available in all areas

4. LOCAL EXCHANGE SERVICES, Continued

4.8 Rates and Charges

4.8.1. Business Rates

	<u>Monthly Rate</u>	<u>Nonrecurring</u>
(A) <u>Basic Business Line</u> ¹ per line	37.00	60.00
(B) <u>Local Usage (Business)</u> , per line/ Channel ²	0.00	0.00

¹ May not be available in all areas

² No Charge (unlimited)

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4. LOCAL EXCHANGE SERVICES, Continued

4.8. Rates and Charges, Continued

4.8.2. Business Rates, Continued

(C) Optional Features (Business)¹: per line/ Channel

	<u>Monthly Rate</u>	<u>Nonrecurring</u>
Touch Tone	0.00	0.00
900/976 Blocking ²	0.00	15.00
International Block ²	0.00	15.00
Call Trace (Per Occurrence)	0.00	8.00
Toll Restriction	15.00	10.00
Per Line Caller ID Blocking	0.00	0.00

¹ May not be available in all areas

² No charge if activated on initial order

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4. LOCAL EXCHANGE SERVICES, Continued

4.8. Rates and Charges

4.8.3. Residential; Rates

	<u>Monthly Rate</u>	<u>Nonrecurring</u>
(A) <u>Basic Residential Line</u> ¹ per line	21.00	36.00
(B) - <u>Local Usage (Residence)</u> , per line/ Channel ²	0.00	0.00

¹ May not be available in all areas

² No Charge unlimited

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San Antonio, Texas 78215

4. LOCAL EXCHANGE SERVICES, Continued

4.8. Rates and Charges, Continued

4 8.4. Residential Rates, Continued

(C) Optional Features (Residence)¹: per line/ Channel

	<u>Monthly Rate</u>	<u>Nonrecurring</u>
Touch Tone	0.00	0.00
900/976 Blocking ²	0.00	15.00
International Block ²	0.00	15 00
Call Trace (Per Occurrence)	0.00	8.00
Toll Restriction	4.00	10.00
Per Line Caller ID Blocking	0.00	0.00

¹ May not be available in all areas

² No charge if activated on initial order

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5. WHITE PAGES DIRECTORY LISTINGS

5.1. General Regulations

5.1.1. Primary Listing

The Company shall provide for a single White Pages Directory Listing, termed the "primary listing," in the local White Pages telephone directory published by the Incumbent Local Exchange Carrier (ILEC) in the Customer's Exchange Area. The primary listing will be the telephone number that is designated as the Customer's main billing number. White Pages Directory Listings of additional Customer telephone numbers associated with the Customer's Service will be provided for a monthly recurring charge per listing.

5.1.2. Length of Directory White Pages Listing

The Company reserves the right to limit the length of any White Pages Directory Listing by the use of abbreviations when, in its judgment, the clearness of the listing or the identification of the Customer is not impaired thereby. Where more than one (1) line is required to properly list the Customer, additional charges will not apply.

5.1.3. Right of Refusal

The Company may refuse a White Pages Directory Listing which is known not to constitute a legally authorized or adopted name, where obscenities or offensive material appear in the listing, or any listing which, in the opinion of the Company, is likely to mislead or deceive calling persons as to the identity of the listed party, or is a contrived name used for advertising purposes or to secure a preferential position in the directory or is more elaborate than is reasonably necessary to identify the listed party. The Company, upon notification to the Customer, will withdraw any White Pages Directory Listing that is found to be in violation of its rules with respect thereto.

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5. WHITE PAGES DIRECTORY LISTINGS, Continued

5.1. General Regulations, Continued

5.1.4. Sections

Each White Pages Directory Listing must be designated as either "Government", "Business" or "Residence" so that it can be placed in the appropriate section of the White Pages Directory. In order to aid the user of the White Pages Directory, and to avoid misleading or deceiving the calling party as to the identity of the listed party, only business listings may be placed in the Business section and only residential listings in the Residential section. The Company, upon notification to the Customer, will withdraw any White Pages Directory Listing that is found to be in violation of its rules with respect thereto.

5.1.5. Schedule

In order for listings to appear in an upcoming White Pages Directory, the Customer must furnish the listing to the Company in time to meet the directory-publishing schedule.

5.1.6. Other Requirements

The Customer's White Pages Directory Listing may be subject to other requirements imposed by the ILEC publishing the telephone directory.

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5. WHITE PAGES DIRECTORY LISTINGS, Continued

5.2. Descriptions

White Pages Directory Listings are provided in connection with each Customer Service as specified herein.

5.2.1. Primary Listing

A primary listing contains the name of the Customer, or the name under which a business is regularly conducted, as well as the address and telephone number of the Customer. A primary White Pages Directory Listing is provided in connection with local exchange Service at no additional charge.

5.2.2. Additional Listings

In connection with Business Service, additional listings are available to be printed in the White Pages Directory in the names of Authorized Users of the Customer's Service, as defined herein. Rates for additional listings are specified in this Tariff.

5.2.3. Non-published Listings

Listings that are not printed in the White Pages Directory are referred to as Non-published Listings. These types of listings are not available from Directory Assistance and are omitted or deleted from Directory Assistance records. Non-published Listing Service will be furnished, at the Customer's request, subject to the provisions of and charges in this Tariff.

5.2.4. Non-listed Service

Non-listed Service will be furnished at the Customer's request, providing for the omission of the Customer's listing from the White Pages Directory. Such listings will be maintained in the Directory Assistance database and other records and will be provided upon request to callers of Directory Assistance. Charges for Non-listed Service are specified in this Tariff.

5. WHITE PAGES DIRECTORY LISTINGS, Continued

5.2. Descriptions

5.2.5. Dual Name Listings

In the case of a residence, where two persons sharing the same surname and residing at the same address, or for a person known by two first names may be listed in the directory with a surname, two first names, address and telephone number. In the case of a business enterprise, the name of the business or of a member, officer, employee, or representative thereof, or the name of another business that the Customer owns, controls, or represents may be listed along with the address and telephone number.

5.2.6. Rates

	<u>Monthly Rate</u>	<u>Nonrecurring</u>
A. <u>Business</u> , per line		
Primary Listing	NC	NC
Additional Listing	\$1.50	NC
Non-Published Listing	NC	NC
Non-Listed Name	NC	NC
Dual Name Listing	NC	NC
B. <u>Residence</u> , per line		
Primary Listing	NC	NC
Additional Listing	1.50	NC
Non-Published Listing	1.50	NC
Non-Listed Name	NC	NC
Dual Name Listing	NC	NC

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6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE

6.1. Operator Services

6.1.1. There are three types of Operator handled Services:

Non-Automated: Non-automated Service is where the person originating the call calls the Company operator who dials the number and collects billing information for the call. Operator handled charges apply.

Semi-Automated: Semi-automated Service is where the person originating the call dials zero plus the desired telephone number and the operator assists in completion of the call. Surcharges apply.

Fully Automated: Fully automated Service is where the call is completed without the assistance of an operator. Surcharges apply to fully automated alternately billed calls. Fully automated alternate billing includes calling card, collect, and Third Number Billing.

6.1.2. Operator Assisted Calls

A. Person to Person

The Service where the person originating the call specifies to the Company operator a particular person, Service point, department or office to be reached:

1. When the connection is established, the person originating the call requests or agrees to talk to any person other than the person or point specified, the classification of the calls remains Person-to-Person; and
2. The Company does not utilize a messenger to bring to a Service point, a called person who cannot be reached at the Service point.

6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.1 Operator Services, Continued

6.1.2. Operator Assisted Calls, Continued

A. Person to Person, Continued

3. There are two levels of Person-to-Person Service They are:

- a. Operator-handled: Operator-handled Service is where the person originating the call requests the operator to dial the number. The operator collects the necessary information to process the call
- b. Operator-assisted: Operator-assisted Service is where the person originating the call dials zero and the telephone number.

B. Station-to-Station:

Station-to-station calls are those calls where the person originating the call to a telephone company operator or dials to a particular telephone number to be reached does not specify any particular person, station point or department. Station-to-Station Services offered are as follows:

1. Dial Station-to-Station is where the person originating the call dials the telephone number desired and the call is completed without the assistance of a Company operator. The call is billed to the originating number. When an operator places a call for the calling party who has attempted to complete the call but has been unable to do so due to network technical difficulties, the dial rate applies.
2. There are three types of Station-to-Station Operator Assistance Services: Non-Automated; Semi-Automated; and Fully Automated.

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6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.2. Operator Assisted Surcharges

The following Services incur surcharges applied on a per call basis:

6.2.1. Calling Card

The Service where a caller requests the call to be charged to an authorized telecommunications calling card. An authorized card is one where the Company can perform billing validation. The Called party can option to have the operator charge the call to the Called parties calling card or third number. Calling Card Services can be non-automated, semi-automated or fully automated. A Calling Card call is either Person-to Person or Station-to-Station.

6.2.2. Third Number Billing

The Service where a caller requests the billing to a telephone number other than the calling and called telephone number. The call is completed with the assistance of an operator. The Called party can choose to have the operator charge the call to the Called parties calling card or third number. The Company may refuse Customer Third Number Billing capability if the Company determines the Customer's Billing Telephone Number has Call Forwarding activated. Third Number Billing is either Person-to-Person or Station-to-Station.

6.2.3. Collect Calling

The Service where a caller request the charge be reversed to the called number provided the charge is accepted. The Called party can option to have the operator charge the call to the Called parties calling card or third number. The Company may refuse the Customer Collect Call capability if the Company determines the Customer's Billing Telephone Number has Call Forwarding activated. A Collect Call is either Person-to-Person or Station-to-Station.

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6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.2. Operator Assisted Surcharges, Continued

6.2.4. Busy Line Verification and Interrupt Service

Busy Line Verification and Interrupt Service which is furnished where and to the extent that facilities permit, provides the Customer with the following options:

A. Busy Line Verification

Upon request of the calling party, the Company will determine if the line is clear or in use and report to the calling party.

B. Busy Line Verification with Interrupt

The operator will verify the called line to determine if busy and then interrupt the call on the called line only if calling party requests interruption.

6.3. Directory Assistance

SBC Long Distance, LLC d/b/a SBC Long Distance furnishes Directory Assistance Service whereby Customers may request assistance in determining local listing information.

6.3.1. Call Allowances

Customers are allowed one (1) local Directory Assistance call per line per month without a charge. The same allowances and limitations apply to each line, regardless of the number of lines per Customer. Subsequent Directory Assistance calls incur a charge.

Call allowances are not transferable between lines or between separately billed accounts of the same Customer s.

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6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.3 Directory Assistance, Continued

6.3.2. Listings Per Call

The Customer will be able to request a maximum of two (2) telephone numbers per each call to Directory Assistance.

- A. No credit will be given for any unused portion of the Customer's allowance. No credit will be given for requested telephone numbers that are non-published or non-listed. No credit will be given for requested telephone numbers that are not found in the directory.
- B. Customers whose physical or visual handicaps prevent them from using the telephone directory are excluded from charges upon presentation of a certificate signed by any physician or issued by any agency recognized by the state as having the authority to certify such handicaps.

6 3 3. Operator Assisted Directory Assistance Call

- A. Where the Customer places a call to the Directory Assistance attendant via an operator and where the Customer experiences technical difficulties, the call placed shall be considered as Customer dialed.

6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.3 Directory Assistance, Continued

6.3.4. Directory Assistance Call Completion

A. Directory Assistance Call Completion (DACC) is a Service that provides the Customer with completion of local calls when the Customer requests a telephone listing from the Directory Assistance operator. The call may be completed automatically or by the Directory Assistance operator.

B. Exceptions

1. Where facilities permit, DACC will be offered to all classes of Service with the following exception:

- a. DACC is not available from Customer Owned Pay Telephone Service.
- b. DACC is not offered with requests for Non Local Service requests for Directory Assistance.
- c. DACC is not available on a restricted line (e.g. coin hotel, inmate, and certain types of PBX).

6.4. National Listing Service

This Service provides the Customers access to Directory Assistance listing information outside the Local Calling Area anywhere in the United States.

Call allowances apply to only Local listings and are not applicable to National Listings.

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6. OPERATOR SERVICES AND DIRECTORY ASSISTANCE, Continued

6.5. Rates and Charges

6.5.1. Directory Assistance Charges

<u>Call type</u>	<u>Rate per call</u>
Local DA with Call Completion	\$0.90
National Listing Service DA	0.90

6.5.2. Operator Assisted Charges (Semi-Automated or Fully Automated)

<u>Call Type</u>	<u>Per Call Rate</u>
Third Number	\$ 4.00
Calling Card	1.50
Collect Calls	4.00

6.5.3. Operator Assisted Charges (Non-automated)

<u>Call Type</u>	<u>Per Call Rate</u>
Third Number	\$ 5.00
Calling Card	5.00
Collect Calls	5.00
Person-to-Person	8.95
Busy Line Verification	13.00
Busy Line Verification with Busy Line Interrupt	13.00

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EXHIBIT E
FINANCIAL STATEMENTS
BOND

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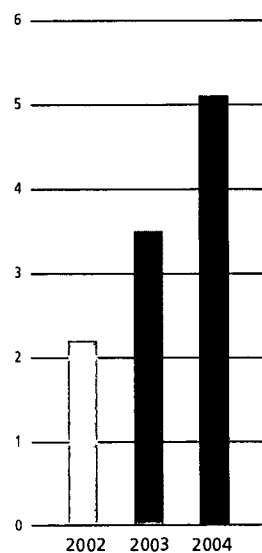


SBC Communications Inc.

2004 ANNUAL REPORT

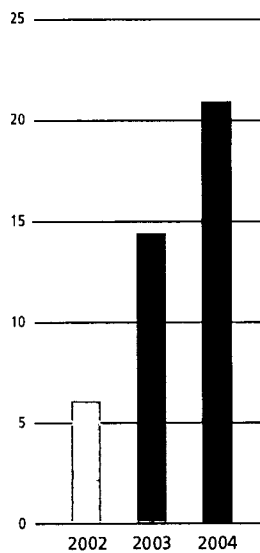
DSL

Lines In millions



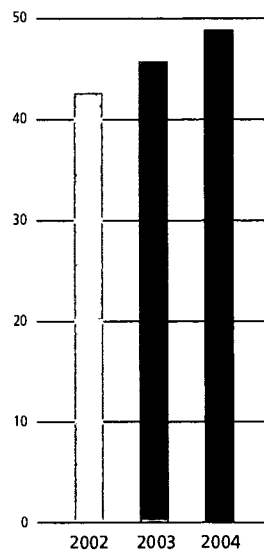
Long Distance

Lines In millions



Cingular Wireless

Pro Forma Subscribers In millions
(combined Cingular and AT&T Wireless subscribers)



In 2004, we took major steps to strengthen SBC.

We created the nation's largest wireless company. We launched plans to deploy an advanced wireline network to deliver next-generation integrated TV, data and voice services. And in January 2005, we announced plans to acquire AT&T Corp., a combination that will transform our company and create a global communications leader. All of these steps represent major growth opportunities for SBC in the years ahead.

At SBC our goal is simple — to be the best-performing, most-respected provider in the communications industry, and in doing so, to return value to our stockholders

We earn this distinction in two ways — through consistent execution to improve operations and benefit customers and through continual innovation, as we deploy advanced technologies, launch next-generation services, integrate services in new ways and responsibly lead industry change

Over the past year, we delivered significant progress in all of these areas. And because of what we have achieved — and the rich areas of opportunity that are available to us — I am very optimistic about our company's future, even as the pace of industry change continues to accelerate

We had some outstanding achievements in 2004

- We added more than 6 million long distance lines to exceed 20 million in service, more than triple our total two years ago
- We accelerated broadband growth and ended the year with more than 5 million DSL lines, the best among U.S. telecom companies
- Our data revenues grew to nearly \$11 billion, more than 40 percent greater than our closest peer
- Cingular Wireless, which is 60 percent owned by SBC, completed its acquisition of AT&T Wireless, delivered strong subscriber growth in its first quarter of combined operations and ended the year with 49 million subscribers, No. 1 among U.S. wireless providers
- We returned to revenue growth two quarters earlier than expected, and as we invested in new initiatives and drove growth, we also managed costs effectively and improved operating margins
- Most important, our solid cash flows allowed us to return substantial value directly to stockholders. In December, we increased our dividend for the 20th consecutive year. And over the past three years, we have returned some \$14.6 billion to stockholders through dividends and share repurchases
- Also, early this year, we agreed to acquire AT&T Corp. for approximately \$16 billion. This combination will create the nation's leading communications company with tremendous global reach

Because of these accomplishments, SBC today is a stronger company. We are a company with sound fundamentals and good momentum, and we are

prepared to meet the challenges of a rapidly changing communications industry

INDUSTRY CHANGE, NEW OPPORTUNITIES

The No. 1 question for every communications company is this: How do we grow and create value for stockholders during a time of industry change?

Over the past few years, every company in our industry has faced pressures from the economy, technology substitution and increased competition. During this time, SBC's financial strength and discipline, along with our solid day-to-day execution, have served us well. We are now strongly positioned to take on the challenges and opportunities ahead.

We will do two things. First, we will remain true to the qualities that have defined our company's success over many years — high-quality customer service, financial discipline, a sound balance sheet. Second, SBC has taken the initiative and developed a set of clear strategic imperatives, a focused set of action items for 2005 and the years ahead.

1. Create the industry's premier wireless provider.

In 2000, we combined our wireless operations with those of BellSouth to create Cingular Wireless. In 2004, we further strengthened Cingular by acquiring AT&T Wireless.

Approvals were completed in just eight months, and Cingular finalized the transaction in October. The result is a new leader in the U.S. wireless market.

The new Cingular has the attributes wireless customers want. Cingular's digital voice and data wireless network is the largest in the country. Its licenses cover a total population area of 290 million, including all of the country's 100 largest metropolitan areas. And it has outstanding spectrum depth, which provides the capacity to deliver excellent voice quality, superior network performance and next-generation data services.

The new Cingular also has the industry's best management team, which has developed an achievable plan to improve performance, reduce costs and drive growth in 2005 and beyond. The plan includes an accelerated network build-out to improve coverage, plus deployment of a third-generation UMTS (Universal Mobile Telecommunications System) network starting in 2005. UMTS technology will provide customers with high speeds for data and video applications, including wireless Internet access. It is also a very efficient technology, since it provides a single platform for both voice and data services.

The good news is that in the first few months following the acquisition of AT&T Wireless, the new Cingular began executing its plan very well. Integration activities are on schedule, and costs are on budget. In the fourth quarter of 2004, its first quarter of combined operations, Cingular increased its pro forma subscriber base by 1.8 million — more than double the two companies' combined pro forma increase in the previous quarter.

The new Cingular is important because it gives SBC a much larger stake in an important growth segment. The U.S. wireless market still has substantial room to grow through new services and increased penetration. Growth in wireless data services has just begun. And Cingular has a sizable opportunity to further expand its business customer base. One of its first steps was to form a national Business Markets Group, focused solely on delivering to enterprises of all sizes wireless solutions that include voice, corporate e-mail access and other data offerings.

The new Cingular also supports a key SBC growth initiative — developing truly integrated wireline/wireless services. These include such products as Unified CommunicationsSM, which lets customers combine voice and e-mail messages on both wireline and wireless services. The ultimate goal is seamless phone services that will combine wireline and wireless through the use of cellular, Wi-Fi and IP (Internet Protocol) technologies to provide customers with added value and create competitive differentiation for SBC.

2. Significantly increase our share of the enterprise space.

We made solid progress in 2004 in establishing SBC as a provider for large enterprise customers, particularly those headquartered in our traditional territory who also have operations in other major cities where we can now provide services through our IP network. And we have expanded our large-business sales organization to reach a broader base of prospects.

However, the acquisition of AT&T Corp. — which we expect to complete by late 2005 or early 2006 — will dramatically accelerate our expansion in this important segment and bring new and innovative services to the SBC portfolio faster and on a broader basis than we currently have available. It will increase our ability to serve business customers not only in the United States but in countries around the world over a network that is unmatched anywhere. AT&T serves virtually every company in the Fortune 1000. This broad network coverage — combined with the strong relationships SBC already has with many of these business customers as their local service provider — positions SBC for stronger growth in the enterprise segment in the years ahead.

3. Capture the future through enhanced broadband, video and VoIP services.

In addition to our progress in the wireless and enterprise segments, we are also driving change in our core wireline business. The keys are IP technology and new video capabilities. These will allow us to transform what was once considered primarily a voice grid into a much more powerful network capable of delivering next-generation, high-speed data and video.

The first wave of this evolution began a few years ago with the launch of DSL high-speed broadband service. We moved aggressively, and today SBC is the clear industry leader in DSL. The next major step-up in capabilities will allow us to deliver video service over an integrated IP-based network that also provides voice and superhigh-speed data.

Again, SBC is at the forefront. In late 2004, we announced plans for Project Lightspeed, our initiative to deploy fiber optics closer to customers and build an advanced network with IP service capabilities that can leapfrog those available today from telephone, cable or satellite TV providers. We expect our new network to reach 18 million households by the end of 2007 with IPTV and superhigh-speed broadband service.

We expect to reap a number of advantages from the approach we have chosen: new revenue-generating products, breakthrough services, a stronger competitive position versus traditional cable TV companies and cost savings in installation and maintenance. In fact, our IPTV service has the potential to completely redefine the video marketplace. Versus other approaches, Project Lightspeed dramatically accelerates our speed to market, giving us the opportunity to win customers and realize savings sooner. Our approach is also more capital efficient, offering prospects for better financial returns.

I am excited about Project Lightspeed. It builds on our strengths. It will help us move our core local business to a more efficient, more powerful network. And it will power a new generation of integrated, IP-based services, which we plan to launch in late 2005 or early 2006 under the brand SBC U-verseSM. IP technology is the future, and SBC intends to lead in IP services.

For some time now, we have provided IP-based solutions for businesses. And in 2004, we won contracts for several large-business VoIP (Voice over IP) deployments, including a contract to create and manage a VoIP network for 50,000 Ford employees located in 110 different facilities. We have also begun trials of residential VoIP services, with a full-scale launch planned for 2005.

4. Enhance the customer experience and revamp our cost structure.

In concert with our other initiatives, we are also working hard to improve our cost structure. We have projects under way across our business to streamline functions and standardize processes to make us more productive. Many of these initiatives will help reduce costs and increase our operating margins to some of the best in the industry. They will also help us achieve best-in-class status in customer service.

Better service helps us retain customers, which over time results in stronger revenues and lower costs. Today, good service also means giving customers online and self-service options, a simplified product portfolio and advanced billing. We have already made substantial progress in all of these areas, and they will be a major focus for SBC in 2005.

Looking to next year and beyond, the assets and capabilities that AT&T Corp. will bring to our company will enable SBC to fundamentally change our cost structure. In fact, the net present value of the expected

cost synergies of the merger exceeds \$15 billion, which equals the value of the stock portion of the transaction. This combination will also allow us to forego expensive capital development costs in a number of areas in the coming years.

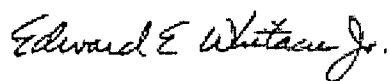
SUBSTANTIAL OPPORTUNITIES, A CLEAR PLAN

SBC's success in the years ahead will be defined by our progress in these four areas. I am very confident in our ability to execute and deliver. And as we do, we will transform our business for the better.

Near-term issues have an impact on stock prices. That was the case in 2004. That said, SBC's long-term prospects are indeed bright. As I look ahead and assess our company's current assets and capabilities, I like what I see. Combine that with the tremendous networks, technological capabilities and enterprise customer base of AT&T Corp., and the outlook for SBC in 2006 and beyond is even brighter.

I see opportunities that are larger than the threats in our environment — opportunities in nationwide wireless, in the large-business space, in next-generation wireline services, in integrated wireline/wireless services and in an improved cost structure. I see a company with great talent and resources. I see energy and enthusiasm for competing and winning customers. I see a company with a clear plan and a willingness to lead in a time of change. I feel very good about SBC's future. Some of our best days are ahead.

Sincerely,



Edward E. Whitacre Jr.
Chairman and Chief Executive Officer
February 25, 2005

In connection with the proposed transaction, SBC intends to file a registration statement, including a proxy statement of AT&T Corp., and other materials with the Securities and Exchange Commission (the "SEC"). Investors are urged to read the registration statement and other materials when they are available because they contain important information. Investors will be able to obtain free copies of the registration statement and proxy statement, when they become available, as well as other filings containing information about SBC and AT&T Corp., without charge, at the SEC's Internet site (www.sec.gov) or by directing a request to SBC Communications Inc., Stockholder Services, 175 E. Houston, San Antonio, Texas 78205. Free copies of AT&T Corp.'s filings may be accessed and downloaded at the AT&T Investor Relations Web Site (www.att.com/ir/sec) or by directing a request to AT&T Corp., Investor Relations, One AT&T Way, Bedminster, New Jersey 07921.

SBC, AT&T Corp. and their respective directors and executive officers and other members of management and employees may be deemed to be participants in the solicitation of proxies from AT&T shareholders in respect of the proposed transaction. Information regarding SBC's directors and executive officers is available in SBC's proxy statement for its 2004 annual meeting of stockholders, dated March 11, 2004, and information regarding AT&T Corp.'s directors and executive officers is available in AT&T Corp.'s proxy statement for its 2004 annual meeting of shareholders, dated March 25, 2004. Additional information regarding the interests of such potential participants will be included in the registration and proxy statement and the other relevant documents filed with the SEC when they become available.

SELECTED FINANCIAL AND OPERATING DATA

Dollars in millions except per share amounts

At December 31 or for the year ended	2004	2003	2002	2001	2000
Financial Data¹					
Operating revenues	\$ 40,787	\$ 40,498	\$ 42,821	\$ 45,381	\$ 50,881
Operating expenses	\$ 34,886	\$ 34,214	\$ 34,383	\$ 35,085	\$ 40,578
Operating income	\$ 5,901	\$ 6,284	\$ 8,438	\$ 10,296	\$ 10,303
Interest expense	\$ 1,023	\$ 1,242	\$ 1,382	\$ 1,599	\$ 1,592
Equity in net income of affiliates	\$ 873	\$ 1,253	\$ 1,921	\$ 1,595	\$ 897
Other income (expense) – net	\$ 922	\$ 1,818	\$ 733	\$ (236)	\$ 2,557
Income taxes	\$ 2,186	\$ 2,857	\$ 2,910	\$ 3,858	\$ 4,748
Income from continuing operations	\$ 4,979	\$ 5,859	\$ 7,361	\$ 6,881	\$ 7,696
Income from discontinued operations, net of tax²	\$ 908	\$ 112	\$ 112	\$ 127	\$ 104
Income before extraordinary item and cumulative effect of accounting changes	\$ 5,887	\$ 5,971	\$ 7,473	\$ 7,008	\$ 7,800
Net income³	\$ 5,887	\$ 8,505	\$ 5,653	\$ 7,008	\$ 7,800
Earnings per common share:					
Income from continuing operations	\$ 1.50	\$ 1.77	\$ 2.21	\$ 2.04	\$ 2.27
Income before extraordinary item and cumulative effect of accounting changes	\$ 1.78	\$ 1.80	\$ 2.24	\$ 2.08	\$ 2.30
Net income³	\$ 1.78	\$ 2.56	\$ 1.70	\$ 2.08	\$ 2.30
Earnings per common share – assuming dilution:					
Income from continuing operations	\$ 1.50	\$ 1.76	\$ 2.20	\$ 2.03	\$ 2.24
Income before extraordinary item and cumulative effect of accounting changes	\$ 1.77	\$ 1.80	\$ 2.23	\$ 2.07	\$ 2.27
Net income³	\$ 1.77	\$ 2.56	\$ 1.69	\$ 2.07	\$ 2.27
Total assets	\$108,844	\$100,233	\$ 95,170	\$ 96,416	\$ 98,735
Long-term debt	\$ 21,231	\$ 16,097	\$ 18,578	\$ 17,153	\$ 15,513
Construction and capital expenditures	\$ 5,099	\$ 5,219	\$ 6,808	\$ 11,189	\$ 13,124
Dividends declared per common share ⁴	\$ 1.26	\$ 1.41	\$ 1.08	\$ 1.025	\$ 1.015
Book value per common share	\$ 12.27	\$ 11.57	\$ 10.01	\$ 9.82	\$ 9.09
Ratio of earnings to fixed charges	6.32	6.35	6.20	5.83	6.73
Debt ratio	40.0%	32.0%	39.9%	44.3%	45.0%
Weighted-average common shares outstanding (000,000)	3,310	3,318	3,330	3,366	3,392
Weighted-average common shares outstanding with dilution (000,000)	3,322	3,329	3,348	3,396	3,433
End of period common shares outstanding (000,000)	3,301	3,305	3,318	3,354	3,386
Operating Data					
Network access lines in service (000)	52,356	54,683	57,083	59,532	61,258
Long-distance lines in service (000)	20,868	14,416	6,071	4,877	3,043
DSL lines in service (000)	5,104	3,515	2,199	1,333	767
Wireless customers (000) – Cingular ⁵	49,109	24,027	21,925	21,596	18,555
Number of employees	162,700	168,950	175,980	193,420	220,090

¹Amounts in the above table have been prepared in accordance with U.S. generally accepted accounting principles.

²Our financial statements for all periods presented reflect results from our sold directory advertising business in Illinois and northwest Indiana as discontinued operations. The operational results and the gain associated with the sale of that business are presented in "Income from discontinued operations, net of tax."

³Amounts include the following extraordinary item and cumulative effect of accounting changes: 2003, extraordinary loss of \$7 related to the adoption of Financial Accounting Standards Board Interpretation No. 46 "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" (FIN 46) and the cumulative effect of accounting changes of \$2,541, which includes a \$3,677 benefit related to the adoption of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (FAS 143) and a \$1,136 charge related to the January 1, 2003 change in the method in which we recognize revenues and expenses related to publishing directories from the "issue basis" method to the "amortization" method, 2002, charges related to a January 1, 2002 adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

⁴Dividends declared by SBC's Board of Directors reflect the following: 2003, includes three additional dividends totaling \$0.25 per share above our regular quarterly dividend payout.

⁵The number presented represents 100% of Cingular Wireless' (Cingular) cellular/PCS customers. The 2004 number includes customers from the acquisition of AT&T Wireless Services Inc. (AT&T Wireless). Cingular is a joint venture in which we own 60% and is accounted for under the equity method.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Dollars in millions except per share amounts

Throughout this document, SBC Communications Inc is referred to as "we" or "SBC." Our subsidiaries and affiliates operate in the communications services industry both domestically and internationally (primarily in Latin America) providing wireline and wireless telecommunications services and equipment as well as directory advertising and publishing services. You should read this discussion in

conjunction with the consolidated financial statements and accompanying notes. A reference to a "Note" in this section refers to the accompanying Notes to Consolidated Financial Statements. In our tables throughout this section, percentage increases and decreases that equal or exceed 100% are not considered meaningful and are denoted with a dash.

RESULTS OF OPERATIONS

Consolidated Results

Our financial results are summarized in the table below. We then discuss factors affecting our overall results for the past three years. These factors are discussed in more detail in our segment results. We also discuss our expected revenue and expense trends for 2005 in the "Operating Environment and Trends of the Business" section.

In accordance with U.S. generally accepted accounting principles (GAAP), our financial statements for all periods presented reflect results from our sold directory advertising business in Illinois and northwest Indiana as discontinued operations (see Note 17). The operational results and the gain associated with the sale of that business are presented in the "Income From Discontinued Operations, net of tax" line item below and on the Consolidated Statements of Income.

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Operating revenues	\$40,787	\$40,498	\$42,821	0.7%	(5.4)%
Operating expenses	34,886	34,214	34,383	2.0	(0.5)
Operating income	5,901	6,284	8,438	(6.1)	(25.5)
Income before income taxes	7,165	8,716	10,271	(17.8)	(15.1)
Income from continuing operations	4,979	5,859	7,361	(15.0)	(20.4)
Income from discontinued operations, net of tax	908	112	112	—	—
Income before extraordinary item and cumulative effect of accounting changes	5,887	5,971	7,473	(1.4)	(20.1)
Extraordinary item ¹	—	(7)	—	—	—
Cumulative effect of accounting changes ^{2,3}	—	2,541	(1,820)	—	—
Net income	5,887	8,505	5,653	(30.8)	50.5
Diluted earnings per share	1.77	2.56	1.69	(30.9)	51.5

¹2003 includes an extraordinary loss on our real estate leases related to the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 46 "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" (FIN 46).

²2003 includes cumulative effect of accounting changes of \$2,541, a \$3,677 benefit related to the adoption of Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (FAS 143), and a \$1,136 charge related to the January 1, 2003 change in the method in which we recognize revenues and expenses related to publishing directories from the "issue basis" method to the "amortization" method.

³2002 includes a cumulative effect of accounting change related to the adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (FAS 142).

Overview Our operating income decreased \$383, or 6.1%, in 2004 and decreased \$2,154, or 25.5%, in 2003. The decrease in 2004 was primarily due to increased cost of sales expense and expenses from strike preparation and labor settlements which more than offset the increase in revenue. Revenue in 2004 increased due to growth in long-distance voice and data revenue, which was partially offset by the decline in voice revenue resulting from a decline in retail access lines. In 2003, operating income declined primarily due to the loss of revenues from declining retail access lines and the increase in our combined net pension and postretirement cost.

The decline in retail access lines historically has been primarily attributable to customers moving from our retail lines to competitors using our wholesale lines provided under the Unbundled Network Element-Platform (UNE-P) rules. UNE-P rules require us to sell our lines and the end-to-end services provided over those lines to competitors at below cost while still absorbing the costs of deploying, provisioning, maintaining and repairing

those lines. Competitors can then take advantage of these below-cost rates to offer services at lower prices. However, by the end of 2004, we reported a decrease in the number of UNE-P lines compared with the end of 2003. This decline reflects continued success in our bundling strategy described below and recently announced pullbacks from competitors in the consumer market but also could result in increased pressure on our operating margins should a customer that was receiving service from a UNE-P provider switch to an alternative technology. Recent federal regulatory developments have altered the UNE-P rules. See our "Competitive and Regulatory Environment" section for further discussion of UNE-P developments.

Additional factors contributing to the declines in retail access lines especially during 2004 were increased competition, including customers using wireless and Voice over Internet Protocol (VoIP) technology and cable instead of phone lines for voice and data, and customers disconnecting their additional lines when purchasing our broadband internet-access (DSL) services. While we lose

some revenue when a wireline customer shifts from one of our retail lines to a competitor that relies on the UNE-P rules to offer service (i.e., one of our wholesale customers), we lose all revenue when a wireline customer shifts to an alternative technology such as cable, wireless or VoIP. However, when a customer signs up for Cingular Wireless (Cingular) service, our net income impact of the lost revenue is lessened because we own a 60% economic interest in Cingular (see Note 6). Increasing use of alternative technologies will continue to pressure our operating margins. Although retail access line losses have continued, the trend has slowed, reflecting in part our ability to now offer retail interLATA (traditional long-distance) service in all of our regions as well as the introduction of offerings combining multiple services for one fixed price ("bundles").

Operating revenues Our operating revenues increased \$289, or 0.7%, in 2004 and decreased \$2,323, or 5.4%, in 2003. Our significant revenue impacts are listed below and discussed in greater detail in our "Wireline Segment Results" section.

- Data revenues increased \$834 in 2004 and \$511 in 2003, primarily driven by continued growth in DSL.
- Long-distance voice revenues increased \$736 in 2004 and \$237 in 2003 primarily driven by increased "bundled" sales of combined long-distance and local calling fixed-fee offerings.

These increases in data and long-distance voice revenues were partially offset in 2004 and more than offset in 2003 by lower voice revenues resulting from the loss of retail access lines, as well as the uncertain U.S. economy (more evident in 2003 and early 2004) and increased competition.

Operating expenses Our operating expenses increased \$672, or 2.0%, in 2004 and decreased \$169, or 0.5%, in 2003. Our significant 2004 increases are listed below and discussed in greater detail in our "Wireline Segment Results" section. The 2004 increases were partially offset by decreases in our combined net pension and postretirement cost (see further discussion below) and lower depreciation and amortization expenses.

- Costs associated with our growth initiatives, including increased equipment sales and services to upgrade and integrate large-business customer network components (network integration services), increased operating expenses approximately \$603.
- In May 2004, after a brief strike, we agreed to a new five-year contract with the Communications Workers of America (CWA). Net impacts from strike preparation and labor settlements increased operating expenses approximately \$263.
- A fourth-quarter amendment to our management pension plan resulted in a noncash charge which increased operating expenses approximately \$90.
- Costs associated with traffic compensation (fees paid for access to another carrier's network), primarily due to higher call volumes generated by growth in our long-distance business, increased operating expenses approximately \$122.

Operating expenses decreased in 2003 due to the following factors:

- Costs were reduced primarily due to the decline in our workforce (down more than 7,000 employees from 2002).
- We recorded charges in 2002, which favorably affected comparisons with 2003. Specifically, these 2002 charges included \$813 related to a workforce reduction program (see Note 2) and additional bad debt reserves of \$125 as a result of the WorldCom Inc. (WorldCom) bankruptcy filing.
- The impact of the adoption of FAS 143 decreased our operating expenses approximately \$280 (see Note 1).
- Our stock option expense decreased approximately \$207 (see Note 12) primarily due to a decrease in options granted during 2003.

The 2003 decreases were partially offset by increasing costs related to our pension and postretirement benefit plans (see further discussion below). Also offsetting the decreases were increased expenses to enhance customer growth, including sales and advertising support for DSL and long-distance marketing initiatives. In particular, our advertising expense increased approximately \$435 in 2003.

Combined Net Pension and Postretirement Cost (Benefit)

Operating expenses include our combined net pension and postretirement cost (benefit) of \$1,287, \$1,835 and \$(82) in 2004, 2003 and 2002. A decrease in our combined net pension and postretirement cost, as happened in 2004, causes our operating expenses to decrease.

Our combined net pension and postretirement expense decreased in 2004 by approximately \$548 primarily because of changes affecting nonmanagement retirees, which decreased expense approximately \$440, better-than-expected asset returns in 2003, which decreased expense \$322, and our accounting for the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act), which decreased expense \$255. Partially offsetting these expense decreases were the following three factors: First, higher-than-expected medical and prescription drug claims increased expense approximately \$156. Second, the reduction of the discount rates used to calculate service and interest cost from 6.75% to 6.25%, in response to lower corporate bond interest rates, increased expense approximately \$141. Third, our medical cost trend rate increased, which increased expense approximately \$83. The trend rate increased because we decided to extend our 2003 medical cost rates into 2004 due to rising claim costs, while maintaining our assumption that the rate will trend to a final expected annual increase of 5.0% in 2009 for all retirees. See Note 10 for further detail of our actuarial estimates of pension and postretirement benefit expense and actuarial assumptions.

In the second quarter of 2004, we entered into new five-year labor agreements with the CWA and the International Brotherhood of Electrical Workers (IBEW). The labor agreements cover approximately 110,000 employees and replaced three-year agreements that

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
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expired during the year. The labor agreements provided for changes to active nonmanagement employees' medical coverage.

As discussed in Note 10, during 2004, the majority of nonmanagement retirees were informed of medical coverage changes that affected cost sharing, which became effective January 1, 2005. These changes reduced our postemployment cost approximately \$440 in 2004.

Retirement Offers Operating expenses also include expenses for enhanced pension and postretirement benefits of approximately \$25, \$44 and \$486 in 2004, 2003 and 2002 in connection with voluntary enhanced retirement programs offered to certain management and nonmanagement employees as part of workforce reduction programs.

The Internal Revenue Service (IRS) sets, and can adjust quarterly, the interest rate applicable for calculations of lump sum payments from pension plans. An increase in the interest rate has a negative impact on the lump sum pension calculation for some of our employees. During certain quarters of 2004 and 2003, we chose to extend the pension plan lump sum benefit payout rate for a specified period of time, allowing our employees to receive a higher payout of their pension benefits. The extension of the lump sum benefit payout rate was accounted for as a special termination benefit and also increased our pension benefit expense approximately \$7 in 2004 and \$28 in 2003.

Pension Settlement Gains/Losses Under GAAP, on a plan-by-plan basis, if lump sum benefit payments made to employees upon termination or retirement exceed required thresholds, we recognize a portion of previously unrecognized pension gains or losses attributable to that plan's assets and liabilities. Until 2002, we had an unrecognized net gain, primarily because our actual investment returns exceeded our expected investment returns. During 2002, we made lump sum benefit payments in excess of the GAAP thresholds, resulting in the recognition of net gains, referred to as "pension settlement gains." We recognized net pension settlement gains of approximately \$29 in 2002. Due to U.S. securities market conditions, our plans experienced investment losses during 2002 resulting in a decline in pension assets, causing us to have a net unrecognized loss. Net settlement gains in 2002 include settlement losses during the latter part of the year, reflecting the continued investment losses sustained by the plan. We did not recognize any material settlement gains or losses in 2004 or 2003.

Interest expense decreased \$219, or 17.6%, in 2004 and \$140, or 10.1%, in 2003. The decrease in 2004 was primarily due to expenses recorded in 2003 that were associated with the early redemption of approximately \$1,743 of our bonds. Interest expense also decreased due to the resulting lower debt levels we experienced during the first three quarters of 2004. We expect our future interest expense to increase as a result of our increased debt levels associated with Cingular Wireless' acquisition of AT&T Wireless Services Inc. (AT&T Wireless). The 2003 decrease was

primarily related to lower debt levels, which decreased approximately \$4,102, including \$1,743 of debt called prior to maturity.

Interest income decreased \$111, or 18.4%, in 2004 and increased \$42, or 7.5%, in 2003. The decrease in 2004 is primarily related to the early settlement in 2003 of our notes receivable associated with the 2002 sale of our investment in Bell Canada Holdings Inc. (Bell Canada) to BCE, Inc. (BCE). This settlement included approximately \$37 of prepaid interest. Also contributing to the decrease in 2004 was our 2003 renegotiation of the interest rates, from 7.5% to 6.0%, charged on our advances to Cingular. The increase in 2003 was due to the prepaid interest described above combined with higher average investment balances in 2003 compared to 2002. These increases, in 2003, were partially offset by a decrease in interest rates charged to Cingular.

Equity in net income of affiliates decreased \$380, or 30.3%, in 2004 and \$668, or 34.8%, in 2003. The 2004 results included increased income from our international holdings of approximately \$206, primarily related to TDC A/S's (TDC) gain on the sale of its interest in Belgacom S.A. (Belgacom) (see Note 2), offset by a decline of \$583 in our proportionate share of Cingular's results.

The 2003 decrease was due to lower results from our international holdings of approximately \$546, largely attributable to gains that occurred in 2002, and foregone equity income from the disposition of investments. The decrease was also due to lower 2003 operating results from Cingular. Our proportionate share of Cingular's results decreased approximately \$146 in 2003.

We account for our 60% economic interest in Cingular under the equity method of accounting and therefore include our proportionate share of Cingular's results in our "Equity in net income of affiliates" line item in our Consolidated Statements of Income. Cingular's operating results are discussed in detail in the "Cingular Segment Results" section and results from our international holdings are discussed in detail in "International Segment Results." Our accounting for Cingular is described in more detail in Note 6.

Other income (expense) – net We had other income of \$922 in 2004, \$1,818 in 2003 and \$733 in 2002. Results for 2004 primarily included a gain of approximately \$832 on the sale of our investment in Belgacom, gains of \$270 on the sale of shares of Amdocs Limited (Amdocs) and Yahoo! (Yahoo) and a gain of \$57 on the sale of shares of Teléfonos de México, S.A. de C.V. (Telmex) and América Móvil S.A. de C.V. (América Móvil). These 2004 gains were partially offset by 2004 losses of approximately \$138 on the sale of all of our shares of TDC, \$82 on the sale of all of our shares of Telkom S.A. Limited (Telkom) and \$21 on the sale of another investment.

Results for 2003 included gains of approximately \$1,574 on the sale of our interest in Cegetel S.A. (Cegetel) and gains of \$201 on the sales of Yahoo and BCE shares.

Results for 2002 primarily included gains of approximately \$603 on the redemption of our investment in Bell Canada and gains of \$191 on the sale of shares of Telmex, América Móvil and Amdocs. These gains were partially offset by a charge of approximately \$75 related to the decrease in value of our investment in WilTel Communications (formerly Williams Communications Group Inc.) combined with a loss on the sale of our webhosting operations.

Income taxes decreased \$671, or 23.5%, in 2004 and \$53, or 1.8%, in 2003. The decrease in income tax in 2004 compared to 2003 was due primarily to lower income before income tax. Our effective tax rate in 2004 was 30.5% compared to 32.8% in 2003. This decrease in effective tax rate is primarily a result of the accrual related to the nontaxable Medicare Act reimbursement accruals, tax settlements and impacts from our foreign operations. The decrease in income tax expense in 2003 compared to 2002 was primarily due to lower income before income taxes partially offset by a lower effective tax rate in 2002. Our effective tax rate in 2002 was 28.3%. The higher effective tax rate in 2003 primarily relates to activity in 2002 that had a positive impact on our rate in that year such as lower state taxes, reductions due to one-time changes in the legal forms of various entities and increased realization of foreign tax credits.

Income from discontinued operations increased \$796 in 2004 and was flat in 2003. Discontinued operations consist of the portion of our directory operations that was sold on September 1, 2004. The increase was due to the gain on the sale of these operations of \$827, net of tax (see Note 17). Revenues from discontinued operations decreased \$170, or 35.3%, in 2004. Expenses decreased \$116, or 39.3%, in 2004. Operating results for 2004 include only eight months of activity prior to the sale, resulting in lower revenues and expenses than in 2003. In 2003, revenues and expenses were essentially flat compared to 2002.

Extraordinary item in 2003 consisted of an extraordinary loss of \$7, net of taxes of \$4, related to consolidation of real estate leases under FIN 46 (see Note 1).

Cumulative effect of accounting changes Effective January 1, 2003, we changed our method of recognizing revenues and expenses related to publishing directories from the "issue basis" to the "amortization method." Our directory accounting change resulted in a noncash charge of \$1,136, net of an income tax benefit of \$714, recorded as a cumulative effect of accounting change on the Consolidated Statement of Income as of January 1, 2003 (see Note 1).

On January 1, 2003, we adopted FAS 143, which changed the way we depreciate certain types of our property, plant and equipment. The noncash gain resulting from adoption was \$3,677, net of deferred taxes of \$2,249, recorded as a cumulative effect of accounting change on the Consolidated Statement of Income as of January 1, 2003 (see Note 1).

On January 1, 2002, we adopted FAS 142. Adoption of FAS 142 means that we stopped amortizing goodwill, and at least annually we will test the remaining book value of

goodwill for impairment. Our total cumulative effect of accounting change from adopting FAS 142 was a noncash charge of \$1,820, net of an income tax benefit of \$5, recorded as of January 1, 2002 (see Note 1).

Segment Results

Our segments represent strategic business units that offer different products and services and are managed accordingly. As required by GAAP, our operating segment results presented in Note 4 and discussed below for each segment follow our internal management reporting. Under GAAP segment reporting rules, we analyze our various operating segments based on segment income. Interest expense, interest income, other income (expense) – net and income tax expense are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our total segment income. Each segment's percentage of total segment operating revenue calculation is derived from our segment results table in Note 4 and reflects amounts before eliminations. We have five reportable segments that reflect the current management of our business: (1) wireline, (2) Cingular, (3) directory, (4) international, and (5) other.

The **wireline segment** accounted for approximately 61% of our 2004 total segment operating revenues as compared to 65% in 2003 and 52% of our 2004 total segment income as compared to 47% in 2003. We operate as both a retail and wholesale seller of communications services providing landline telecommunications services, including local and long-distance voice, switched access, data and messaging services and satellite television services through our agreement with EchoStar Communications Corp. (EchoStar).

The **Cingular segment** accounted for approximately 32% of our 2004 total segment operating revenues as compared to 28% in 2003 and 2% of our 2004 total segment income as compared to 12% in 2003. This segment reflects 100% of the results reported by Cingular, our wireless joint venture with BellSouth Corporation (BellSouth), excluding the effects of Cingular's February 2005 announcement (see "Cingular Segment Results"). Cingular offers both wireless voice and data communications services across most of the United States, providing cellular and PCS services. On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. The decline in segment income was primarily attributable to incremental operating expenses and costs associated with Cingular's acquisition of AT&T Wireless. Although we analyze Cingular's revenues and expenses under the Cingular segment, we eliminate the Cingular segment in our consolidated financial statements. In our consolidated financial statements, we report our 60% proportionate share of Cingular's results as equity in net income of affiliates.

The **directory segment** accounted for approximately 6% of our 2004 total segment operating revenues as compared to 7% in 2003 and 30% of our 2004 total segment income as compared to 25% in 2003. This segment includes all

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directory operations, including Yellow and White Pages advertising and electronic publishing. Results for this segment are shown under the amortization method which means that revenues and direct expenses are recognized ratably over the life of the directory title, typically 12 months. Results for all periods presented in this segment have been restated to reflect the sale of our interest in the directory advertising business in Illinois and northwest Indiana to R H Donnelley Corporation (Donnelley). In November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth and acquired the internet directory provider YellowPages.com (YPC) (see Note 2).

All investments with primarily international operations are included in the *international segment*, which accounted for less than 1% of our 2004 and 2003 total segment operating revenues and 12% of our 2004 total segment income as compared to 7% in 2003. Most of our

international investments are accounted for under the equity method and therefore their results are reflected in segment income but not in segment revenue or expense. During 2004, we sold our entire interests in TDC, Belgacom and Telkom.

The *other segment* includes results from paging services, all corporate and other operations as well as the equity income from our investment in Cingular. Although we analyze Cingular's revenues and expenses under the Cingular segment, we record equity in net income of affiliates (from non-international investments) in the other segment.

The following tables show components of results of operations by segment. We discuss significant segment results following each table. We discuss capital expenditures for each segment in "Liquidity and Capital Resources."

**Wireline
Segment Results**

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Segment operating revenues					
Voice	\$20,796	\$21,986	\$24,636	(5.4)%	(10.8)%
Data	10,984	10,150	9,639	8.2	5.3
Long-distance voice	3,297	2,561	2,324	28.7	10.2
Other	1,810	1,843	1,960	(1.8)	(6.0)
Total Segment Operating Revenues	36,887	36,540	38,559	0.9	(5.2)
Segment operating expenses					
Cost of sales	16,603	15,941	15,703	4.2	1.5
Selling, general and administrative	9,206	8,794	8,445	4.7	4.1
Depreciation and amortization	7,454	7,763	8,442	(4.0)	(8.0)
Total Segment Operating Expenses	33,263	32,498	32,590	2.4	(0.3)
Segment Income	\$ 3,624	\$ 4,042	\$ 5,969	(10.3)%	(32.3)%

Our wireline segment operating income margin was 9.8% in 2004, compared to 11.1% in 2003 and 15.5% in 2002. The continued decline in our wireline segment operating income margin in 2004 was due primarily to the continued loss of voice revenue from the decline in total access lines (as shown in the following table) from 2003 to 2004 of 2,327,000, or 4.3%. This revenue decline was caused by an increase in customers disconnecting additional lines and using alternative technologies, such as wireless and cable instead of phone lines for voice and data, our bundling strategy and other pricing responses to competitors' offerings, and lower demand for services due to the uncertain U.S. economy (primarily in 2003 and the first

half of 2004). Revenue also has declined over the past several years as our retail customers have disconnected their lines in order to obtain service from competitors who lease our lower-margin UNE-P lines. While UNE-P lines declined by 167,000 from 2003 levels (see table below), they were 1,534,000, or 30.9%, higher than at the end of 2002. The impact of the UNE-P rules on our operating income margin is discussed below. (The UNE-P rules are discussed in "Consolidated Results" and in "Operating Environment and Trends of the Business.") Our operating income margin was also pressured on the cost side due to our growth initiatives in long-distance, DSL and the large-business market.

Following is a summary of our switched access lines at December 31, 2004, 2003 and 2002

Switched Access Lines

(In 000s)	2004	2003	2002	Increase (Decrease)	
				2004 vs 2003	2003 vs 2002
Retail Consumer					
Primary	23,206	23,948	25,636	(742)	(1,688)
Additional	4,322	4,894	5,723	(572)	(829)
Retail Consumer Subtotal	27,528	28,842	31,359	(1,314)	(2,517)
Retail Business	17,552	18,264	19,450	(712)	(1,186)
Retail Subtotal	45,080	47,106	50,809	(2,026)	(3,703)
Percent of total switched access lines	86.1%	86.1%	89.0%		
UNE-P	6,497	6,664	4,963	(167)	1,701
Resale	349	445	801	(96)	(356)
Wholesale Subtotal	6,846	7,109	5,764	(263)	1,345
Percent of total switched access lines	13.1%	13.0%	10.1%		
Payphone (Retail and Wholesale)	430	468	510	(38)	(42)
Percent of total switched access lines	0.8%	0.9%	0.9%		
Total Switched Access Lines	52,356	54,683	57,083	(2,327)	(2,400)
DSL Lines in Service	5,104	3,515	2,199	1,589	1,316

Total switched access lines in service at December 31, 2004 were 52,356,000, a decline of 2,327,000, or 4.3%, from December 31, 2003 levels. Of this total, retail access lines of 45,080,000 represent 86.1% of total access lines. During 2004, wholesale lines (which include UNE-P and resale) decreased by 263,000 to 6,846,000. Wholesale lines represent 13.1% of total access lines at December 31, 2004. The decline in total access lines reflects many factors, including the disconnection of additional lines as our existing customers purchase our DSL broadband services and for other reasons, the continued growth in alternative communications technologies, such as wireless, cable and other internet-based systems, and continuing slow demand from U.S. businesses. While we lose some revenue when a wireline customer shifts from one of our retail lines to a competitor that relies on the UNE-P rules to offer service (i.e., one of our wholesale customers), we lose all customer revenue when a retail wireline customer shifts to an alternative technology such as cable, wireless or the Internet using VoIP. Increasing use of alternative technologies and the continuing existence of the UNE-P rules will continue to pressure our wireline segment's operating margins. For recent developments affecting the UNE-P rules see "December 2004 FCC Unbundling Rules."

Total switched access lines in service at December 31, 2003 were 54,683,000, a decline of 2,400,000, or 4.2%, from December 31, 2002 levels. Of this total, retail access lines of 47,106,000 represent 86.1% of total access lines, while at December 31, 2002, retail access lines accounted for 89.0% of total access lines. During this same period, wholesale lines increased by 1,345,000, or 23.3%, to 7,109,000. Wholesale lines represent 13.0% of total access lines at December 31, 2003, compared to 10.1% of total lines a year earlier.

While retail access lines continued to decline, the trend slowed in our West, Midwest and Southwest regions reflecting our ability to offer retail interLATA (traditional long-distance) service and the introduction of bundled offerings in those regions (see "Long-distance voice" below). Our West region includes the California and Nevada markets. Our Midwest region includes the Michigan, Illinois, Indiana, Ohio and Wisconsin markets. Our Southwest region includes the Arkansas, Kansas, Missouri, Oklahoma and Texas markets. In late 2003, we began offering retail interLATA service in our Midwest region (see our "Operating Environment and Trends of the Business" section). Retail access lines for the Midwest region have decreased 4.4% since December 31, 2003, compared with declines of 4.7% in the Southwest region and 3.7% in the West region, for the same period. See further discussion of the details of our wireline segment revenue and expense fluctuations below.

Voice revenues decreased \$1,190, or 5.4%, in 2004 and \$2,650, or 10.8%, in 2003 primarily due to the loss of retail access lines. The decline in retail lines primarily reflects increased competition, including customers using wireless technology and cable instead of phone lines for voice and data, the disconnection of additional lines for DSL service and other reasons, and the uncertain economy. The access line declines decreased revenues approximately \$841 in 2004 and \$1,416 in 2003. Pricing responses to competitors' offerings and regulatory changes reduced revenues approximately \$390 in 2004 and \$398 in 2003. A decline in demand for calling features (e.g., Caller ID and voice mail) due in part to the access line declines and an uncertain economy decreased revenues approximately \$180 in 2004 and \$329 in 2003.

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Continued declines in demand for voice equipment located on customer premises decreased revenues approximately \$87 in 2004 and \$59 in 2003. Revenue from "local plus" plans (expanded local calling area) declined approximately \$76 in 2004 and \$92 in 2003, as more customers chose broader long-distance and other bundled offerings. Reduced demand for inside wire service agreements decreased revenues approximately \$61 in 2004 and \$138 in 2003. Lower demand for retail payphone services decreased revenues approximately \$57 in 2004 and \$99 in 2003. We expect payphone access lines and revenue to continue to decline in future periods.

Partially offsetting these revenue declines, wholesale services (primarily UNE-P lines provided to competitors) increased revenues approximately \$94 in 2004 and \$478 in 2003. The 2004 increase reflects UNE rate increases approved by various state utilities commissions while the 2003 increase reflects growth in UNE-P lines during 2003. Net settlements and billing adjustments with our wholesale customers increased revenues approximately \$204 in 2004 and decreased revenue \$297 in 2003. Revenue also increased by \$37 in 2004 due to the reduction of an accrual related to Federal Communications Commission (FCC) proceedings on the inclusion of other postretirement benefit costs in previous tariff filings. Revenue increased by \$71 in 2004 related to a September 2004 ruling by the California Public Utility Commission (CPUC) that retroactively increased UNE-P rates we could charge in California. In 2003, revenue decreased approximately \$210 due to an earlier California regulatory order that reduced UNE-P pricing.

Data revenues increased \$834, or 8.2%, in 2004 and \$511, or 5.3%, in 2003. These increases were primarily due to continued growth in DSL, our broadband internet-access service, which increased data revenues approximately \$538 in 2004 and \$484 in 2003. The number of DSL lines in service grew to approximately 5.1 million in 2004 as compared to 3.5 million at the end of 2003 and 2.2 million at the end of 2002. Revenues from large-business customers (as well as DSL) typically consist of revenue from the initial installation of equipment followed by services provided over multiple years.

Additionally in 2004, revenue from data equipment sales and network integration services increased approximately \$402, reflecting our expansion into the large-business market.

Partially offsetting the 2004 increases, revenue from our high-capacity transport services decreased approximately \$81 in 2004. Our high-capacity transport services, which include DS1s and DS3s (types of dedicated high-capacity lines), and SONET (a dedicated high-speed solution for multisite businesses), represented about 61% of total data revenues in 2004. Included in the 2004 decrease in high-capacity transport revenues was the impact of a one-time MCI, Inc. (MCI) (formerly known as WorldCom) 2003 settlement of approximately \$45 which affected year-over-year comparisons. Also included in our high-capacity results was the impact of the continued implementation of the 2000 federal Coalition for Affordable Local and

Long Distance Services (CALLS) order which decreased revenue approximately \$44 in 2004. Our 2004 high-capacity results also reflected a revenue decrease of \$21 related to the September 2004 California order described above which retroactively lowered UNE-P rates for data services.

In 2003, revenue from our high-capacity transport services decreased approximately \$16 and represented about 66% of our total data revenues. Included in our 2003 high-capacity transport results was the impact of the one-time MCI settlement mentioned above which increased 2003 high-capacity revenues approximately \$45. This increase was partially offset by approximately \$26 related to a prior-year WorldCom settlement which increased 2002 revenue. Also included in our high-capacity results was the impact of the continued implementation of the 2000 federal CALLS order which decreased revenue approximately \$82 in 2003.

Long-distance voice revenues increased \$736, or 28.7%, in 2004 and \$237, or 10.2%, in 2003. The 2004 increase was primarily driven by increased sales of combined long-distance and local calling fixed-fee offerings (referred to as "bundling"). Sales of our bundling offers continued to increase in our Midwest, West and Southwest regions with the most significant improvements in results occurring in our Midwest region, where we launched long-distance service in late September and October 2003.

Retail interLATA (traditional) long-distance revenues increased approximately \$825 in 2004, reflecting our ability to offer nationwide long-distance services. In addition to our previous entries into the long-distance markets in our Southwest region and Connecticut, we entered the long-distance markets in our West region in late December 2002 and April 2003 and our Midwest region in late September and October of 2003. Also contributing to the increase was continued growth in our international calling bundles and our business long-distance service. Our retail international long-distance revenue increased approximately \$135 due to higher call volumes that originate or terminate internationally. In addition, revenue from our toll-free and calling card services increased approximately \$64 during 2004.

Partially offsetting these increases was a decline of approximately \$317 in retail intraLATA long-distance (local toll) revenues. The decrease in intraLATA revenues was due to a decline in minutes of use, price decreases caused by increased competition and our fixed-fee bundling offerings, and access line losses. Market-driven price reductions decreased intraLATA revenues approximately \$91. IntraLATA revenues declined approximately \$51 due to access line losses. The decline in minutes of use mainly related to the increased sales of our fixed-fee bundles, which do not separately bill minutes of use. If the growth rate in these fixed-fee bundles were to decline as our interLATA long-distance markets continue to mature, we would expect these declining intraLATA revenue trends to also diminish.

The 2003 increase was primarily driven by increased sales of combined long-distance and local calling fixed-fee offerings in our West, Southwest and Midwest regions.

due to our entry into these regions mentioned above Retail interLATA long-distance (traditional long-distance) revenues increased approximately \$385 reflecting our ability to offer nationwide long-distance services Also contributing to the increase was continuing growth in our international calling bundles and our business long-distance service Our retail international long-distance revenue increased approximately \$112 due to higher call volumes that originate or terminate internationally

Partially offsetting these 2003 increases was a decline of approximately \$286 in retail intraLATA long-distance revenues The decrease in intraLATA revenues is due to a decline in minutes of use, access line losses and price decreases caused by increased competition and our fixed-fee bundling packages The 2003 intraLATA revenue decline was primarily due to decreases in billed intraLATA minutes of use IntraLATA revenues declined approximately \$106 due to access line losses Market-driven price reductions decreased intraLATA revenues approximately \$53

Other operating revenues decreased \$33, or 1.8%, in 2004 and \$117, or 6.0%, in 2003 Revenue from directory and operator assistance, billing and collection services provided to other carriers and other miscellaneous products and services decreased approximately \$97 in 2004 and \$119 in 2003 Various one-time billing adjustments also decreased revenues approximately \$71 in 2004 and \$75 in 2003 Commissions revenue received from Cingular related to Cingular customers added through SBC sales sources decreased approximately \$27 in 2004 after increasing \$57 in 2003 reflecting more stringent credit policies put in place in 2004 Partially offsetting these revenue decreases, our co-branded SBC | DISH Network satellite TV service and other pricing changes increased revenue approximately \$94 and \$20, respectively in 2004 Price increases, primarily in directory assistance, increased revenues approximately \$48 in 2004 and \$38 in 2003

Cost of sales expenses increased \$662, or 4.2%, in 2004 and \$238, or 1.5%, in 2003 Cost of sales consists of costs we incur to provide our products and services, including costs of operating and maintaining our networks Costs in this category include repair services, certain network planning and engineering expenses, operator services, information technology, property taxes related to elements of our network, and payphone operations Pension and postretirement costs are also included to the extent that they are allocated to our network labor force and other employees who perform the functions listed in this paragraph

Costs associated with equipment sales and related network integration services, our SBC | DISH Network satellite TV service and DSL modems increased approximately \$603 in 2004 and \$77 in 2003, reflecting our emphasis on our growth initiatives in the large-business market, DSL and video Costs associated with equipment for large-business customers (as well as DSL and video) typically are greater than costs associated with services that are provided over multiple years Our 2004 costs accordingly reflect our initial expansion into the large-business market during 2004 We expect continued

increases in expenses related to our SBC | DISH Network satellite TV service and large-business initiatives

Salary and wage merit increases and other bonus accrual adjustments increased expense approximately \$356 in 2004 and \$508 in 2003 As a result of our labor contract settlements, the accrual and partial payment of a retiree bonus increased expenses approximately \$154 in 2004 Traffic compensation expense (for access to another carrier's network) increased approximately \$122 in 2004 as our long-distance service generated higher traffic (telephone call) expenses of \$522 which was partially offset by a decrease of \$400 due to lower rates we paid on local traffic terminating on competitor networks and to wireless customers In 2003, traffic compensation expense increased approximately \$36 as the higher traffic expense generated from our long-distance service of \$248 was partially offset by a decrease of \$212 due to lower rates we paid on local traffic terminating on competitor networks and to wireless customers Expenses increased approximately \$54 in 2004 due to higher severance accruals, after decreasing \$221 in 2003 In 2003, our combined net pension and postretirement cost (which include certain employee-related benefits) increased approximately \$824 due to net investment losses and pension settlement gains recognized in previous years, which reduced the amount of unrealized gains recognized in 2003 Also contributing to the increased net pension and postretirement costs was a lower assumed long-term rate of return on plan assets, a reduction in the discount rate used to calculate service and interest costs, higher-than-expected medical and prescription drug claims and an increase in our medical cost trend rates (see Note 10)

Partially offsetting the increases, our combined net pension and postretirement cost decreased approximately \$306 in 2004 reflecting changes in nonmanagement retirees' medical coverage and our accounting for the Medicare Act See our "Consolidated Results" section for further discussion of combined net pension and postretirement cost Lower employee levels decreased expenses, primarily salary and wages, approximately \$208 in 2004 and \$312 in 2003 Nonemployee-related expenses such as contract services, agent commissions and materials and supplies costs decreased approximately \$148 in 2004 and \$545 in 2003 Other employee-related expenses including travel, training and conferences were essentially flat in 2004 and decreased approximately \$34 in 2003

Selling, general and administrative expenses increased \$412, or 4.7%, in 2004 and \$349, or 4.1%, in 2003 Selling, general and administrative expenses consist of our provision for uncollectible accounts, advertising costs, sales and marketing functions, including our retail and wholesale customer service centers, centrally managed real estate costs, including maintenance and utilities on all owned and leased buildings, credit and collection functions and corporate overhead costs, such as finance, legal, human resources and external affairs Pension and postretirement costs are also included to the extent they relate to employees who perform the functions listed in this paragraph

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Nonemployee-related expenses such as contract services, agent commissions and materials and supplies costs increased approximately \$188 in 2004 and decreased \$120 in 2003. Salary and wage merit increases and other bonus accrual adjustments increased expenses approximately \$127 in 2004 and \$470 in 2003. Expenses increased approximately \$111 in 2004 due to higher severance accruals, after decreasing \$148 in 2003. As a result of our labor contract settlements, the accrual and partial payment of a retiree bonus increased expenses approximately \$79 in 2004. Other employee-related expenses including travel, training and conferences increased approximately \$29 in 2004 and decreased \$23 in 2003. In 2003, our combined net pension and postretirement cost (which include certain employee-related benefits) increased approximately \$404 due to net investment losses and pension settlement gains recognized in previous years, which reduced the amount of unrealized gains recognized in 2003. Also contributing to the increased net pension and postretirement costs was a lower assumed long-term rate of return on plan assets, a reduction in the discount rate used to calculate service and interest costs, higher-than-expected medical and prescription drug claims and an increase in our medical cost trend rates (see Note 10).

Partially offsetting the increases, our combined net pension and postretirement cost decreased approximately \$22 in 2004 reflecting changes in nonmanagement retirees' medical coverage and our accounting for the Medicare Act

See our "Consolidated Results" section for further discussion of combined net pension and postretirement cost

Our provision for uncollectible accounts decreased approximately \$21 in 2004 and \$479 in 2003 as we experienced fewer losses from our retail customers and a decrease in bankruptcy filings by our wholesale customers. Contributing to the decrease in 2003 was the 2003 reversal of WorldCom bad debt reserves of \$86 as a result of a settlement reached with WorldCom (see "Other Business Matters"). Year-over-year comparisons were also affected by our recording in 2002 of an additional bad debt reserve of \$125 as a result of the WorldCom bankruptcy filing.

Advertising expense decreased approximately \$43 in 2004 and increased \$368 in 2003. The advertising increase in 2003 was primarily driven by our launch of long-distance service in new markets and bundling initiatives, which declined slightly in 2004. Additionally, lower employee levels decreased expenses, primarily salary and wages, approximately \$36 in 2004 and \$121 in 2003.

Depreciation and amortization expenses decreased \$309, or 4.0%, in 2004 and \$679, or 8.0%, in 2003. Lower expense in 2004 was due primarily to lower capital expenditures over the last three years. The change in our depreciation rates when we adopted FAS 143 (see Note 1) decreased expenses approximately \$340 in 2003. Reduced capital expenditures accounted for the remainder of the decrease in 2003.

**Cingular
Segment Results**

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Segment operating revenues					
Service	\$17,473	\$14,223	\$13,922	22.9%	2.2%
Equipment	1,963	1,260	981	55.8	28.4
Total Segment Operating Revenues	19,436	15,483	14,903	25.5	3.9
Segment operating expenses					
Cost of services and equipment sales	7,487	5,683	5,106	31.7	11.3
Selling, general and administrative	7,347	5,422	5,426	35.5	(0.1)
Depreciation and amortization	3,079	2,089	1,850	47.4	12.9
Total Segment Operating Expenses	17,913	13,194	12,382	35.8	6.6
Segment Operating Income	1,523	2,289	2,521	(33.5)	(9.2)
Interest Expense	900	856	911	5.1	(6.0)
Equity in Net Income (Loss) of Affiliates	(390)	(323)	(265)	(20.7)	(21.9)
Other, net	(70)	(60)	(94)	(16.7)	36.2
Segment Income	\$ 163	\$ 1,050	\$ 1,251	(84.5)%	(16.1)%

Accounting for Cingular

We account for our 60% economic interest in Cingular under the equity method of accounting in our consolidated financial statements since we share control equally (i.e., 50/50) with our 40% economic partner BellSouth in the joint venture. We have equal voting rights and representation on the board of directors that controls Cingular. This means that our consolidated results include

Cingular's results in the "Equity in net income of affiliates" line. However, when analyzing our segment results, we evaluate Cingular's results on a stand-alone basis using information provided by Cingular during the year. In February 2005, we announced we were recording a charge against fourth-quarter 2004 results to reflect the correction of an error relating to the lease accounting practices of Cingular. Cingular restated previous financial results. Our

prior-years' financial results were not restated due to the immateriality of this adjustment to the results of operations, cash flows and financial position for the current year or any individual or prior period. As a result of the charge, we reduced our fourth-quarter 2004 equity in net income of affiliates by approximately \$105. This charge does not affect Cingular's cash flows and is primarily related to the timing of recording rental expense, which would balance out over the life of the affected operating leases. Because this was a noncash charge which had an immaterial impact on reported segment results for the periods presented and since the information used for analysis did not include this adjustment, in the segment table above, we present 100% of Cingular's revenues and expenses excluding this adjustment under "Segment operating revenues" and "Segment operating expenses." Including 100% of Cingular's results in our segment operations (rather than 60% in equity in net income of affiliates) affects the presentation of this segment's revenues, expenses, operating income, nonoperating items and segment income but does not affect our consolidated net income.

Acquisition of AT&T Wireless

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. In connection with the acquisition, we entered into an investment agreement with BellSouth and Cingular. Under the investment agreement, we and BellSouth funded, by means of an equity contribution to Cingular, a significant portion of the acquisition's purchase price. Based on our 60% equity ownership of Cingular, and after taking into account cash on hand at AT&T Wireless, we provided additional equity of approximately \$21,600 to fund the consideration. In exchange for this equity contribution, Cingular issued to us and BellSouth new membership interests in Cingular. Equity ownership and management control of Cingular remains unchanged after the acquisition. See "Liquidity and Capital Resources" and Note 16 for more details.

With the acquisition, Cingular now serves over 49 million customers and is the largest provider of mobile wireless voice and data communications services in the United States, based on the number of wireless customers. In December 2004, Cingular closed its previously announced agreement with Triton PCS (Triton), whereby Cingular received wireless properties and spectrum in Virginia (including one of the top 50 metropolitan areas) from Triton and in exchange Triton received AT&T Wireless' spectrum and properties in North Carolina and Puerto Rico and \$176 in cash. Upon completion of the AT&T Wireless and Triton transactions, Cingular has license coverage serving an aggregate population of potential customers, referred to as "POPs", of approximately 290 million, including all of the 100 largest metropolitan areas. As required by the FCC and the United States Department of Justice, Cingular will divest assets, including wireless services and spectrum licenses, in parts of 11 states. These divestitures, when made, will not materially affect Cingular's financial results or business, including Cingular's ability to provide services in the top 100 metropolitan areas.

Cingular's Operating Results

Our Cingular segment operating income margin was 7.8% in 2004, 14.8% in 2003, and 16.9% in 2002. The lower 2004 margin was caused by increased expenses that were only partially offset by increased revenues. The primary driver for 2004 increases in almost every component of Cingular's total operating revenues and operating expenses was the acquisition of AT&T Wireless in late October 2004 and inclusion of AT&T Wireless operating results since the acquisition. At December 31, 2004, Cingular served more than 49 million wireless customers as compared to approximately 24 million at December 31, 2003 and 22 million at December 31, 2002.

Cingular's operating expenses increased \$4,719, or 35.8%, in 2004 primarily due to incremental expenses from AT&T Wireless, merger and integration costs of \$288 related to the acquisition of AT&T Wireless, acquisition costs associated with significantly higher customer additions, and extensive customer retention and customer service initiatives. Network operating costs also increased due to growth in customer usage and incremental costs related to Cingular's Global System for Mobile Communication (GSM) network upgrade completion and redundant expenses related to concurrently operating its Time Division Multiple Access (TDMA) and GSM networks. Equipment costs increased at a higher rate than equipment revenues due to Cingular's sales of handsets below cost, through direct sales sources, to customers who committed to one-year or two-year contracts or in connection with other promotions. Handset equipment costs increased \$843 in 2004. Costs slightly decreased in other areas, including prior and ongoing system and process consolidations and roaming costs. Operating expenses also included a \$31 charge related to a decrease in the fair value of Cingular Interactive's Mobitex business.

Only partially offsetting these expense increases was revenue growth, including incremental revenues from the acquisition of AT&T Wireless. Average revenue per customer declined in 2004 compared to 2003 due to customer shifts to all-inclusive rate plans that include roaming, long-distance and "rollover" minutes (which allow customers to carry over unused minutes from month to month for up to one year). An increase in customers on rollover plans tends to lower average monthly revenue since unused minutes (and associated revenue) are deferred until subsequent months, up to one year.

The lower 2003 margin as compared to 2002 was caused by a number of factors. Cingular's operating expenses increased primarily due to acquisition costs related to higher customer additions and extensive customer retention and customer service initiatives in anticipation of number portability. Network operating costs also increased due to ongoing growth in customer usage and incremental costs related to Cingular's GSM network upgrade. Only partially offsetting these expense increases were modest revenue growth and slightly decreased costs in other areas, including prior and ongoing system and process consolidations. The continued decline in Cingular's

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operating margin also reflects continued customer shifts to all-inclusive rate plans that include roaming, long-distance and rollover minutes. See further discussion of the details of our Cingular segment revenues and expenses below.

Service revenues increased \$3,250, or 22.9%, in 2004 and \$301, or 2.2%, in 2003. Cingular's service revenues are comprised of local voice and data services, roaming, long-distance and other revenue. Cingular's local voice revenues increased approximately \$2,706 in 2004 due to the acquisition of AT&T Wireless, the increase in Cingular's wireless customer base of more than 25 million (which increased Cingular's average number of wireless customers by 28.3%) and greater local minutes of use. The remaining increase in local voice revenues primarily resulted from increases in USF and regulatory compliance fees and lower rollover plan revenue deferrals. Data service revenues increased \$438 in 2004, primarily in text messaging services. Data service revenues represented approximately 4.6% of Cingular's total revenues for 2004. AT&T Wireless incremental revenues accounted for approximately 43.8% of the data service revenue increase. Roaming revenues from other wireless carriers for use of Cingular's and AT&T Wireless' network was flat in 2004. Roaming revenues from Cingular customers was essentially flat and is expected to decline due to customers continuing to migrate to all-inclusive regional and national rate plans that include roaming and long-distance. The remaining service revenue increases were mainly due to long-distance and other incremental revenue from AT&T Wireless.

For 2003, Cingular's local voice revenues increased approximately \$319 due to higher customer net additions and greater local minutes of use. Data services also increased \$168, primarily in text messaging services. These increases were partially offset by decreases of approximately \$172 in roaming and long-distance revenues, of which \$57 were attributable to Cingular customers continuing to migrate to all-inclusive regional and national rate plans that include roaming and long-distance. Roaming revenues from other wireless carriers for use of Cingular's network decreased approximately \$115 in 2003, primarily due to lower negotiated roaming rates, which offset the impact of increasing volumes. In addition, approximately \$35 of activation revenues from Cingular's own sales sources were reclassified from local service revenues to equipment sales as a result of the July 2003 adoption of Emerging Issues Task Force Interpretation No. 00-21 (EITF 00-21) (see Note 1).

Equipment revenues increased \$703, or 55.8%, in 2004 and \$279, or 28.4%, in 2003. For 2004, equipment sales were driven by increased handset revenues primarily as a result of significantly higher gross customer additions and increases in existing customers upgrading their units. Upgrade unit sales reflect an increase in GSM upgrades and Cingular's efforts to increase the number of customers under contract.

For 2003, equipment sales were driven by increased handset revenues primarily as a result of significantly higher customer additions and increases in existing customers upgrading their units. In addition, 2003

equipment revenues also increased \$35 due to the July 2003 adoption of EITF 00-21 mentioned previously (see Note 1).

Cost of services and equipment sales expenses increased \$1,804, or 31.7%, in 2004 and \$577, or 11.3%, in 2003. More than half of the 2004 increase in cost of services was due to incremental costs related to the acquired AT&T Wireless network. Cost of services increased due to increases in network usage with a 54.2% increase in minutes of use for 2004. Local network costs also increased due to system expansion and increased costs of redundant TDMA networks during the current GSM/General Packet Radio Services (GPRS)/Enhanced Data Rates for GSM Evolution (EDGE) network overlays and included the \$31 charge related to Cingular's Mobitex business, mentioned previously.

Equipment sales expense increased \$843 in 2004 primarily due to higher handset unit sales associated with the significant increase in customer additions and existing customers upgrading their units. AT&T Wireless customer additions contributed to more than 50% of the equipment costs increase. Equipment costs increased at a higher rate than equipment revenues due to Cingular's sales of handsets below cost, through direct sales sources, to customers who committed to one-year or two-year contracts or in connection with other promotions.

The 2003 increase in cost of services and equipment sales expense was primarily due to increased equipment costs of \$496 as well as higher network costs. The increased equipment costs were driven primarily by higher handset unit sales associated with the significant increase in customer additions and existing customers upgrading their units. Increased equipment costs also resulted from higher per-unit handset costs due to a shift to higher-end handsets such as the dual-system TDMA/GSM handsets in use during Cingular's GSM system conversion and newly introduced GSM-only handsets. In addition, Cingular sold handsets below cost as mentioned previously. Network costs increased due to a 19.1% increase in minutes of use for 2003. Local network costs also increased due to system expansion and increased costs of redundant TDMA networks during the GSM system upgrade in 2003.

Selling, general and administrative expenses increased \$1,925, or 35.5%, in 2004 and decreased \$4, or 0.1%, in 2003. Cingular's 2004 expenses increased primarily due to incremental expenses associated with the acquisition of AT&T Wireless. These incremental expenses included \$277 of merger integration and planning expenses, which were primarily related to re-branding and advertising of the Cingular and AT&T Wireless combination, and project management and information technology costs to support customer service, sales and billing systems integrations. Sales expense increased \$232 primarily due to the higher customer additions and significant incremental costs related to acquiring AT&T Wireless. General and administrative expenses increased primarily due to incremental expenses from AT&T Wireless and merger integration costs.

Cost also increased due to the significantly higher customer gross additions and other customer service and support initiatives. Commissions expense increased approximately \$289 in 2004 due to the impact of higher gross customer additions and customer upgrades. AT&T Wireless customer additions and upgrades contributed to more than 50% of the commissions expense increase. General and administrative expenses also increased due to a higher number of employees and employee-related expenses related to customer retention and customer service improvement initiatives and increases in bad debt expense.

Cingular's 2003 expense was basically flat compared to 2002 due to lower billing, administrative and bad debt expenses partially offset by increased selling expenses. The lower billing expenses reflected efficiencies gained from 2002 system conversions and related consolidations. The decreased administrative costs were due to reduced employee-related costs and decreased information technology and development expenses resulting from a 2002 workforce reorganization. The decline in bad debt expense included a \$20 recovery of 2002 WorldCom write-offs. Partially offsetting these declines were increased selling expenses of approximately \$103 driven primarily by higher advertising costs and commissions expense. The commissions expense increase reflected the nearly 14% increase in total postpaid and prepaid gross customer additions compared with 2002.

Depreciation and amortization expenses increased \$990, or 47.4%, in 2004 and \$239, or 12.9%, in 2003. The 2004 increase included depreciation and amortization expenses of \$740 related to the acquisition of AT&T Wireless, comprised of increased depreciation expense of \$325 and increased amortization expense of \$415 primarily related to the purchase price valuation of AT&T Wireless customer contracts acquired. Excluding this impact, Cingular's depreciation and amortization expense increased approximately \$250 primarily related to on-going capital spending for network upgrades, including the GSM/GPRS/EDGE network overlays, and increased depreciation on certain network assets which resulted from Cingular's further review and decision in 2004 to shorten the estimated remaining useful life of TDMA assets based on Cingular's projected transition of network traffic to GSM technology. These TDMA assets will be fully depreciated by the end of 2007. Included in the \$250 expense increase was a \$46 decline in amortization expense due to certain intangibles being fully amortized during 2004.

The 2003 increase was primarily related to higher capital expenditures for network upgrades, including the GSM overlay, and increased depreciation on certain network assets resulting from Cingular's 2003 decision to shorten the estimated remaining useful life of TDMA assets, mentioned previously.

Other Cingular Transactions

In December 2004, Cingular entered into a definitive agreement to sell their indirect interest in IDEA Cellular Ltd (IDEA), a cellular telecommunications company in India, to

a joint venture between STT Communications Ltd and TM International Sdn, a wholly owned subsidiary of Telekom Malaysia Berhd. Cingular will receive approximately \$210, which represents 9.1 billion rupees converted to U.S. dollars at December 31, 2004. The transaction is subject to approval by several regulatory agencies in India as well as the lenders of IDEA.

In November 2004, Cingular entered into a definitive agreement with Alltel Corporation to sell certain former AT&T Wireless assets and properties (which included licenses, network assets and subscribers) that Cingular currently operates in several markets, the largest of which is Oklahoma City, Oklahoma. Cingular also agreed to sell 20 MHz of spectrum and the network assets formerly held by AT&T Wireless in Wichita, Kansas.

In October 2004, Cingular sold Cingular Interactive, L.P. (Cingular Interactive) to affiliates of Cerberus Capital Management, L.P. (Cerberus). The sale included Cingular Interactive's Mobitex network, customer service operations, information technology systems and the transfer of most of Cingular Interactive's customers. Cingular will continue offering Mobitex data products as a reseller of Cerberus services. In connection with this transaction, Cingular evaluated the recoverability of its Cingular Interactive long-lived asset carrying values, including property, plant and equipment and FCC licenses, and recorded a charge of approximately \$31 reflecting a decline in the assets' fair value.

In May 2004, Cingular announced it would end its network infrastructure joint venture with T-Mobile USA (T-Mobile) in New York City, California and Nevada. Upon the dissolution of the joint venture, Cingular will sell its California/Nevada network and certain California/Nevada spectrum to T-Mobile for approximately \$2,300 in cash, net of dissolution payments, and retain the right to utilize the California/Nevada and New York City networks during a four-year transition period. In connection with the dissolution of the venture, Cingular and T-Mobile will exchange spectrum at a future date. As agreed to as part of the original joint venture agreement, Cingular will receive 10 MHz of spectrum in New York City and T-Mobile will receive 5 MHz of spectrum in nine basic trading areas (BTAs) in California and Nevada, the largest of which is San Diego. Cingular also agreed to sell 10 MHz of spectrum to T-Mobile in each of the San Francisco, Sacramento and Las Vegas BTAs for \$180. T-Mobile will also have the option to purchase an additional 10 MHz of spectrum in the Los Angeles and San Diego BTAs from Cingular within two years, under certain circumstances. The first stage of these transactions closed on January 5, 2005. As required by GAAP, Cingular will not report its gains on these transactions until 2007 due to the continuing involvement by Cingular during the transition period and until the completion of the spectrum exchange.

In April 2004, Cingular completed the purchase of licenses for wireless spectrum issued by the FCC in 34 markets for \$1,400 from NextWave Telecom, Inc.

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**Directory
Segment Results**

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Total Segment Operating Revenues	\$3,759	\$3,773	\$3,966	(0.4)%	(4.9)%
Segment operating expenses					
Cost of sales	890	847	864	5.1	(2.0)
Selling, general and administrative	754	790	767	(4.6)	3.0
Depreciation and amortization	9	21	30	(57.1)	(30.0)
Total Segment Operating Expenses	1,653	1,658	1,661	(0.3)	(0.2)
Segment Income	\$2,106	\$2,115	\$2,305	(0.4)%	(8.2)%

In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana. Our directory segment results for all periods shown have been restated to exclude the results of those operations (see Note 17). In December 2004, our directory segment entered into a joint venture agreement with BellSouth and acquired the internet directory provider, YPC.

Our directory segment operating income margin was 56.0% in 2004, 56.1% in 2003 and 58.1% in 2002. The segment operating income margin in 2004 compared to 2003 was essentially unchanged as our revenues and expenses for both periods were relatively flat. The segment operating income margin in 2003 compared to 2002 decreased as a result of lower revenue. See further discussion of the details of our directory segment revenue and expense fluctuations below.

Operating revenues decreased \$14, or 0.4%, in 2004 and \$193, or 4.9%, in 2003. Revenues in 2004 decreased primarily in our local Yellow Pages advertising, which decreased \$95 in 2004, as a result of competition from other publishers and other advertising media. The decrease in 2004 was partially offset by an increase of \$30 in internet advertising revenue and an improvement of \$27 in revenue adjustments related to customer complaints.

The decrease in revenue in 2003 was related to a decrease of \$172 in our local Yellow Pages advertising and \$31 in our national Yellow Pages advertising. This decrease was partially offset by an increase in internet advertising of \$21 and an improvement of \$12 in revenue adjustments related to customer complaints.

Cost of sales increased \$43, or 5.1%, in 2004 and decreased \$17, or 2.0%, in 2003. In 2004, cost of sales increased due to higher costs for commissions of \$20, publishing of \$18 and distribution of \$10 which were partially offset by a decrease in costs for paper and printing. Cost of sales decreased in 2003 as a result of lower costs for commissions, distribution and publishing.

Selling, general and administrative expenses decreased \$36, or 4.6%, in 2004 and increased \$23, or 3.0%, in 2003. Decreased expenses in 2004 were primarily due to lower uncollectible expense of \$68 partially offset by increases in advertising expense of \$25 and increased employee benefit-related costs of \$14. The increase in expenses in 2003 was the result of higher costs of \$62 for employee-related items such as salaries, pensions and other benefits, which were partially offset by a decrease in sales agency costs of \$21 and a reduction in uncollectible expense of \$10.

**International
Segment Results**

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Total Segment Operating Revenues	\$ 22	\$ 30	\$ 35	(26.7)%	(14.3)%
Total Segment Operating Expenses	31	47	85	(34.0)	(44.7)
Segment Operating Income (Loss)	(9)	(17)	(50)	47.1	66.0
Equity in Net Income of Affiliates	812	606	1,152	34.0	(47.4)
Segment Income	\$803	\$589	\$1,102	36.3%	(46.6)%

Our international segment consists primarily of equity investments in international companies, the income from which we report as equity in net income of affiliates. Revenues from direct international operations are less than 1% of our consolidated revenues.

Our earnings from foreign affiliates are sensitive to exchange-rate changes in the value of the respective local currencies. See Note 1 for a discussion of foreign currency

translation. Our foreign investments are recorded under GAAP, which include adjustments for the purchase method of accounting and exclude certain adjustments required for local reporting in specific countries. In discussing Equity in Net Income of Affiliates, all dollar amounts refer to the effect on our income. We first summarize in a table the individual results for our significant equity holdings then discuss our annual results. See "Other income

(expense) – net” and Note 2 for information on the sale of several investments during 2004

Segment operating revenues decreased \$8, or 26.7%, in 2004 and \$5, or 14.3%, in 2003. Revenues declined primarily due to lower management-fee revenues.

Segment operating expenses decreased \$16, or 34.0%, in 2004 and \$38, or 44.7%, in 2003. The decreases were primarily due to lower corporate-allocated charges.

Our equity in net income of affiliates by major investment at December 31, are listed below:

	2004	2003	2002
America Movil	\$132	\$ 76	\$ 60
Belgacom ¹	49	28	218
Bell Canada ¹	—	—	53
Cegetel ¹	—	—	88
TDC ¹	328	182	481
Telkom South Africa ¹	115	121	31
Telmex	180	196	219
Other	8	3	2
International Equity in Net Income of Affiliates	\$812	\$606	\$1,152

¹Investment sold

Equity in net income of affiliates increased \$206, or 34.0%, in 2004 and decreased \$546, or 47.4%, in 2003. The increase in 2004 was primarily due to a gain of approximately \$235 from TDC, related to the sale of its interest in Belgacom. Equity income in 2004 also increased due to a settlement loss of \$160 in 2003 on a transfer of pension liabilities which affected year-over-year comparisons. The settlement loss in 2003 resulted from a transfer of pension liabilities by Belgacom to the Belgian government and included a loss of approximately \$115 from Belgacom and TDC's loss of \$45 associated with the same transaction. 2004 equity in net income of affiliates also increased approximately (1) \$53 due to favorable operating results, primarily at América Móvil, (2) \$46 due to prior-year restructuring charges at TDC, and (3) \$65 due to favorable financing and exchange-rate impacts. These increases were partially offset by lower equity income of approximately \$314 related to asset sales, including

(1) \$131 from the sale of our and TDC's investment in Belgacom, (2) \$38 from the sale of our interest in Telkom and (3) \$145 from the sale of our interest in TDC. The increases were also offset by combined charges of approximately \$51 for 2004 restructuring charges at TDC and impairment of our goodwill associated with a TDC subsidiary.

The decrease in 2003 was primarily due to transactions at Belgacom, including a settlement loss on the transfer of pension liabilities in 2003 mentioned above, and gains on a sale by Belgacom and TDC which occurred in 2002 and affected year-over-year comparisons. The 2002 gains included approximately \$180 from Belgacom, related to a sale of a portion of its Netherlands wireless operations and TDC's gain of approximately \$336 associated with that same sale. Additionally, comparisons for 2003 were affected by 2002 gains of \$17 from Belgacom, related to a merger involving one of its subsidiaries and TDC's gain of approximately \$7 associated with that same transaction.

Equity income for 2003 also decreased due to restructuring charges of \$39 at TDC and foregone equity income of approximately \$88 and \$53 from the sales of Cegetel and Bell Canada, respectively. Equity income from Telmex decreased approximately \$23 for 2003 due primarily to 2002 deferred tax adjustments and unfavorable exchange rates, partially offset by lower financing costs.

The decrease for 2003 was partially offset by the year-over-year comparison of \$101 from a 2002 restructuring charge at Belgacom, as well as a favorable exchange-rate impact at TDC of \$28. Also offsetting the 2003 decrease were improved operating results from Belgacom of \$58 primarily driven by wireline and wireless operations and \$32 at TDC primarily due to improved TDC Switzerland operations. Additionally, equity income from América Móvil for 2003 increased approximately \$15 resulting from improved operating results and lower financing, partially offset by tax adjustments. Equity income from Telkom for 2003 increased approximately \$89 resulting primarily from a favorable exchange-rate impact, improved operating results and a gain resulting from the significant reduction of an arbitration accrual.

Other Segment Results

	2004	2003	2002	Percent Change	
				2004 vs 2003	2003 vs 2002
Total Segment Operating Revenues	\$244	\$263	\$389	(7.2)%	(32.4)%
Total Segment Operating Expenses	64	119	175	(46.2)	(32.0)
Segment Operating Income	180	144	214	25.0	(32.7)
Equity in Net Income of Affiliates	61	647	769	(90.6)	(15.9)
Segment Income	\$241	\$791	\$983	(69.5)%	(19.5)%

Our other segment results in 2004, 2003 and 2002 primarily consist of corporate and other operations.

Segment operating revenues decreased in 2004 compared to 2003 as a result of lower revenues from paging and capital leasing subsidiaries. 2003 revenues

decreased as a result of lower operating revenue from a capital leasing subsidiary.

Substantially all of the Equity in Net Income of Affiliates represents the equity income from our investment in Cingular.

Dollars in millions except per share amounts

OPERATING ENVIRONMENT AND TRENDS OF THE BUSINESS

2005 Revenue Trends We expect our revenues to stabilize and result in low year-over-year growth. Our revenue expectations assume that we will experience improvement in our retail access line trends, partially offset by a decline in the number of wholesale lines we provide, based on favorable developments in the federal regulatory environment (see our "Regulatory Developments" section). Federal regulatory developments have also allowed us to expand services utilizing our broadband network (see "Project Lightspeed" discussed in our "Expected Growth Areas"). As a result, we assume that we will experience growth in DSL consistent with our 2004 results and additional opportunities in the national data markets (see "Expected Growth Areas"). We also assume continued long-distance subscriber growth, providing long-distance service to approximately 60% of our retail access lines by the end of 2005. During the fourth quarter of 2004, Cingular completed its acquisition of AT&T Wireless and is now the largest wireless service provider in the United States. While Cingular's revenues are not included in our consolidated revenues, we expect the increased availability and competitiveness of its service offerings will enhance our bundling opportunities (see "Cingular" below). However, we also expect that increasing competition in the communications industry, including the continued growth of alternative technologies such as wireless, cable and VoIP and our response to competitors' pricing strategies, will pressure revenue. Nevertheless, we expect continued success with our bundling strategy to offset such pressure by improving customer retention and slowing our access line losses.

2005 Expense Trends We expect our operating income margin to improve slightly over 2004, due primarily to expected improvement in our revenues and continued cost control measures. In particular, we expect net workforce reductions during 2005 of approximately 7,000 employees, primarily through attrition. Expenses related to growth initiatives, such as Project Lightspeed (see "Expected Growth Areas"), and an expected increase in pension and other postretirement benefits costs, discussed below, will apply some pressure to our operating income margin.

2005 Pension and Retiree Medical Cost Expense Trends We expect combined net pension and postretirement cost of between \$1,400 and \$1,550 in 2005, compared to our combined net pension and postretirement cost of \$1,287 in 2004. Because of the continued high cost of our combined net pension and postretirement benefits, we have taken steps to implement additional cost controls (see Note 10). Approximately 10% of these annual costs are capitalized as part of construction labor, providing a reduction in the net expense recorded. Certain factors, such as investment returns, depend largely on trends in the U.S. securities market and the general U.S. economy. In particular, uncertainty in the securities markets and U.S. economy could result in investment returns less than those assumed

and a decline in the value of plan assets used in pension and postretirement calculations, which under GAAP we will recognize over the next several years. Should the securities markets decline and medical and prescription drug costs continue to increase significantly, we would expect increasing annual combined net pension and postretirement costs for the next several years.

For the majority of our labor contracts that contain an annual dollar value cap for the purpose of determining contributions required from nonmanagement retirees, we have waived the cap during the relevant contract periods and thus not collected contributions from those retirees. Therefore, in accordance with the substantive plan provisions required in accounting for postretirement benefits under GAAP, we do not account for the cap in the value of our accumulated postretirement benefit obligation (i.e., for GAAP purposes, we assumed the cap would be waived for all future contract periods). If we had accounted for the cap as written in the contracts, our postretirement benefit cost would have been reduced by \$696, \$884 and \$606 in 2004, 2003 and 2002. (See Note 10).

Cingular

In October 2004, Cingular acquired AT&T Wireless. As of December 31, 2004, Cingular served over 49 million customers and is the largest provider of mobile wireless voice and data communications services in the United States, based on the number of wireless customers. Also as a result of the acquisition, Cingular has access to licenses on the 850 and 1900 MHz bands to provide cellular or PCS wireless communications services covering an aggregate population of potential customers of approximately 290 million, or approximately 98% of the U.S. population, including all of the 100 largest U.S. metropolitan areas.

The addition of new licensed and facilities-covered spectrum as a result of the acquisition is expected to significantly enhance Cingular's footprint and its ability to offer new services as well as improve customer satisfaction and retention by improving call clarity and reducing call interruptions. Cingular's emphasis on retaining customers reflects industry trends that the wireless market is maturing and existing competitors must distinguish themselves through attractive service offerings and quality customer service in order to maintain operating margins.

From 2002 up to the acquisition, AT&T Wireless had reported operating revenues and average revenues per user higher than those of Cingular, but with significantly lower operating margins. For the nine months ended September 30, 2004, AT&T Wireless reported weak net customer additions, higher churn and decreases in service revenues and operating income, as compared with prior periods. Although AT&T Wireless' average revenue per user historically had been higher than Cingular's, it did decline versus the prior-year periods. As one of its post-acquisition priorities, Cingular expects to focus on reducing customer deactivations and increasing the level of customer service.

Cingular expects operations from the AT&T Wireless properties to remain weak for some time which may dilute Cingular's performance results until it integrates AT&T Wireless' assets and operations and successfully brings those operations under Cingular's management. Cingular expects its costs for 2005 will increase significantly as it begins to integrate the operations of AT&T Wireless and that the integration of and accounting for the transaction will result in continuing higher costs for the next few years, principally due to noncash amortization expense associated with intangible assets. Cingular expects the most significant merger synergy cost savings to begin later in 2005 from the elimination of redundant facilities, advertising costs, staff, functions, capital expenditures and other resources. Cingular expects these synergy savings to partially offset merger integration costs and higher amortization expense in the first two years and then contribute to higher operating margins beginning during 2007.

Pending Acquisition of AT&T

On January 30, 2005, we agreed to acquire AT&T Corp (AT&T) using shares of SBC stock (see Note 19). The transaction has been approved by the Board of Directors of each company and also must be approved by the stockholders of AT&T. The transaction is subject to review by the Department of Justice and approval by the FCC and various other regulatory authorities. We expect that the acquisition of AT&T will create overall net synergies, primarily from reduced costs, with a present value of more than \$15,000. We anticipate that nearly half the net synergies will come from the network operations and information technology areas, as facilities and operations are consolidated, and that the remaining cost synergies will come from combining business services organizations and eliminating duplicative corporate functions. We expect that 10 to 15 percent of net synergies will come from additional revenues. We expect that the acquisition will slow our revenue growth rate in the near term following the closing, but that the transaction will increase our earnings per share beginning in 2008.

Operating Environment Overview

In the Telecommunications Act of 1996 (Telecom Act), Congress established a pro-competitive, deregulatory national policy framework to bring the benefits of competition and investment in advanced telecommunications facilities and services to all Americans by opening all telecommunications markets to competition and reducing or eliminating burdensome regulation. Since the Telecom Act was passed, the FCC and state regulatory commissions have maintained many of the extensive regulatory requirements applicable to incumbent local exchange companies (ILECs), including our wireline subsidiaries, and imposed significant new regulatory requirements in a purported effort to jump-start a specific definition of competition.

In three successive orders (each of which was subsequently overturned by the federal courts as discussed below), the FCC required us to lease parts of our network

(unbundled network elements, or UNEs) in a combined form known as the UNE-P to competing local exchange companies (CLECs), including AT&T and MCI. The states set the wholesale rates that we are allowed to charge our competitors for UNEs by utilizing the FCC prescribed Total Element Long Run Incremental Cost (TELRIC) methodology. TELRIC allows the state commissions to set UNE rates by speculating on what would be the forward-looking cost of building and operating a purely hypothetical network that utilizes the most efficient technology available. While many of the state commissions in our 13-state area have raised certain UNE rates modestly in the last year, we believe that overall UNE rates continue to be below our actual cost of providing services utilizing the existing network. Competitors have used these artificially low rates to target many of our highest revenue customers. For further discussion, see "State UNE Pricing Proceedings."

In March 2004, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) overturned significant portions of the FCC's third order on unbundling requirements for our traditional network ("narrowband facilities"), including those mandating the availability of the UNE-P. In the same decision, the court upheld the FCC's decision to limit our obligation to provide competitors unbundled access to new broadband investments.

Since the D.C. Circuit's March 2004 decision, the FCC has encouraged both ILECs and CLECs to negotiate private commercial agreements regarding access and interconnection to the ILECs' networks without regulatory intervention. We have signed commercial agreements with several CLECs, one of which was our third largest UNE-P purchaser at the time of the agreement. We expect these contracts will result in a slight incremental increase in our total revenue versus the previously mandated UNE-P rates. We are actively negotiating private commercial agreements with other CLECs as well.

In August 2004, the FCC released interim rules that perpetuate nationwide unbundling of narrowband facilities through at least the end of February 2005. As a result, certain ILECs asked the D.C. Circuit to enforce its March 2004 order that had vacated those very same rules. Based upon the FCC's response that it would issue new rules by the end of the year, the D.C. Circuit asked for a report on January 4, 2005.

In December 2004, the FCC adopted a new fourth set of rules for unbundling requirements to comply with the D.C. Circuit's decision, which provide some significant relief from unbundling for mass market customers. In other respects, however, the FCC's revised rules fail to fully comply with the D.C. Circuit's decision, for example, the FCC retained unbundling requirements for many of our high-capacity loop and transport facilities. The revised rules include a one dollar increase in the current rates for existing UNE-P, which would remain in effect through a transition period (12 months from the effective date of the order). Because the FCC did not release its written order containing these revised rules until February 4, 2005, we have not yet been able to fully evaluate the impact of these new rules on our

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Dollars in millions except per share amounts

financial position or results of operations. However, we believe that the FCC's revised rules do not accurately and fully address the concerns raised by the D.C. Circuit in its March 2004 order, therefore, we (together with several other parties) filed a petition challenging the revised rules with the D.C. Circuit on February 14, 2005, asking the court to order the FCC to adopt rules that are consistent with the court's decision. See "December 2004 FCC Unbundling Rules" for a more detailed discussion of the revised rules.

In October 2004, the FCC approved three orders regarding the unbundling rules applicable to broadband. Each of the orders favorably limits our unbundling obligations. The FCC limited our obligation to unbundle fiber facilities to multiple dwelling units, such as apartment buildings. The FCC also limited our unbundling obligations as to fiber facilities deployed in fiber-to-the-curb arrangements. Finally, the FCC rejected CLEC arguments that these fiber facilities should be unbundled under another statutory provision. These orders have added some clarity to the applicable rules and enabled us to announce our intent to accelerate our planned deployment of our advanced fiber network (see "Project Lightspeed" discussed in "Expected Growth Areas").

It is unclear how state regulatory commissions will respond to these new FCC rules. Our ability to implement the D.C. Circuit's decision and to negotiate private commercial agreements has been constrained because many CLECs are hopeful that some state commissions nevertheless will attempt to require that all network elements continue to be unbundled under state law. We believe that the D.C. Circuit's ruling in March 2004 precludes the states from determining which network elements must be unbundled. Continued unfavorable regulations imposed at the state level could cause us to experience additional declines in access line revenues and could reduce our invested capital and employment levels related to those services. For further discussion, see "State UNE Pricing Proceedings" discussed below.

Because of opportunities made available by the FCC rulings discussed above on broadband, we expect that our capital expenditures in 2005 will increase to a target range of between \$5,400 and \$5,700. We expect that the business opportunities made available in the broadband area will allow us to expand our products and services (see "Project Lightspeed" discussed in "Expected Growth Areas"). Despite a slightly more positive regulatory outlook and these broadband opportunities, increasing competition and the growth of alternative technologies such as cable, wireless and VoIP have created significant challenges for our business.

Expected Growth Areas

We expect our primary wireline products and wireless services to remain the most significant portion of our business and have also discussed trends affecting the segments in which we report results for these products (see "Wireline Segment Results" and "Cingular Segment Results"). Over the next few years we expect an increasing percentage of our revenues to come from (1) data, through existing services, new services to be provided by

our Project Lightspeed initiative, and upon the closing of our pending acquisition of AT&T (see our "Operating Environment and Trends of the Business" section), and (2) Cingular's wireless service. We expect data revenue from large businesses in particular to continue to increase since federal regulation (preventing us from offering traditional long-distance service) greatly limited our ability to market to those businesses on a regional and national level prior to 2004. In addition, we expect the acquisition of AT&T to strengthen the reach and sophistication of our network facilities, increase our large-business customer base and enhance Cingular's ability to market its services to that customer base. Whether, or the extent to which, growth in these areas will offset declines in other areas of our business is not known.

Data/Broadband Our data services include DSL/Internet (broadband) as well as services to large businesses. At December 31, 2004, our wireline data revenues represented approximately 27% of our consolidated revenues, an increase of 2% from 2003. DSL is available to approximately 77% of our wireline customer locations. Our DSL lines continue to grow and were approximately 5.1 million at December 31, 2004 compared to 3.5 million at the end of 2003.

The above-mentioned orders issued by the FCC in October 2004 have added some clarity to the applicable rules for broadband and enabled us to announce our intent to accelerate deployment of our Project Lightspeed initiative.

Project Lightspeed In June 2004, we announced key advances in developing a network capable of delivering a new generation of integrated IP video, super-high-speed broadband and VoIP services to our residential and small-business customers, referred to as Project Lightspeed. For those customers who will not have access to or do not choose to utilize this network, we plan to continue to offer bundles that include high speed access to the Internet, voice services (including VoIP service) and satellite television services provided through our agreement with EchoStar. We are conducting trials using the proposed technology, and if successful, we expect to begin our build-out of our fiber-optic network in the first quarter of 2005.

We anticipate that we will deploy approximately 38,800 miles of fiber, reaching approximately 18 million households by year-end 2007, and expect to spend approximately \$4,000 over the next three years in deployment costs and \$1,000 in customer-activation capital expenditures spread over 2006 and 2007.

We believe that our planned deployment is subject to federal oversight as an "information service" under the Federal Communications Act, but not subject to state or local regulation. However, some cable providers and municipalities have claimed that certain IP service should be treated as a cable service and therefore subject to the applicable state and local regulation, which could include the requirement to obtain local franchises for our IP video service. If the courts were to decide that state and local regulation were applicable to our Project Lightspeed services, it could have a materially adverse effect on our deployment plans.

Wireless Cingular, our wireless joint venture with BellSouth, began operations in October 2000. During 2004, Cingular completed its acquisition of AT&T Wireless, which established Cingular as the largest provider of mobile wireless voice and data communications services in the United States, based on the number of wireless customers. At December 31, 2004, Cingular served approximately 49 million customers and had access to licenses to provide wireless communications services covering an aggregate population of potential customers of approximately 290 million, or approximately 98% of the U.S. population, including all of the 100 largest U.S. metropolitan areas.

Cingular's wireless networks use equipment with digital transmission technologies known as GSM and TDMA technology. Cingular has upgraded its existing TDMA markets to use GSM technology in order to provide a common voice standard. Cingular is also adding high-speed wireless data services such as GPRS and EDGE. EDGE technology will allow customers to access the Internet from their wireless devices at higher speeds than even GPRS.

We expect that intense industry competition and market saturation will likely cause the wireless industry's customer growth rate to moderate in comparison with historical growth rates. While the wireless telecommunications industry does continue to grow, a high degree of competition exists among four national carriers, their affiliates and smaller regional carriers. This competition will continue to put pressure upon pricing, margins and customer turnover as the carriers compete for potential customers. Future carrier revenue growth is highly dependent upon the number of net customer additions a carrier can achieve and the average revenue per customer. The effective management of customer turnover is also important in minimizing customer acquisition costs and maintaining and improving margins.

Cingular faces many challenges and opportunities in the future and is focused on the following key initiatives:

- Further establishing its position as a premier provider for business and government accounts by providing these customers access to sales and support professionals focused solely on their specialized needs.
- Continued improvement on the coverage and quality of its network. In 2004, Cingular began network enhancement in several states and a major expansion of the network in California and Nevada, which it expects to complete in 2006.
- Progression of plans to deploy Universal Mobile Telecommunications System (UMTS) third-generation (3G) network technology with High-Speed Downlink Packet Access (HSDPA) concurrent with its network integration over the next two years. UMTS and HSDPA provides superior speeds for data and video services, as well as operating efficiencies using the same spectrum and infrastructure for voice and data on an IP-based platform.

REGULATORY DEVELOPMENTS

Set forth below is a summary of the most significant developments in our regulatory environment during 2004. While these issues, for the most part, apply only to our

wireline subsidiaries, the words "we," "SBC" and "our" are used to simplify the discussion. In addition, the following discussions are intended as a condensed summary of the issues rather than a precise legal description of all of those specific issues.

Federal Regulation A summary of significant 2004 federal regulatory developments follows:

Network Unbundling Requirements In March 2004, the D.C. Circuit overturned significant portions of the FCC's third set of rules regarding the obligation of ILECs, such as our wireline subsidiaries, to provide unbundled access to our traditional network. These rules were adopted by the FCC in its Triennial Review Order (TRO) in August 2003 to replace the FCC's second set of unbundling rules, which were vacated by the D.C. Circuit in February 2003. Among other things, the D.C. Circuit vacated rules requiring us and other ILECs to provide unbundled mass-market switching (and therefore the UNE-P) and unbundled high-capacity loop and transport facilities. The D.C. Circuit also remanded the FCC's rules requiring ILECs to make available enhanced extended links (EELs), which can be used as a substitute for special access services, a component of our wireline revenues, and questioned whether any requirement that ILECs provide EELs in place of special access could be lawful. The D.C. Circuit upheld the FCC's decision not to unbundle broadband investment, including its decision to phase out line-sharing (which allows competitors to offer high-speed internet access over the high-frequency portion of traditional copper voice lines).

In August 2004, the FCC released interim rules requiring that, until March 13, 2005, or the effective date of the final fourth set of rules, whichever occurs earlier, ILECs continue to provide unbundled access to switching, enterprise market loops, and dedicated transport under the same rates, terms and conditions that were in effect on June 15, 2004, except that state commission orders raising rates can be implemented. Along with other ILECs, we voluntarily agreed not to raise rates unilaterally for certain UNEs (i.e., mass market UNE-P, and certain high-capacity loops and transport between our central offices) through the end of 2004, unless pursuant to a state commission decision.

In October 2004, we and other interested parties filed comments on the proposed new unbundling rules. Significantly, AT&T, which has long been a supporter of UNE-P, stated that it no longer seeks regulatory mandated access to the UNE-P (although other carriers, including MCI, continue to support access to the UNE-P).

December 2004 FCC Unbundling Rules In December 2004, the FCC adopted its fourth set of rules concerning an ILEC's (such as our wireline subsidiaries) obligation to make elements of its network available to other competitors (such as AT&T and MCI). On February 4, 2005, the FCC released its written order containing the new rules, which will become effective on March 11, 2005. The FCC's decision provides significant relief from unbundling by, among other things, eliminating our obligation to provide the UNE-P for mass market customers. However, because we believe that the FCC's revised rules do not fully comply with the directives of the D.C. Circuit, we (together with several other parties) filed a petition challenging the

Dollars in millions except per share amounts

revised rules with the D C Circuit on February 14, 2005, asking the court to order the FCC to adopt rules that are consistent with the court's March 2004 order

Set forth below is a summary of these revised unbundling rules. Because the FCC did not issue the written order containing these revised rules until February 4, 2005, we have not yet been able to fully evaluate the impact of the order on our financial position or results of operations.

- **Use Restrictions** The revised rules prohibit the use of UNEs for the exclusive provision of telecommunications services in the mobile wireless and long-distance markets, which the FCC previously found to be competitive. The FCC's decision reverses its decision in the TRO to permit wireless carriers to purchase UNEs in place of special access services.
- **UNE-P** The UNE-P is a combination of all of the network elements necessary to provide complete end-to-end local service to a customer. The revised rules eliminate our obligation to unbundle mass market switching, consistent with the D C Circuit's decision. From a practical perspective, the "switching" network element is the most significant component of the UNE-P, (i.e., the element that routes a telephone call or data to its destination). By eliminating the requirement to provide a network element, the FCC eliminated our obligation to provide the combination of elements, (i.e., the UNE-P, to CLECs). Under the FCC's decision, ILECs need not provide the UNE-P to CLECs to serve any new customers following the March 11, 2005, effective date of the order. The revised rules also establish a 12-month transition period (running from the effective date of the order) to transition the existing base of UNE-P customers to some other service arrangement. During the transition, we will be allowed to raise the rate for the UNE-P by one dollar.
- **Enhanced Extended Links** The revised rules do not alter the requirement adopted in the TRO that we must provide combinations of unbundled high-capacity loops and transport elements (often referred to as "enhanced extended links" or EELs) to competitors. EELs are used to provide switched and dedicated services. Because the availability of EELs depends on where the underlying high-capacity loop and dedicated transport facilities must be unbundled, and the order was not released until February 4, 2005, we have not yet been able to fully evaluate the impact of the EELs rules. However, we expect that the revised rules could adversely affect our special access revenues. To mitigate this potential impact, we are developing alternatives including new product bundles and new contract arrangements that could significantly reduce our potential decrease in wireline revenues and we continue to challenge this portion of the rules in federal appeals court.
- **Dedicated Transport** The revised rules eliminate the unbundling of entrance facilities, which are transmission facilities that provide connections between our network and competitor networks, and

limit our obligation to provide dedicated transport (interoffice lines with varying capacity, e.g., DS1 and DS3, used by only a single customer) to only those transmission facilities connecting our switches or central offices. We must continue to provide access to DS1, DS3 and dark fiber (unused fiber that must be "lit" before it can transmit a communications signal) transport except on routes where there are competitive alternatives, or on routes that connect wire centers (e.g., a central office) with a large number of business lines. Where the criteria are met to eliminate unbundling of dedicated transport facilities, there is a 12-month transition for DS1 and DS3 transport, and an 18-month transition for dark fiber transport. During transition, CLECs will not be permitted to purchase new dedicated transport facilities on routes that meet these criteria, and we will be permitted to increase the rate for the existing base by 15%. In our petition filed with the D C Circuit on February 14, 2005, we specifically challenged this portion of the revised rules, which we believe is not consistent with the D C Circuit's March 2004 decision.

- **Dark Fiber and Entrance Facilities** The revised rules eliminated our obligation to provide dark fiber loops and entrance facilities (which are facilities connecting our network to a CLEC's network) as UNEs. There is an 18-month transition plan for dark fiber loops, which does not permit CLECs to purchase new dark fiber loops and allows ILECs to increase the rate for pre-existing dark fiber loops.
- **High-Capacity Loops** The revised rules require us to continue to provide access to DS1 and DS3 loops, except in wire centers containing a large number of business lines and in which multiple competitors have deployed competitive fiber facilities. Where the criteria are met to eliminate unbundling of high-capacity loops, there is a 12-month transition for DS1 and DS3 loops. During the transition, the CLECs will not be permitted to purchase new high-capacity loops in wire centers that meet the criteria for eliminating unbundling, and we will be permitted to increase the rate for the existing base by 15%. In our petition filed with the D C Circuit on February 14, 2005, we specifically challenged this portion of the revised rules, which we believe is not consistent with the D C Circuit's March 2004 decision.

"All-Or-Nothing" Rule The FCC has encouraged both ILECs and CLECs to negotiate commercial agreements regarding access to an ILEC network and the availability of UNEs without regulatory intervention. To this end, in July 2004, the FCC adopted a new "all-or-nothing" rule for agreements governing wholesale access to an ILEC's network and eliminated the previous "pick and choose" rule, which permitted CLECs to opt into only the most favorable provisions of multiple network access agreements. Prior to the all-or-nothing rule, a CLEC requesting network access could "pick and choose" rates and other terms from various network access agreements between an

ILEC and other CLECs, thereby minimizing or eliminating negotiations between the ILEC and the CLEC requesting access. Under the new rule, if the CLEC wishes to adopt terms of another CLEC's agreement rather than negotiating its own agreement, the CLEC must adopt the other CLEC's agreement in its entirety.

Since the D.C. Circuit's decision vacating significant portions of the TRO, we have signed commercial agreements with several CLECs, one of which was our third largest UNE-P purchaser at the time of the agreement, for a UNE-P replacement service. We expect these contracts will result in a slight incremental increase in our total revenue versus the previously mandated UNE-P rates. Our ability to implement the court's decision and negotiate commercial agreements has been constrained because some state commissions remain insistent on requiring us to provide UNEs beyond those authorized by the FCC and on regulating commercial agreements.

Broadband The TRO eliminated unbundling of certain advanced telecommunications technology that is primarily used for transmitting data and high-speed internet access across telephone lines (generally referred to as "broadband"). This portion of the TRO was upheld by the D.C. Circuit in its March 2004 decision. For example, the TRO eliminated unbundling of the packet-switching capabilities (a highly efficient method of transmitting data) of our local loops and eliminated unbundling of certain fiber-to-the-home (FTTH) loops. FTTH loops are fiber-optic loops that connect directly from our network to customers' premises. Traditional telephone lines are copper, fiber-optic lines are made of glass and can carry more information over far longer distances than copper. Under the TRO, packet-switching and FTTH loops are not subject to unbundling requirements, therefore, we are not required to sell them to competitors at below-cost UNE prices. However, we must continue to provide unbundled access to copper-loop and sub-loop lines. In areas where fiber-optic lines are installed in place of existing copper-loop lines, we are required to provide our competitors access either to the existing copper loop or a nonpacketized transmission path capable of providing voice-grade service over the fiber-optic lines.

Under a previous FCC order, we were required to share, on an unbundled basis, the high-frequency portion of local telephone lines, which is used primarily to provide DSL service, with competitors. Under the TRO, this high-frequency portion of the telephone line was no longer considered a UNE. Competitors were allowed to purchase new line sharing arrangements until October 2, 2004, but were required to pay increasing amounts for such new line sharing arrangements over the next three years, at the end of which customers must be transitioned to new arrangements. The California State Regulatory Commission has stated in a decision that it has independent authority to decide whether the high-frequency portion of the local telephone line is a UNE in disregard of the TRO, and we are challenging that decision in federal court.

In October 2004, the FCC approved three orders regarding the unbundling rules applicable to broadband. Each of the orders favorably limits our unbundling obligations. The FCC limited our obligation to unbundle fiber facilities to multiple dwelling units, such as apartment buildings. The FCC also limited our unbundling obligations as to fiber facilities deployed in fiber-to-the-curb arrangements. Finally, the FCC rejected CLEC arguments that these fiber facilities should be unbundled under another statutory provision. These orders have added some clarity to the applicable rules and enabled us to announce our intent to accelerate our planned deployment of our advanced fiber network (see "Project Lightspeed" discussed in "Expected Growth Areas").

While our unbundling obligations have been reduced during 2004, we continue to evaluate and challenge the FCC's unbundling rules when they exceed the requirements of the Telecom Act. The FCC's rulings on broadband have allowed us to announce the expansion of our fiber network, which we believe will provide us with future opportunities. At the same time, however, increasing competition from alternative technologies such as cable, wireless and VoIP, present significant challenges for our business.

Voice over Internet Protocol VoIP is generally used to describe the transmission of voice using internet-based technology. A company using this technology can provide voice services (although depending on the bandwidth allocated it may not necessarily be of the same quality as a traditional telephone service) often at a lower cost because a traditional network need not be constructed and maintained and because this technology has not been subject to traditional telephone industry regulation. While the deployment of VoIP will result in increased competition for our wireline voice services, it also presents growth opportunities for us to develop new products for our customers, both within and outside of our 13-state area.

Over the last year, the FCC has issued a variety of decisions regarding VoIP services. For example, during 2004, the FCC declared that services that do not use a public switched telephone network (a traditional telephone network) to provide "peer-to-peer" service (i.e., subscribers communicate with each other solely over Internet Protocol networks) are unregulated.

- **IP-Enabled Services** In March 2004, the FCC opened a proceeding to establish the regulatory framework for IP-enabled services, including VoIP, that involve use of a public switched telephone network. In this proceeding, the FCC will address various regulatory issues, including universal service, intercarrier compensation, numbering, disability access, consumer protection, and customer access to 911 emergency service. Notwithstanding the unresolved regulatory questions before the FCC and various state utility commissions, numerous communications providers, including SBC, began providing various forms of VoIP in 2003 and 2004, or announced their intentions to do so in the near future. These providers include both established companies as well as new entrants.

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- **Application of Switched Access Charges** In April 2004, the FCC denied AT&T's October 2002 request that access charges (which are paid to telephone companies providing local service, including our wireline subsidiaries) do not apply to long-distance service that AT&T transports for some distance using internet-based technology. The FCC ruled that long-distance calls that both originate and terminate on local phone company networks, such as those operated by our wireline subsidiaries, are subject to access charges, regardless of the technology used to transport those calls and that AT&T must pay access charges when providing its internet-based long-distance services. However, the FCC did not address the issue of whether AT&T would be required to pay our wireline subsidiaries (and other companies providing local service) the access charges it has avoided paying in the past. Instead, the FCC said that it expects this issue to be litigated in court. In April 2004, we sued AT&T in the Federal District Court for the Eastern District of Missouri (District Court), seeking at least \$141 in damages, including interest, and a permanent injunction prohibiting AT&T from continuing its access charge avoidance activities. In June 2004, based upon an arbitration provision in an agreement between the parties governing access billing disputes, AT&T asked the District Court to enjoin this litigation and submit the dispute to arbitration. In September 2004, the District Court rejected AT&T's request. AT&T thereafter obtained a stay of the litigation from the Federal Court of Appeals for the Eighth Circuit (Eighth Circuit) and appealed the District Court decision rejecting arbitration. That appeal is scheduled to be heard by the Eighth Circuit in March 2005.
- **Vonage Decision** In November 2004, the FCC issued an order pre-empting the Minnesota Public Utilities Commission (MPUC) from applying its traditional telephone company regulations to Vonage Holding Corp.'s (Vonage) DigitalVoice service (which includes VoIP and other communications capabilities). The FCC concluded that DigitalVoice could not be separated into interstate and intrastate communications for regulatory purposes without thwarting federal laws and policies that mandate a minimalistic regulatory environment for these types of services. The FCC did not express its opinion on the applicability of Minnesota's general business laws concerning taxation, fraud, general commercial dealings, marketing and advertising. The FCC also left undecided broader questions regarding the regulatory obligations of IP-enabled services, which are being addressed in the FCC's proceeding on IP-enabled services. Finally, the FCC stated that its authority pre-empts state regulation of other types of IP-enabled services having basic characteristics similar to DigitalVoice. These characteristics include a requirement for a broadband connection from the user's location, a need for IP-compatible customer

premises equipment, and a service offering that provides integrated capabilities and features that allow customers to manage personal communications, including receiving voice communications and accessing other features and capabilities, even video. Various parties, including state public utilities commissions, have filed appeals of the FCC order.

Intercarrier Compensation Reform In October 2004, the Intercarrier Compensation Forum, a diverse group of telecommunications industry participants representing ILECs (including SBC), CLECs, long distance companies, rural telephone companies and wireless providers, submitted to the FCC a plan for reforming the current system of rates that telecommunications companies charge each other for network access and fees to ensure universal telephone service in the United States. In February 2005, the FCC initiated a rulemaking proceeding to consider the plan and other proposals for intercarrier compensation reform. However, due to the complexities of this issue we are not able to predict when a final rule will be issued.

Ruling on Reciprocal Compensation In 2001, the FCC ruled that telephone calls placed to Internet Service Providers (ISPs) are not subject to the reciprocal compensation requirements of the Telecom Act, which require that the carrier which originates and transports a call on its network that terminates on another carrier's network in the same local calling area pay a fee to that terminating carrier. The FCC concluded that requiring reciprocal compensation for ISP-bound traffic caused market distortions because CLECs offering ISP services could recover a disproportionate share of their costs from other carriers, rather than from their ISP customers, since calls rarely originate from the ISP. The FCC then concluded that a system of bill-and-keep (under which carriers look to their own customers to recover their costs) would eliminate CLEC incentives to engage in such arbitrage. The FCC adopted an interim compensation plan for ISP-bound traffic while it considered broader intercarrier compensation reform. The interim plan, among other things, capped the rate paid for ISP-bound traffic (the "rate" cap), the total number of minutes that could be compensated (the "growth" cap) and limited compensation for traffic not previously exchanged between carriers prior to the order (the "new markets" rule). In October 2004, the FCC lifted the growth cap and new markets rule, but declined to lift the other restrictions in its 2001 order, including the rate cap. As a result of this 2004 ruling, we may become liable to pay reciprocal compensation on additional ISP-bound traffic, which previously was not compensable because of the caps. We estimate that we may incur additional reciprocal compensation payments for 2005 of approximately \$40 for such traffic, based on the expected number of minutes for 2005. We have petitioned the FCC to reconsider its order, and we have petitioned to intervene in an appeal of the order filed by BellSouth in the D.C. Circuit.

Special Access Pricing Flexibility In October 2002, AT&T requested the FCC to revoke current pricing rules for special access services, a component of our wireline

revenues AT&T subsequently filed a similar petition in the D C Circuit We and other parties have challenged AT&T's petition, which remains pending before the FCC In January 2004, the FCC filed its opposition to AT&T's petition, and we and other carriers filed a request to intervene in support of the FCC with the D C Circuit In January 2005, AT&T's petition was denied by the D C Circuit The FCC initiated a rulemaking proceeding to consider whether it should modify its pricing flexibility rules, and, if so, how However, due to the magnitude of the issue and the current transitions at the FCC and within the telecommunications industry, an order is not expected until late 2006

Number Portability In November 2003, the FCC adopted rules allowing customers to keep their wireline or wireless number when switching to another company (generally referred to as "wireless number portability") In April 2004, the FCC allowed ILECs, including our wireline subsidiaries, to recover through customer rate charges, their carrier-specific costs of implementing wireless number portability We estimate our total costs to be approximately \$60 We began cost recovery over a four-month period in 11 of our states in June 2004, in Connecticut in October 2004 and will begin in Nevada in early 2005

For several years, customers have been able to retain their numbers when switching their local service between wireline companies (generally referred to as "local number portability"), and the FCC allowed ILECs to recover, through customer rate charges, their carrier-specific costs of implementing local number portability We were allowed to recover our costs over a five-year term by charging on a per line basis However, the per-line rate charges were determined based on a projected number of access lines Since the actual number of access lines has now turned out to be lower than estimated, in February 2005 we requested the FCC grant an exception to its five-year limitation rules regarding this cost recovery that would allow us to recover our costs over a longer period of time If our request is granted, we expect to recover previously authorized costs of approximately \$210

Ameritech Merger In association with its approval of the October 1999 Ameritech merger, the FCC set specific performance and reporting requirements and enforcement provisions that mandate approximately \$2,000 in potential payments through May 2004, if certain goals were not met Associated with these conditions, we incurred additional expenses of less than \$1 in 2004 and approximately \$14 and \$20 in 2003 and 2002, which included payments for failing to meet certain performance measurements

The effects of the FCC decisions on the above topics are dependent on many factors including, but not limited to, the ultimate resolution of the pending appeals, the number and nature of competitors requesting interconnection, unbundling or resale, and the results of the state regulatory commissions' review and handling of related matters within their jurisdictions Accordingly, we are not able to assess the total potential impact of the FCC orders and proposed rulemakings

State Regulation A summary of significant 2004 state regulatory developments follows

California Audit On February 26, 2004, the CPUC decided several major monetary issues in the 1997-1999 audit of our California wireline subsidiary The CPUC determined that we were in compliance with regulatory accounting rules for pension and depreciation and that no refunds were owed by our subsidiary to customers The CPUC determined that we should fund amounts for certain employee benefits into a Voluntary Employee Benefit Association (VEBA) trust, which resulted in our March 2004 contribution of approximately \$232 In April 2004, other parties filed petitions for rehearing However, the CPUC has yet to rule on those petitions

State UNE Pricing Proceedings We have requested that several state commissions review and increase the wholesale prices we (through our wireline subsidiaries in each state) are allowed to charge competitors for leasing unbundled network elements (UNE rates) mandated by the FCC Our competitors, including AT&T and MCI, have asked several states to reduce these prices While many states in our 13-state area have modestly increased our wholesale prices, the rates still remain below our cost of providing services During 2004, the state commissions in California, Illinois, Indiana, Michigan, Ohio and Wisconsin all increased the UNE rates However, there are appeals or applications for rehearing pending in all states but Michigan Additionally during 2004, the commission in the state of Texas voted to decrease the UNE rates, but because of the FCC's interim bundling rules, the commission did not require us to reduce our rates The foregoing changes in UNE rates are not expected to have a material impact on our financial results

As discussed above in "December 2004 FCC Unbundling Rules," the FCC eliminated our obligation to provide unbundled local switching (and thus the UNE-P) on a prospective basis The FCC also eliminated our obligation prospectively to provide high-capacity loops and dedicated transport in certain markets Also as discussed above, the FCC established a transition plan for existing UNE-P customers and high-capacity loops and dedicated transport circuits that no longer will be subject to unbundling Under that plan, we will be able to increase our UNE-P rates by one dollar, and our rates for high-capacity loops and dedicated transport by 15% during the transition As a consequence, state regulatory commissions should have a more limited role over the scope and terms of our network element offerings

In September 2004, the CPUC voted to increase the UNE-P rates The order became effective immediately, allowing us to retroactively charge the new rates back to May 2002, as contemplated in the May 2002 interim order These rates include both higher rates, notably for UNE-P, and lower rates notably for certain high capacity data services In January 2005, a decision from the United States Court of Appeals for the Ninth Circuit remanded to the CPUC an appeal challenging how the CPUC had priced one component of the UNE-P rates in a previous order Various CLECs are now contending before the CPUC that this remand should be applied to the September 2004

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ruling and reduce the amount of refunds that we are entitled to collect back to May 2002. We are opposing those efforts. If the CPUC were to reduce the refund piece of the September 2004 order, we would have to reverse a portion of the net increase in revenues of approximately \$51 that we recorded in our third-quarter 2004 results.

COMPETITION

Competition continues to increase for telecommunications and information services, and regulations, such as the FCC's unbundling rules, have increased the opportunities for alternative communications service providers. Technological advances have expanded the types and uses of services and products available. In addition, lack of regulation of comparable alternative technologies (e.g., VoIP) has lowered costs for alternative providers. As a result, we face heightened competition as well as some new opportunities in significant portions of our business.

Wireline

Our wireline subsidiaries expect increased competitive pressure in 2005 from multiple providers in various markets, including facilities-based local competitors, interexchange carriers and resellers. In some markets, we compete with large cable companies such as Comcast Corporation, Cox Communications, Inc. and Time Warner Inc. for local and high-speed internet services customers and long-distance companies such as MCI and, to a lesser extent, AT&T for both long-distance and local services customers. Substitution of wireless and internet-based services for traditional local service lines also continues to increase. At this time, we are unable to quantify the effect of competition on the industry as a whole, or financially on us, but we expect both losses of market share in local service and gains resulting from new business initiatives especially in the area of bundling of products and services including wireless and video, large-business data services, broadband and long-distance service.

Our wireline subsidiaries remain subject to extensive regulation by state regulatory commissions for intrastate services and by the FCC for interstate services. In contrast, our competitors are often subject to less or no regulation in providing comparable voice and data services. Under the Telecom Act, companies seeking to interconnect to our wireline subsidiaries' networks and exchange local calls must enter into interconnection agreements with us. These agreements are then subject to approval by the appropriate state commission. As noted in the "State UNE-P Proceedings" section above, the mandated rates set by certain state commissions remain below our cost and have contributed to our continued decline in access line revenues and profitability. Recent developments at the FCC regarding UNE-P regulations have resulted in the reversal during 2004 of the trend over the last several years of access lines losses due to UNE-P. However, we continue to lose access lines due to competitors (e.g., wireless, cable and VoIP providers) who can provide comparable services at lower prices because they are not subject to traditional telephone industry regulation and have lower cost structures. We also have moved forward with product

offerings, such as bundling, that may mitigate future competitive pressure.

In addition to these wholesale rate and service regulations noted above, all of our wireline subsidiaries operate under state-specific elective "price cap regulation" for retail services (also referred to as "alternative regulation") that was either legislatively enacted or authorized by the appropriate state regulatory commission. Prior to price cap regulation, our wireline subsidiaries were under "rate of return regulation." Under rate of return regulation, the state regulatory commissions determined an allowable rate of return we could earn on plant in service and set tariff rates to recover the associated revenues required to earn that return. Under price cap regulation, price caps are set for regulated services and are not tied to the cost of providing the services or to rate of return requirements. Price cap rates may be subject to or eligible for annual decreases or increases and also may be eligible for deregulation or greater pricing flexibility if the associated service is deemed competitive under some state regulatory commission rules. Minimum customer service standards may also be imposed and payments required if we fail to meet the standards.

In response to the multiple competitive pressures discussed above, we launched in late 2002, our bundling strategy that rewards customers who consolidate their services (e.g., local and long-distance telephone, DSL, wireless and video) with us. In 2004, we continued to focus on bundling wireline and wireless services, including combined packages of minutes, and added to our bundled offerings a video service through an agreement with EchoStar. During 2005, we will continue to develop innovative products that capitalize on our expanding fiber network.

Cingular

During 2004, Cingular completed its acquisition of AT&T Wireless (see Note 16). Cingular faces substantial and increasing competition in all aspects of the wireless communications industry. Under current FCC rules, six or more PCS licensees, two cellular licensees and one or more enhanced specialized mobile radio licensees may operate in each of Cingular's markets, which results in the presence of multiple competitors. Cingular's competitors are principally four national (Verizon Wireless, Sprint PCS, Nextel Communications and T-Mobile) and a larger number of regional providers of cellular, PCS and other wireless communications services.

Cingular may experience significant competition from companies that provide similar services using other communications technologies and services. While some of these technologies and services are now operational, others are being developed or may be developed in the future. Cingular competes for customers based principally on price, service offerings, call quality, coverage area and customer service. See discussion of EDGE technology in "Wireless" under "Expected Growth Areas" above.

Directory

Our directory subsidiaries face competition from approximately 75 publishers of printed directories in their operating areas. Direct and indirect competition

also exists from other advertising media, including newspapers, radio, television and direct-mail providers, as well as from directories offered over the Internet

ACCOUNTING POLICIES AND STANDARDS

Significant Accounting Policies and Estimates Because of the size of the financial statement line items they relate to, some of our accounting policies and estimates have a more significant impact on our financial statements than others

- Our depreciation of assets, including use of composite group depreciation and estimates of useful lives, is described in Notes 1 and 5. We assign useful lives based on periodic studies of actual asset lives. Changes in those lives with significant impact on the financial statements must be disclosed, but no such changes have occurred in the three years ended December 31, 2004. However, if all other factors were to remain unchanged, we expect a one-year increase in the useful lives of three of the largest categories of our plant in service (which accounts for approximately 60% of our total plant in service) would result in a decrease of between \$390 and \$420 in our 2005 depreciation expense and a one-year decrease would result in an increase of between \$415 and \$445 in our 2005 depreciation expense. Effective January 1, 2003, as required by FAS 143, we decreased our depreciation rates to exclude costs of removal in certain circumstances. This change is discussed in Note 1.
- Our bad debt allowance is estimated primarily based on analysis of history and future expectations of our retail and our wholesale customers in each of our operating companies. For retail customers, our estimates are based on our actual historical write-offs, net of recoveries, and the aging of accounts receivable balances. Our assumptions are reviewed at least quarterly and adjustments are made to our bad debt allowance as appropriate. For our wholesale customers, we use a statistical model based on our aging of accounts receivable balances. Our risk categories, risk percentages and reserve balance assumptions built into the model are reviewed monthly and the bad debt allowance is adjusted accordingly. If uncollectibility of our billed revenue changes by 1%, we would expect a change in uncollectible expense of between \$200 and \$250.
- Our actuarial estimates of retiree benefit expense and the associated significant weighted-average assumptions are discussed in Note 10. One of the most significant of these is the return on assets assumption, which was 8.5% for the year ending December 31, 2004. This assumption will remain unchanged for 2005. If all other factors were to remain unchanged, we expect a 1% decrease in the expected long-term rate of return would cause 2005 combined pension and postretirement cost to increase approximately \$388 over 2004 (analogous decrease would result from a 1% increase). The 10-year returns on our pension plan were 11.03% through 2004 including returns in excess of our assumed rate of return for 2004. Under GAAP, the expected long-term rate of return is

calculated on the market-related value of assets (MRVA). GAAP requires that actual gains and losses on pension and postretirement plan assets be recognized in the MRVA equally over a period of up to five years. We use a methodology, allowed under GAAP, under which we hold the MRVA to within 20% of the actual fair value of plan assets, which can have the effect of accelerating the recognition of excess actual gains and losses into the MRVA in less than five years. Largely due to investment returns in 2003, this methodology did not have a significant additional effect on our 2004 combined net pension and postretirement expense. Due to investment losses on plan assets experienced through 2002, this methodology contributed approximately \$605 to our combined net pension and postretirement cost in 2003 as compared with the methodology that recognizes gains and losses over a full five years. This methodology did not have a significant effect on our 2004 or 2002 combined net pension and postretirement benefit as the MRVA was almost equal to the fair value of plan assets. Note 10 also discusses the effects of certain changes in assumptions related to medical trend rates on retiree health care costs.

- Our estimates of income taxes and the significant items giving rise to the deferred assets and liabilities are shown in Note 9 and reflect our assessment of actual future taxes to be paid on items reflected in the financial statements, giving consideration to both timing and probability of these estimates. Actual income taxes could vary from these estimates due to future changes in income tax law or results from the final review of our tax returns by the IRS or state tax authorities. We have considered these potential changes and have provided amounts within our deferred tax assets and liabilities that reflect our judgment of the probable outcome of tax contingencies. We continue to believe that our tax return positions are fully supportable. Unfavorable settlement of any particular issue could require use of our cash. Favorable resolution could be recognized as a reduction to our tax expense and cash refunds. We periodically review the amounts provided and adjust them in light of changes in facts and circumstances, such as the progress of a tax audit.
- Our policy on valuation of intangible assets is described in Note 1. In addition, for cost investments, we evaluate whether mark-to-market declines are temporary and reflected in other comprehensive income, or other than temporary and recorded as an expense in the income statement, this evaluation is based on the length of time and the severity of decline in the investment's value. Significant asset and investment valuation adjustments we have made are discussed in Note 2.
- We use the fair value recognition provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (FAS 123) to account for our stock option grants. The estimated

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fair value of the options granted is amortized to expense over the options' vesting period. The fair value for these options was estimated at the date of grant, using a Black-Scholes option pricing model. Two of the more significant assumptions used in this estimate are the expected option life and the expected volatility, which we estimate based on historical information. Had we not adopted the fair value recognition provisions of FAS 123 and chose to continue using the intrinsic value-based method of accounting, we would not have recorded any stock option expense in all years presented. Assuming we continue our recent trend of reducing the number of options granted, this policy will become less significant in the future.

New Accounting Standards

FSP FAS 106-2 In January 2004, in response to the recently passed Medicare Act, the FASB issued preliminary guidance on accounting for the Medicare Act (FSP FAS 106-1). In accordance with FSP FAS 106-1, a sponsor of a postretirement health care plan that provides a prescription drug benefit, such as us, may make a one-time election to defer accounting for the subsidy provided by the Medicare Act. In order for us to receive the subsidy payment under the Medicare Act, the value of our offered prescription drug plan must be at least equal to the value of the standard prescription drug coverage provided under Medicare Part D, referred to as actuarially equivalent. Due to our lower deductibles and better coverage of drug costs, we believe that our plan is of greater value than Medicare Part D. Accordingly, we adopted FSP FAS 106-1 and accounted for the Medicare Act as a plan amendment and recorded the adjustment in the amortization of our liability, from the date of enactment of the Medicare Act, December 2003. Upon adoption, this decreased our accumulated postretirement benefit obligation by \$1,629.

In May 2004, the FASB issued final guidance on how employers should account for provisions of the Medicare Act (referred to as FSP FAS 106-2). FSP FAS 106-2 requires us to account for the Medicare Act as an actuarial gain or loss and, had an employer's previous recognition of the Medicare Act differed from the final guidance issued by the FASB, the employer would recognize the restatement of their 2003 results as a cumulative effect of accounting change. Because our initial accounting for the effects of the Medicare Act differed from the final guidance issued, in accordance with FSP FAS 106-2, we have changed our accounting from a plan amendment to an actuarial gain or loss. Due to the immaterial impact of the change in accounting on our 2003 results (since the Medicare Act was enacted in December 2003), we did not record a cumulative effect of accounting change as of January 1, 2004.

We expect that accounting for the Medicare Act will result in an annual decrease in our prescription drug expenses ranging from \$200 to \$300 in future years. Our accounting assumes that the plans we offer will continue

to provide drug benefits equivalent to Medicare Part D, that these plans will continue to be the primary plan for our retirees and that we will receive the subsidy. We expect that the Medicare Act will not have a significant effect on our retirees' participation in our postretirement benefit plan.

FIN 46(R) In January 2003, the FASB issued FIN 46 which provides guidance for determining whether an entity is a variable interest entity (VIE) and which equity investor of that VIE, if any, should include the VIE in its consolidated financial statements. In December 2003, the FASB staff revised FIN 46 (FIN 46(R)) to clarify some of the provisions. The revision delayed the effective date for application of FIN 46(R) by large public companies, such as us, until periods ending after March 15, 2004 for all types of VIEs other than special-purpose entities, including our investment in Cingular. In 2003, we recorded an extraordinary loss of \$7, net of taxes of \$4, related to consolidation of real estate leases under FIN 46.

In accordance with the provisions of FIN 46(R), we performed a quantitative study of potential cash flows of Cingular, covering a wide range of scenarios that valued Cingular significantly above and below the estimated fair value of Cingular. The probability of these scenarios was assessed to establish the weighted-average amount that these scenarios were both above and below the average of all the scenarios. These are the "residual returns" and "expected losses" as defined by FIN 46(R). As Cingular's total capitalization has a high equity component, the "expected losses" of the FIN 46(R) calculations were significantly below not only the fair value of Cingular's equity, but also its book value. Therefore, we determined that Cingular did not qualify for consolidation by us under the provisions of FIN 46(R), and our accounting treatment of our investment in Cingular remained unchanged. Cingular's acquisition of AT&T Wireless (see Note 16) was accomplished entirely through equity contributions to Cingular. Cingular's debt increased only by the amount of AT&T Wireless public debt assumed in connection with the acquisition. When we reassessed whether Cingular should be consolidated under FIN 46(R), primarily because of the large increase in the fair value of Cingular's equity as a result of the transaction, we concluded the acquisition of AT&T Wireless did not change our accounting for Cingular under FIN 46(R).

FAS 123(R) In December 2004, the FASB revised FAS 123 (FAS 123(R)) which, among other items, requires the expensing of stock-based compensation. The statement is effective for the first interim or annual period beginning after June 15, 2005. As we had previously adopted the expensing provisions of FAS 123, we do not expect FAS 123(R) to have a significant effect on our compensation expense when adopted. See Note 1 for further discussion of FAS 123(R).

OTHER BUSINESS MATTERS

WorldCom Bankruptcy In July 2002, WorldCom and more than 170 related entities filed petitions for reorganization under Chapter 11 of the United States Bankruptcy Code. Our claims against WorldCom totaled approximately \$661. Our claims included receivables, claims for refunds that are the subject of litigation, and a variety of contingent and unliquidated items, including unbilled charges.

On April 20, 2004, MCI, formerly WorldCom, emerged from federal bankruptcy. As part of the settlement agreement we reached with WorldCom in July 2003, we received the escrowed portion of that settlement, \$68, upon MCI's emergence from bankruptcy. In addition to our receipt of this \$68 and our existing reserve, the agreement also settled our approximately \$320 in receivables related to pre-petition issues by offsetting amounts we owed but withheld from WorldCom, pending resolution of WorldCom's bankruptcy proceeding. As a result of a fourth-quarter 2004 settlement with MCI, our remaining pre-bankruptcy claims with WorldCom were dismissed.

Antitrust Litigation Eight consumer antitrust class actions were filed in 2003 against us in the United States District Court for the District of Connecticut (District Court). The primary claim in these suits was that our wireline subsidiaries have, in violation of federal and state law, maintained monopoly power over local telephone service in all 13 states in which our subsidiaries are incumbent local exchange companies.

These cases were consolidated under the first filed case *Twombly v SBC Communications Inc.* and were stayed by agreement of the parties pending the United States Supreme Court's (Supreme Court) decision in a similar case against another incumbent local exchange company. In January 2004, the Supreme Court decided that case in favor of the incumbent local exchange company and, on February 23, 2004, the District Court approved a voluntary dismissal in these eight cases, thus ending the litigation.

In addition, two consumer antitrust class actions were filed in the United States District Court for the Southern District of New York against SBC, Verizon, BellSouth and Qwest alleging that they have violated federal and state antitrust laws by agreeing not to compete with one another and acting together to impede competition for local telephone services (*Twombly v Bell Atlantic Corp., et al.*) In October 2003, the court granted the joint defendants' motion to dismiss these suits on the ground that the plaintiffs' complaints failed to state a claim under the antitrust laws. The plaintiffs appealed to the Second Circuit Court of Appeals and oral arguments have been heard.

We continue to believe that an adverse outcome having a material effect on our financial statements in these two cases is unlikely but will continue to evaluate the potential impact of these suits on our financial results as they progress.

LIQUIDITY AND CAPITAL RESOURCES

We had \$760 in cash and cash equivalents available at December 31, 2004. Cash and cash equivalents included cash of approximately \$261, money market funds of

\$423 and other cash equivalents of \$76. In addition, at December 31, 2004 we held \$99 in other short-term held-to-maturity securities.

During 2004, our primary sources of funds were cash from operating activities of \$10,955, proceeds from long-term debt issuances and short-term borrowing of approximately \$9,859 and proceeds of \$6,622 primarily from the sale of our nonstrategic business assets. Also contributing to our sources of funds was the September 2004 sale of our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley for net proceeds of approximately \$1,397. During 2004, we contributed cash of \$2,232 to our pension and postretirement benefit plans. In October 2004, we used substantially all of our cash and cash equivalents to fund our portion of the purchase price for AT&T Wireless (see "Cingular" below).

During 2005 we expect to use our available excess cash primarily to reduce our debt levels. We expect to repay current maturities of long-term debt of \$1,337 with cash from operations. Available excess cash will be used to repay our commercial paper borrowings of \$4,397 or to further reduce long-term debt.

Cash from Operating Activities

Our 2004 cash flow from operations remained relatively stable compared to 2003 excluding the \$2,232 contribution to our pension and postretirement benefit plans and a \$2,761 decline in our deferred income tax expense.

Our primary source of funds for 2003 and 2002 was cash generated from operating activities, as shown in the Consolidated Statements of Cash Flows. During 2003, our cash flow from operations remained relatively stable compared to 2002 excluding the noncash increase in pension and postretirement expenses.

Cash from Investing Activities

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000. In connection with the acquisition, we entered into an investment agreement with BellSouth and Cingular. Under the investment agreement, we and BellSouth funded, by means of an equity contribution to Cingular, a significant portion of the acquisition's purchase price. Based on our 60% equity ownership of Cingular, and after taking into account cash on hand at AT&T Wireless, we provided additional equity of approximately \$21,600 to fund the purchase price. In exchange for this equity contribution, Cingular issued to us and BellSouth new membership interests in Cingular. See "Cingular" section below and Note 16 for further details.

In 2004, 2003 and 2002, our cash receipts from dispositions exceeded cash expended on acquisitions (see Note 2). Our investing activities during 2004 primarily included proceeds of approximately \$2,063 from the disposition of our investment in Belgacom, \$2,864 from the disposition of our interest in TDC, \$1,186 from the sale of our interest in Telkom, \$323 from the sale of a portion of our interest in Yahoo and Amdocs and \$178 from the sale of shares of Telmex and América Móvil. In the fourth quarter of 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth

Dollars in millions except per share amounts

and purchased the internet directory provider, YPC, for approximately \$98, of which our portion was \$65

To provide high-quality communications services to our customers, we must make significant investments in property, plant and equipment. The amount of capital investment is influenced by demand for services and products, continued growth and regulatory commitments.

Our capital expenditures totaled \$5,099 for 2004, \$5,219 for 2003 and \$6,808 for 2002. Capital expenditures in the wireline segment, which represented substantially all of our total capital expenditures, decreased by 2.8% in 2004 and 23.6% in 2003. Our 2004 capital spending plans reflected the uncertain U.S. economy, the changing regulatory environment and our resulting revenue expectations. However, in response to an improving federal regulatory environment and competition, we recently began our Project Lightspeed trials, and if successful, we expect to begin our build-out of our fiber-optic network in 2005 and expect to spend approximately \$4,000 over the next three years in deployment costs and \$1,000 in customer-activation capital expenditures spread over 2006 and 2007 (see "Expected Growth Areas" for additional details). We expect total capital spending for 2005 to be between our targeted range of \$5,400 and \$5,700, excluding Cingular, substantially all of which we expect to relate to our wireline segment primarily for our wireline subsidiaries' networks, Project Lightspeed and support systems for our long-distance service.

Substantially all of our capital expenditures are made in the wireline segment. We expect to fund these expenditures using cash from operations and incremental borrowings, depending on interest rate levels and overall market conditions. Our international segment operations should be self-funding as it is substantially equity investments and not direct SBC operations. We expect to fund any directory segment capital expenditures using cash from operations. We discuss our Cingular segment below.

For 2004 investing activities included the purchase of approximately \$135 and maturities of \$499 of other held-to-maturity securities, which have maturities greater than 90 days.

In addition, during 2004, we received proceeds of approximately \$50 related to the repayment of a note receivable from Covad Communications Group, Inc.

Cash from Financing Activities

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. In October 2004, we entered into a \$12,000, 364-day revolving credit agreement with certain investment and commercial banks to fund our \$21,600 equity contribution. On October 26, 2004, we borrowed \$8,750 under this agreement at an interest rate based on the daily federal funds rate, with an initial rate of 1.76% plus applicable margin. We repaid this borrowing with proceeds from commercial paper borrowings. We terminated this credit agreement as of November 26, 2004. To partially repay these commercial paper borrowings, in November 2004, we issued \$5,000 of long-term debt consisting of \$2,250 of 4.125% 5-year notes, \$2,250 of 5.100% 10-year notes, and \$500 of 6.150% 30-year bonds. We also used the aggregate net proceeds of approximately

\$1,382 from the dispositions in November 2004 of our remaining interests in TDC and Telkom to further reduce our commercial paper borrowings.

In October 2004, we entered into a 3-year credit agreement totaling \$6,000 with a syndicate of banks replacing our \$4,250, 364-day credit agreement that was terminated October 18, 2004. The expiration date of the current credit agreement is October 18, 2007. Advances under this agreement may be used for general corporate purposes, including support of commercial paper borrowings and other short-term borrowings. There is no material adverse change provision governing the drawdown of advances under this credit agreement. However, we are subject to a debt-to-EBITDA (a metric defined in the agreement and nominally representing earnings before interest, taxes, depreciation and amortization, although other adjustments are also included) covenant, and if advances are received, we are subject to a negative pledge covenant, both as defined in the agreement. Defaults under the agreement, which would permit the lenders to accelerate required payment, include nonpayment of principal or interest beyond any applicable grace period, failure by SBC or any subsidiary to pay when due other debt above a threshold amount that results in acceleration of that debt (commonly referred to as "cross-acceleration") or commencement by a creditor of enforcement proceedings within a specified period after a money judgment above a threshold amount has become final, acquisition by any person of beneficial ownership of more than 50% of SBC common shares or a change of more than a majority of SBC's directors in any 24-month period other than as elected by the remaining directors (commonly referred to as a "change of control"), material breaches of representations in the agreement, failure to comply with the negative pledge or debt-to-EBITDA ratio covenants described above, failure to comply with other covenants for a specified period after notice, failure by SBC or certain affiliates to make certain minimum funding payments under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and specified events of bankruptcy or insolvency. We are in compliance with all covenants under the agreement. We had no borrowings outstanding under committed lines of credit as of December 31, 2004 or 2003.

Our consolidated commercial paper borrowings increased \$3,398 during 2004, and at December 31, 2004, totaled \$4,397. All of these commercial paper borrowings are due within 90 days.

In August 2004, we received net proceeds of \$1,487 from the issuance of \$1,500 of long-term debt, of which \$750 has an interest rate of 5.625% and matures June 15, 2016. The remainder of the debt carries an interest rate of 6.45% and matures June 15, 2034.

During 2004, approximately \$849 of long-term debt matured, (excluding capital lease payments) of which \$833 related to current maturities of long-term debt with interest rates ranging from 5.8% to 9.5%, with an average yield of 6.7%. Our 2004 capital lease payments were approximately \$32. Funds from operations were used to repay these obligations.

We have approximately \$1,337 of long-term debt that is scheduled to mature in 2005. We expect to use funds from operations to repay these obligations.

Dividends declared by the Board of Directors of SBC totaled \$1.26 per share in 2004, \$1.41 per share in 2003 and \$1.08 per share in 2002. In December 2004, our Board of Directors approved a 3.2% increase in the regular quarterly dividend to \$0.3225 per share. The \$0.15 decline in dividends declared during 2004 was primarily due to the 2003 additional dividends declared of \$0.25, above our regular quarterly dividend payout. Dividends declared during 2003 included two increases in the regular quarterly dividend and three additional dividends, totaling \$0.25, above our regular quarterly payout. The total dividends declared were \$4,170 in 2004, \$4,674 in 2003 and \$3,591 in 2002. Total cash paid for dividends were \$4,141 in 2004, \$4,539 in 2003 and \$3,557 in 2002. Our dividend policy considers both the expectations and requirements of stockholders, internal requirements of SBC and long-term growth opportunities. All dividends remain subject to approval by our Board of Directors.

In December 2003, our Board of Directors authorized the repurchase of up to 350 million shares of SBC common stock, this authorization expires at the end of 2008. During 2004, we repurchased approximately 17 million shares at a cost of \$448 (see "Issuer Equity Repurchases" table).

During 2005 we expect to use our available cash primarily to reduce our debt levels, which will provide us greater financial flexibility. As opportunities permit, we may also repurchase shares of SBC common stock under our repurchase program.

Pending Acquisition of AT&T

On January 30, 2005, we agreed to acquire AT&T in a transaction in which each share of AT&T common stock will be exchanged for 0.77942 shares of SBC common stock (equivalent to approximately 19% of SBC's outstanding shares as of December 31, 2004). At the closing of the transaction, AT&T also will pay each AT&T stockholder a special dividend of \$1.30 per share. Based on the closing price of SBC stock on January 28, 2005, the exchange ratio equals \$18.41 per share. The value of the total consideration to be received by AT&T stockholders is approximately \$16,000, including the special dividend. After the acquisition, AT&T will be a wholly owned subsidiary of SBC. The transaction has been approved by the Board of Directors of each company and also must be approved by the stockholders of AT&T. The transaction is subject to review by the Department of Justice and approval by the FCC and various other regulatory authorities. We expect the transaction to close in late 2005 or early 2006. See "Operating Environment and Trends of the Business" for more details.

Other

Our total capital consists of debt (long-term debt and debt maturing within one year) and stockholders' equity. Our capital structure does not include debt issued by our international equity investees or Cingular. Total capital increased approximately \$11,245 in 2004 and \$942 in 2003. The 2004 total capital increase was primarily due to

increased current and long-term debt of \$8,989, of which \$8,750 related to funding our share of Cingular's purchase of AT&T Wireless. See "Cingular" discussion below. Stockholders' equity increased due to our net income, the 2004 adjustment to our additional minimum pension liability as a result of our merger of substantially all of our pension plan participants into one of our existing plans (see Note 10) and the repurchase of common shares through our stock repurchase program. Partially offsetting these equity increases were settlement costs associated with the interest rate forward contracts and foreign currency translation losses. Our debt ratio was 40.0%, 32.0% and 39.9% at December 31, 2004, 2003 and 2002. The debt ratio is affected by the same factors that affect total capital. The primary factor that impacted our debt ratio was the increased current and long-term debt, partially offset by the equity increases, mentioned previously.

Cingular

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. In connection with the acquisition, we entered into an investment agreement with BellSouth and Cingular. Under the investment agreement, we and BellSouth funded, by means of an equity contribution to Cingular, a significant portion of the acquisition's purchase price. Based on our 60% equity ownership of Cingular, and after taking into account cash on hand at AT&T Wireless, we provided additional equity of approximately \$21,600 to fund the purchase price. See above discussion, "Cash from Financing Activities," for details on borrowings we incurred to finance this amount.

As a result of this transaction, we recorded the \$21,600 contributed to Cingular as an increase in "Investments in and Advances to Cingular Wireless." We recorded the components of this contribution by recording the related \$8,750 of debt issued as "Debt maturing within one year" and "Long-Term Debt," and a reduction in "Cash and cash equivalents" of \$12,850. In connection with funding our equity contribution to Cingular, on October 26, 2004, we borrowed \$8,750 through drawings from our \$12,000, 364-day revolving credit facility, which we entered into on October 12, 2004. We repaid this borrowing with proceeds from commercial paper borrowings. On November 3, 2004, we issued \$5,000 in long-term debt to partially repay these commercial paper borrowings. The \$5,000 of long-term debt consisted of \$2,250 of 4.125% 5-year notes, \$2,250 of 5.100% 10-year notes and \$500 of 6.150% 30-year bonds.

In April 2004, we entered into interest rate forward contracts with a notional amount of \$5,250 to partially hedge interest expense related to financing of Cingular's acquisition of AT&T Wireless. During the third quarter we utilized a notional amount of \$1,500 of these interest rate forward contracts, and incurred settlement costs of \$52, by issuing \$1,500 of long-term debt of which \$750 matures in June 2016 with the remainder maturing in June 2034. The settlement costs are accounted for as a component of "Other comprehensive income" and are being amortized as interest expense over the term of the interest payments of the related debt issuances. On November 3, 2004 we issued additional long-term debt and utilized the remaining amount of our interest rate forward contracts.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Dollars in millions except per share amounts

for a settlement cost of \$250, which will be accounted for as previously discussed

Effective August 1, 2004, we and BellSouth agreed to finance Cingular's capital and operating cash requirements to the extent Cingular requires funding above the level provided by operations. Cingular's Board of Directors also approved the termination of its bank credit facilities and its intention to cease issuing commercial paper and long-term debt. In addition, we and BellSouth entered into a one-year revolving credit agreement with Cingular to provide short-term financing for operations on a pro rata basis at an interest rate of LIBOR plus 0.05%. The agreement is renewable annually upon agreement of the parties. This agreement includes a provision for the repayment of our and BellSouth's advances made to Cingular in the event there are no outstanding amounts due under the revolving credit agreement and to the extent Cingular has excess cash, as defined by the agreement. At December 31, 2004, our share of advances to Cingular related to this revolving credit agreement was approximately \$1,002 and was reflected as an increase in "Investments in and Advances to Cingular Wireless" on our Consolidated Balance Sheet.

The upgrade, integration and expansion of the Cingular and AT&T Wireless networks and the networks acquired in a transaction with Triton PCS will require substantial amounts of capital over the next several years. Including the incremental capital requirements during 2005 as a result of the AT&T Wireless acquisition, Cingular expects 2005 capital investments for completing network upgrades, integrating its network with that of AT&T Wireless and funding other ongoing capital expenditures to be approximately \$6,800 to \$7,200, including Cingular's recently announced plans to deploy 3G UMTS network technology with HSDPA over the next two years.

CONTRACTUAL OBLIGATIONS,
COMMITMENTS AND CONTINGENCIES

Current accounting standards require us to disclose our material obligations and commitments to make future payments under contracts, such as debt and lease

agreements, and under contingent commitments, such as debt guarantees. We occasionally enter into third-party debt guarantees, but they are not, nor are they reasonably likely to become, material. We disclose our contractual long-term debt repayment obligations in Note 7 and our operating lease payments in Note 5. In the ordinary course of business we routinely enter into commercial commitments for various aspects of our operations, such as plant additions and office supplies. However, we do not believe that the commitments will have a material effect on our financial condition, results of operations or cash flows.

Below is a table of our contractual obligations as of December 31, 2004. The purchase obligations listed below are those for which we have guaranteed funds and will be funded with cash provided by operations or through incremental borrowings. Approximately 93% of our purchase obligations are in our wireline segment and the remainder is attributable to commitments in our directory segment for paper and printing services. Due to the immaterial value of our capital lease obligations, they have been included with long-term debt. Our total capital lease obligations are \$35, with approximately \$7 to be paid in less than one year. The table does not include the fair value of our interest rate swaps of \$79 and our other long-term liabilities because it is not certain when our other long-term liabilities will become due. Our other long-term liabilities are: deferred income taxes (see Note 9) of \$15,660, postemployment benefit obligations (see Note 10) of \$9,076, unamortized investment tax credits of \$188, and other noncurrent liabilities of \$3,290, which included supplemental retirement plan liabilities (see Note 10) and deferred lease revenue from our agreement with SpectraSite, Inc (see Note 5). Additionally, included in "Other current liabilities" on the Consolidated Balance Sheet was \$350 of preferred stock in subsidiaries that may be redeemed at any time by holders of those subsidiaries' securities (see Note 8). The table below does not include this amount because it is not certain when this liability will come due.

Contractual Obligations

	Payments Due By Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Long-term debt obligations ^{1,2}	\$22,631	\$1,337	\$3,551	\$3,885	\$13,858
Commercial paper obligations	4,397	4,397	—	—	—
Operating lease obligations	1,286	327	435	267	257
Purchase obligations	1,999	719	815	249	216
Retirement benefit funding obligation	1,000	—	—	—	1,000
Total Contractual Obligations	\$31,313	\$6,780	\$4,801	\$4,401	\$15,331

¹Included in the "Less than 1 Year" column is \$239 of 5.95% debentures due to an exercise of a put option (See Note 7)

²Included in the "More than 5 Years" column is \$1,000 of 4.18% Puttable Reset Securities (PURS) maturing in 2021 with a put option by holder in 2005 and \$125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006 (See Note 7)

MARKET RISK

We are exposed to market risks primarily from changes in interest rates and foreign currency exchange rates. In managing exposure to these fluctuations, we may engage in various hedging transactions that have been authorized according to documented policies and procedures. We do not use derivatives for trading purposes, to generate income or to engage in speculative activity. Our capital costs are directly linked to financial and business risks. We seek to manage the potential negative effects from market volatility and market risk. The majority of our financial instruments are medium- and long-term fixed rate notes and debentures. Fluctuations in market interest rates can lead to significant fluctuations in the fair value of these notes and debentures. It is our policy to manage our debt structure and foreign exchange exposure in order to manage capital costs, control financial risks and maintain financial flexibility over the long term. Where appropriate, we will take actions to limit the negative effect of interest and foreign exchange rates, liquidity and counterparty risks on stockholder value.

QUANTITATIVE INFORMATION ABOUT MARKET RISK

Interest Rate Sensitivity The principal amounts by expected maturity, average interest rate and fair value of our liabilities that are exposed to interest rate risk are described in Notes 7 and 8. Following are our interest rate derivatives subject to interest rate risk as of December 31, 2004. The interest rates illustrated in the interest rate swaps section of the table below refer to the average expected rates we would receive and the average expected rates we would pay based on the contracts. The notional amount is the principal amount of the debt subject to the interest rate swap contracts. The fair value represents the amount we would receive if we exited the contracts as of December 31, 2004.

	Maturity						Total	Fair Value 12/31/04
	2005	2006	2007	2008	2009	After 2009		
Interest Rate Derivatives								
Interest Rate Swaps								
Receive Fixed/Pay Variable Notional Amount	—	\$1,000	—	—	—	\$3,250	\$4,250	\$79
Variable Rate Payable ¹	4.6%	5.0%	5.5%	5.7%	5.9%	6.4%		
Weighted-Average Fixed Rate Receivable	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%		

¹Interest payable based on current and implied forward rates for Three or Six Month LIBOR plus a spread ranging between approximately 64 and 170 basis points.

At December 31, 2004, we had interest rate swaps with a notional value of \$4,250 and a fair value of approximately \$79. In January 2004, we entered into \$750 in variable interest rate swap contracts on our 6.25% fixed rate debt that matures in March 2011.

In April 2004, we entered into interest rate forward contracts with a notional amount of \$5,250 to partially hedge interest expense related to financing Cingular's acquisition of AT&T Wireless. During the third quarter of 2004, we utilized a notional amount of \$1,500 of these interest rate forward contracts, and incurred settlement costs of \$52 (\$34 net of tax benefit), by issuing \$1,500 of long-term debt of which \$750 matures in June 2016, with the remainder maturing in June 2034. The settlement costs are accounted for as a component of "Other comprehensive income" and are being amortized as interest expense over the term of the interest payments of the related debt issuances. During the fourth quarter of 2004, we issued additional long-term debt and utilized the

remaining amount of our interest rate forward contracts for a settlement cost of \$250 (\$162 net of tax benefit), which will be accounted for as previously mentioned.

QUALITATIVE INFORMATION ABOUT MARKET RISK

Foreign Exchange Risk From time to time, we make investments in businesses in foreign countries, are paid dividends, receive proceeds from sales or borrow funds in foreign currency. Before making an investment, or in anticipation of a foreign currency receipt, we often will enter into forward foreign exchange contracts. The contracts are used to provide currency at a fixed rate. Our policy is to measure the risk of adverse currency fluctuations by calculating the potential dollar losses resulting from changes in exchange rates that have a reasonable probability of occurring. We cover the exposure that results from changes that exceed acceptable amounts. We do not speculate in foreign exchange markets.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED)

Dollars in millions except per share amounts

Interest Rate Risk We issue debt in fixed and floating rate instruments. Interest rate swaps are used for the purpose of controlling interest expense by managing the mix of fixed and floating rate debt. Interest rate forward contracts were utilized to hedge interest expense related to financing Cingular's acquisition of AT&T Wireless. We do not seek to make a profit from changes in interest rates. We manage interest rate sensitivity by measuring potential increases in interest expense that would result from a probable change in interest rates. When the potential increase in interest expense exceeds an acceptable amount, we reduce risk through the issuance of fixed rate (in lieu of variable rate) instruments and purchasing derivatives.

Issuer Equity Repurchases

In July 2003, we announced our intention to resume our previously announced stock repurchase program. In December 2003, our Board of Directors authorized the repurchase of up to 350 million shares of SBC common stock, this authorization expires at the end of 2008. During 2004, we repurchased approximately 17 million shares at a cost of \$448, as shown below.

Purchase Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October 27, 2004 – October 28, 2004	1,000,000	\$25.10	1,000,000	349,000,000
November 1, 2004 – November 17, 2004	16,250,000	\$26.00	16,250,000	332,750,000
Total	17,250,000	\$25.95	17,250,000	332,750,000

Certification by the Chief Executive Officer

As required under the rules of the New York Stock Exchange (NYSE), our chief executive officer has timely submitted to the NYSE his annual certification that he is not aware of any violation by the company of NYSE corporate governance standards. Also as required

under the rules of the NYSE, readers are advised that the certifications required under Section 302 of the Sarbanes-Oxley Act of 2002 are not included in this report but instead are included as exhibits to our Annual Report on Form 10-K for 2004.

CAUTIONARY LANGUAGE CONCERNING FORWARD-LOOKING STATEMENTS

Information set forth in this report contains forward-looking statements that are subject to risks and uncertainties, and actual results could differ materially. We claim the protection of the safe harbor for forward-looking statements provided by the Private Securities Litigation Reform Act of 1995.

The following factors could cause our future results to differ materially from those expressed in the forward-looking statements:

- Adverse economic changes in the markets served by us or in countries in which we have significant investments
- Changes in available technology and the effects of such changes including product substitutions and deployment costs
- Uncertainty in the U.S. securities market and adverse medical cost trends
- The final outcome of Federal Communications Commission proceedings and reopenings of such proceedings, including the Triennial Review and other rulemakings, and judicial review, if any, of such proceedings, including issues relating to access charges, broadband deployment, availability and pricing of, unbundled network elements and platforms (UNE-Ps) and unbundled loop and transport elements (EELs)
- The final outcome of regulatory proceedings in our 13-state area and reopenings of such proceedings, and judicial review, if any, of such proceedings, including proceedings relating to interconnection terms, access charges, universal service, UNE-Ps and resale and wholesale rates, broadband deployment including Project Lightspeed, performance measurement plans, service standards and traffic compensation
- Enactment of additional state, federal and/or foreign regulatory and tax laws and regulations pertaining to our subsidiaries and foreign investments
- Our ability to absorb revenue losses caused by increasing competition, including offerings using alternative technologies (e.g., cable, wireless and VoIP) and UNE-P requirements, and to maintain capital expenditures
- The extent of competition in our 13-state area and the resulting pressure on access line totals and wireline and wireless operating margins
- Our ability to develop attractive and profitable product/service offerings to offset increasing competition in our wireline and wireless markets

- The ability of our competitors to offer product/service offerings at lower prices due to adverse regulatory decisions, including state regulatory proceedings relating to UNE-Ps and nonregulation of comparable alternative technologies (e.g., VoIP)
- The timing, extent and cost of deployment of our Project Lightspeed broadband initiative and the development of attractive and profitable service offerings
- The issuance by the Financial Accounting Standards Board or other accounting oversight bodies of new accounting standards or changes to existing standards
- The issuance by the Internal Revenue Service and/or state tax authorities of new tax regulations or changes to existing standards and actions by federal, state or local tax agencies and judicial authorities with respect to applying applicable tax laws and regulations
- The impact of the wireless joint venture with BellSouth, known as Cingular, including marketing and product-development efforts, customer acquisition and retention costs, access to additional spectrum, network upgrades, technological advancements, industry consolidation including the acquisition of AT&T Wireless and availability and cost of capital
- Cingular's failure to achieve, in the amounts and within the timeframe expected, the capital and expense synergies and other benefits expected from its acquisition of AT&T Wireless and our costs in financing our portion of the merger's purchase price
- The impact of our pending acquisition of AT&T, including our ability to obtain governmental approvals of the acquisition on the proposed terms and schedule, the failure of AT&T stockholders to approve the transaction, the risk that the businesses will not be integrated successfully, the risk that the cost savings and any other synergies from the acquisition may not be fully realized or may take longer to realize than expected, disruption from the acquisition making it more difficult to maintain relationships with customers, employees or suppliers, and competition and its effect on pricing, spending, third-party relationships and revenues
- Changes in our corporate strategies, such as changing network requirements or acquisitions and dispositions, to respond to competition and regulatory and technology developments

Readers are cautioned that other factors discussed in this report, although not enumerated here, also could materially impact our future earnings.

CONSOLIDATED STATEMENTS OF INCOME

Dollars in millions except per share amounts

	2004	2003	2002
Operating Revenues			
Voice	\$20,796	\$21,986	\$24,636
Data	10,984	10,150	9,639
Long-distance voice	3,297	2,561	2,324
Directory advertising	3,832	3,894	4,056
Other	1,878	1,907	2,166
Total operating revenues	40,787	40,498	42,821
Operating Expenses			
Cost of sales (exclusive of depreciation and amortization shown separately below)	17,383	16,739	16,474
Selling, general and administrative	9,939	9,605	9,331
Depreciation and amortization	7,564	7,870	8,578
Total operating expenses	34,886	34,214	34,383
Operating Income	5,901	6,284	8,438
Other Income (Expense)			
Interest expense	(1,023)	(1,242)	(1,382)
Interest income	492	603	561
Equity in net income of affiliates	873	1,253	1,921
Other income (expense) – net	922	1,818	733
Total other income (expense)	1,264	2,432	1,833
Income Before Income Taxes	7,165	8,716	10,271
Income taxes	2,186	2,857	2,910
Income From Continuing Operations	4,979	5,859	7,361
Income From Discontinued Operations, net of tax	908	112	112
Income Before Extraordinary Item and Cumulative Effect of Accounting Changes	5,887	5,971	7,473
Extraordinary item, net of tax	—	(7)	—
Cumulative effect of accounting changes, net of tax	—	2,541	(1,820)
Net Income	\$ 5,887	\$ 8,505	\$ 5,653
Earnings Per Common Share:			
Income From Continuing Operations	\$ 1.50	\$ 1.77	\$ 2.21
Income Before Extraordinary Item and Cumulative Effect of Accounting Changes	\$ 1.78	\$ 1.80	\$ 2.24
Net Income	\$ 1.78	\$ 2.56	\$ 1.70
Earnings Per Common Share – Assuming Dilution:			
Income From Continuing Operations	\$ 1.50	\$ 1.76	\$ 2.20
Income Before Extraordinary Item and Cumulative Effect of Accounting Changes	\$ 1.77	\$ 1.80	\$ 2.23
Net Income	\$ 1.77	\$ 2.56	\$ 1.69

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

CONSOLIDATED BALANCE SHEETS

Dollars in millions except per share amounts

	December 31,	
	2004	2003
Assets		
Current Assets		
Cash and cash equivalents	\$ 760	\$ 4,806
Short-term investments	99	378
Accounts receivable – net of allowances for uncollectibles of \$881 and \$908	5,480	6,160
Prepaid expenses	746	760
Deferred income taxes	566	741
Other current assets	890	926
Assets of discontinued operations	—	252
Total current assets	8,541	14,023
Property, Plant and Equipment – Net	50,046	52,128
Goodwill	1,625	1,611
Investments in Equity Affiliates	1,798	6,924
Investments in and Advances to Cingular Wireless	33,687	11,003
Other Assets	13,147	14,544
Total Assets	\$108,844	\$100,233
Liabilities and Stockholders' Equity		
Current Liabilities		
Debt maturing within one year	\$ 5,734	\$ 1,879
Accounts payable and accrued liabilities	10,038	10,658
Accrued taxes	1,787	402
Dividends payable	1,065	1,033
Liabilities of discontinued operations	310	328
Total current liabilities	18,934	14,300
Long-Term Debt	21,231	16,097
Deferred Credits and Other Noncurrent Liabilities		
Deferred income taxes	15,621	15,070
Postemployment benefit obligation	9,076	12,691
Unamortized investment tax credits	188	220
Other noncurrent liabilities	3,290	3,607
Total deferred credits and other noncurrent liabilities	28,175	31,588
Stockholders' Equity		
Preferred shares (\$1 par value, 10,000,000 authorized none issued)	—	—
Common shares (\$1 par value, 7,000,000,000 authorized issued 3,433,124,836 at December 31, 2004 and 2003)	3,433	3,433
Capital in excess of par value	12,804	13,010
Retained earnings	29,352	27,635
Treasury shares (132,212,645 at December 31, 2004 and 127,889,010 at December 31, 2003, at cost)	(4,535)	(4,698)
Additional minimum pension liability adjustment	(190)	(1,132)
Accumulated other comprehensive income	(360)	—
Total stockholders' equity	40,504	38,248
Total Liabilities and Stockholders' Equity	\$108,844	\$100,233

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

Dollars in millions, increase (decrease) in cash and cash equivalents

	2004	2003	2002
Operating Activities			
Net income	\$ 5,887	\$ 8,505	\$ 5,653
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	7,564	7,870	8,578
Undistributed earnings from investments in equity affiliates	(542)	(965)	(1,586)
Provision for uncollectible accounts	761	846	1,381
Amortization of investment tax credits	(32)	(24)	(30)
Deferred income tax expense	646	3,446	2,474
Net gain on sales of investments	(939)	(1,775)	(794)
Extraordinary item, net of tax	—	7	—
Cumulative effect of accounting changes, net of tax	—	(2,541)	1,820
Income from discontinued operations, net of tax	(908)	(112)	(112)
Retirement benefit funding	(2,232)	(1,645)	(3)
Changes in operating assets and liabilities			
Accounts receivable	(81)	(338)	(530)
Other current assets	(102)	(14)	472
Accounts payable and accrued liabilities	777	511	(1,919)
Other – net	156	(414)	(268)
Total adjustments	5,068	4,852	9,483
Net Cash Provided by Operating Activities	10,955	13,357	15,136
Investing Activities			
Construction and capital expenditures	(5,099)	(5,219)	(6,808)
Investments in affiliates – net	(22,660)	—	(139)
Purchases of held-to-maturity securities	(135)	(710)	(1)
Maturities of held-to-maturity securities	499	248	2
Dispositions	6,622	3,020	4,349
Acquisitions	(74)	(8)	(731)
Proceeds from note repayment	50	—	—
Purchases of other investments	—	(436)	—
Proceeds from sales of other investments	50	—	—
Net Cash Used in Investing Activities	(20,747)	(3,105)	(3,328)
Financing Activities			
Net change in short-term borrowings with original maturities of three months or less	3,398	(78)	(1,791)
Issuance of other short-term borrowings	—	—	4,618
Repayment of other short-term borrowings	—	(1,070)	(7,718)
Issuance of long-term debt	6,461	—	2,251
Repayment of long-term debt	(881)	(3,098)	(1,499)
Purchase of treasury shares	(448)	(490)	(1,456)
Issuance of treasury shares	216	102	147
Issuance of preferred shares of subsidiaries	—	—	43
Dividends paid	(4,141)	(4,539)	(3,557)
Other	—	—	(56)
Net Cash Provided by (Used in) Financing Activities	4,605	(9,173)	(9,018)
Net increase (decrease) in cash and cash equivalents from continuing operations	(5,187)	1,079	2,790
Net increase in cash and cash equivalents from discontinued operations	1,141	156	77
Net increase (decrease) in cash and cash equivalents	(4,046)	1,235	2,867
Cash and cash equivalents beginning of year	4,806	3,571	704
Cash and Cash Equivalents End of Year	\$ 760	\$ 4,806	\$ 3,571

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
Dollars and shares in millions except per share amounts

	2004		2003		2002	
	Shares	Amount	Shares	Amount	Shares	Amount
Common Stock						
Balance at beginning of year	3,433	\$ 3,433	3,433	\$ 3,433	3,433	\$ 3,433
Balance at end of year	3,433	\$ 3,433	3,433	\$ 3,433	3,433	\$ 3,433
Capital in Excess of Par Value						
Balance at beginning of year		\$13,010		\$12,999		\$12,820
Issuance of shares		(315)		(181)		(165)
Stock option expense		75		183		390
Other		34		9		(46)
Balance at end of year		\$12,804		\$13,010		\$12,999
Retained Earnings						
Balance at beginning of year		\$27,635		\$23,802		\$21,737
Net income (\$1 78, \$2 56 and \$1 70 per share)		5,887		8,505		5,653
Dividends to stockholders (\$1 26, \$1 41 and \$1 08 per share)		(4,170)		(4,674)		(3,591)
Other		—		2		3
Balance at end of year		\$29,352		\$27,635		\$23,802
Treasury Shares						
Balance at beginning of year	(128)	\$ (4,698)	(115)	\$ (4,584)	(79)	\$ (3,482)
Purchase of shares	(17)	(448)	(21)	(490)	(44)	(1,456)
Issuance of shares	13	611	8	376	8	354
Balance at end of year	(132)	\$ (4,535)	(128)	\$ (4,698)	(115)	\$ (4,584)
Additional Minimum Pension Liability Adjustment						
Balance at beginning of year		\$ (1,132)		\$ (1,473)		\$ —
Required adjustments (net of taxes of \$578, \$210 and \$904)		942		341		(1,473)
Balance at end of year		\$ (190)		\$ (1,132)		\$ (1,473)
Accumulated Other Comprehensive Income, net of tax						
Balance at beginning of year		\$ —		\$ (978)		\$ (1,589)
Currency translation adjustments						
Foreign currency translation adjustment, net of taxes of \$(17), \$302 and \$258		(31)		561		480
Less reclassification adjustment for cumulative currency translation adjustments realized in net income		(97)		—		148
Net unrealized gains (losses) on securities						
Unrealized gains (losses), net of taxes of \$102, \$264 and \$(19)		189		536		(38)
Less reclassification adjustment realized in net income		(225)		(119)		7
Less reclassification adjustment for loss included in deferred revenue		—		—		14
Unrealized gains (losses) on cash flow hedges, net of taxes of \$(106)		(196)		—		—
Other comprehensive income (loss)		(360)		978		611
Balance at end of year		\$ (360)		\$ —		\$ (978)
Total Comprehensive Income						
Net income		\$ 5,887		\$ 8,505		\$ 5,653
Additional minimum pension liability adjustments per above		942		341		(1,473)
Other comprehensive income (loss) per above		(360)		978		611
Total Comprehensive Income		\$ 6,469		\$ 9,824		\$ 4,791

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation – Throughout this document, SBC Communications Inc is referred to as “we” or “SBC.” The consolidated financial statements include the accounts of SBC and our majority-owned subsidiaries. Our subsidiaries and affiliates operate in the communications services industry both domestically and internationally (primarily in Latin America) providing wireline and wireless telecommunications services and equipment as well as directory advertising and publishing services.

All significant intercompany transactions are eliminated in the consolidation process. Investments in partnerships, joint ventures, including Cingular Wireless (Cingular), and less than majority-owned subsidiaries where we have significant influence are accounted for under the equity method. We account for our 60% economic interest in Cingular under the equity method since we share control equally (i.e., 50/50) with our 40% economic partner in the joint venture. We have equal voting rights and representation on the board of directors that controls Cingular. Earnings from certain foreign investments accounted for using the equity method are included for periods ended within up to three months of our year end (see Note 6).

In January 2003, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin (ARB) No. 51” (FIN 46). FIN 46 provides guidance for determining whether an entity is a variable interest entity (VIE) and which equity investor of that VIE, if any, should include the VIE in its consolidated financial statements. In December 2003, the FASB staff revised FIN 46 (FIN 46(R)) to clarify some of the provisions. The revision delayed the effective date for application of FIN 46(R) by large public companies, such as us, until periods ending after March 15, 2004, for all types of VIEs other than special-purpose entities, including our investment in Cingular. In 2003, we recorded an extraordinary loss of \$7, net of taxes of \$4, related to consolidation of real estate leases under FIN 46.

In accordance with the provisions of FIN 46(R), we performed a quantitative study of potential cash flows of Cingular, covering a wide range of scenarios that valued Cingular significantly above and below the estimated fair value of Cingular. The probability of these scenarios was assessed to establish the weighted-average amount that these scenarios were both above and below the average of all the scenarios. These are the “residual returns” and “expected losses” as defined by FIN 46(R). As Cingular’s total capitalization has a high equity component, the “expected losses” of the FIN 46(R) calculations were significantly below not only the fair value of Cingular’s equity, but also its book value. Therefore, we determined that Cingular did not qualify for consolidation by us under the provisions of FIN 46(R), and our accounting treatment of our investment in Cingular remained unchanged. Cingular’s acquisition of AT&T Wireless Services Inc. (AT&T Wireless) (see Note 16) was accomplished entirely through equity contributions to Cingular, Cingular’s debt increased only by the amount of AT&T Wireless public debt assumed in connection with the acquisition. When we reassessed whether Cingular should be consolidated under FIN 46(R), primarily because of the large increase in the fair value

of Cingular’s equity as a result of the transaction, we concluded the acquisition of AT&T Wireless did not change our accounting for Cingular under FIN 46(R).

In May 2004, in response to the federal Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Act), the FASB issued final guidance on how employers that provide postretirement health care benefits should account for the Medicare Act (referred to as FSP FAS 106-2). FSP FAS 106-2 requires us to account for the Medicare Act as an actuarial gain or loss. As allowed under the FASB’s preliminary guidance (referred to as FSP FAS 106-1), we initially accounted for the Medicare Act as a plan amendment and recorded the adjustment in the amortization of our liability, from the December 2003 date of enactment of the Medicare Act. Because our initial accounting for the effects of the Medicare Act differed from the final guidance issued, in accordance with FSP FAS 106-2, we restated our first-quarter 2004 results to reflect the recognition as an actuarial gain or loss. While the gain realized from the Medicare Act is the same amount when recognized as an actuarial gain or loss instead of as a plan amendment, the gain is recognized over a longer period of time, which decreases the annual impact on our results. This restatement decreased our first-quarter 2004 net income approximately \$11 (with no tax effect), or less than \$0.01 per diluted share. Due to the immaterial impact of the change in accounting on 2003 (since the Medicare Act was enacted in December), we did not record a cumulative effect of accounting change as of January 1, 2004. (See Note 10).

On December 16, 2004, the FASB issued FASB Statement No. 123 (revised 2004), “Share-Based Payment” (FAS 123(R)), which is a revision of FASB Statement No. 123, “Accounting for Stock-Based Compensation” (FAS 123). FAS 123(R) supersedes APB Opinion No. 25, “Accounting for Stock Issued to Employees,” and amends FASB Statement No. 95, “Statement of Cash Flows.” Generally, the approach in Statement 123(R) is similar to the approach described in Statement 123. However, Statement 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

FAS 123(R) must be adopted no later than July 1, 2005. FAS 123(R) permits public companies to adopt its requirements using the following methods:

- The “modified prospective” method in which compensation cost is recognized beginning with the effective date (a) based on the requirements of FAS 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of FAS 123 for all awards granted to employees prior to the effective date of FAS 123(R) that remain unvested on the effective date.
- The “modified retrospective” method which includes the requirements of the modified prospective method described above, but also permits entities to restate based on the amounts previously recognized under FAS 123 for purposes of pro forma disclosures either (a) all prior periods presented or (b) prior interim periods of the year of adoption.

We are still considering which method to adopt under FAS 123(R). We adopted the fair-value-based method of

accounting for share-based payments allowed under FAS 123 effective January 1, 2002, using the retroactive restatement method of adoption described in FASB Statement No. 148, "Accounting for Stock-Based Compensation – Transition and Disclosure." This included restatement of results from January 1, 2000 forward as those were the years for which audited income statements were included in the 2002 SBC Annual Report. Upon adoption of FAS 123(R), if we were to adopt the retrospective method, we would also restate results for 1994 through 1999 for the effects on our equity. We are currently using the Black-Scholes option pricing model to estimate the value of stock options granted to employees and expect to continue to use this acceptable option valuation model upon the required adoption of FAS 123(R). We anticipate that adoption of FAS 123(R) will not have a material impact on compensation expense. However, there are possible income tax consequences (see Note 9).

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes, including estimates of probable losses and expenses. Actual results could differ from those estimates.

Reclassifications – We have reclassified certain amounts in prior-period financial statements to conform to the current period's presentation, including those related to our discontinued operations (see Note 17).

Income Taxes – Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. We provide valuation allowances against the deferred tax assets for amounts when the realization is uncertain. Management reviews these items regularly in light of changes in tax laws and court rulings at both federal and state levels. Our income tax returns are regularly audited and reviewed by the Internal Revenue Service (IRS) and state taxing authorities. The IRS has completed field examinations for all tax years through 1999, and examinations of subsequent years are in progress. The IRS has issued assessments challenging the timing and amounts of various deductions for the 1997-1999 period. We paid the taxes on these assessments and filed refund claims, which the IRS has denied. We are currently considering remediation options, which include litigation. The resolution of this litigation is not expected to have any material adverse impact on the financial statements.

Investment tax credits earned prior to their repeal by the Tax Reform Act of 1986 are amortized as reductions in income tax expense over the lives of the assets which gave rise to the credits.

Cash Equivalents – Cash and cash equivalents include all highly liquid investments with original maturities of three months or less, and the carrying amounts approximate fair value. At December 31, 2004, we held \$261 in cash, \$423 in money market funds and \$76 in other cash equivalents.

Investment Securities – Investments in securities principally consist of held-to-maturity or available-for-sale instruments. Short-term and long-term investments in money market securities and other auction-type securities

are carried as held-to-maturity securities. Available-for-sale securities consist of various debt and equity securities that are long term in nature. Unrealized gains and losses, net of tax, on available-for-sale securities are recorded in accumulated other comprehensive income.

Revenue Recognition – Revenues and associated expenses related to nonrefundable, upfront wireline service activation fees are deferred and recognized over the average customer life of five years. Expenses, though exceeding revenue, are only deferred to the extent of revenue.

Certain revenues derived from local telephone, long-distance, data and wireless services (principally fixed fees) are billed monthly in advance and are recognized the following month when services are provided. Other revenues derived from telecommunications services, principally long-distance and wireless airtime usage (in excess or in lieu of fixed fees) and network access, are recognized monthly as services are provided.

Prior to 2003, we recognized revenues and expenses related to publishing directories on the "issue basis" method of accounting, which recognizes the revenues and expenses at the time the initial delivery of the related directory is completed. See the discussion of our 2003 change in directory accounting in the "Cumulative Effect of Accounting Changes" section below.

The Emerging Issues Task Force (EITF), a task force established to assist the FASB on significant emerging accounting issues, has issued EITF 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables" (EITF 00-21). EITF 00-21 addresses certain aspects of accounting for sales that involve multiple revenue-generating products and/or services sold under a single contractual agreement. For us, this rule became effective for sales agreements entered into beginning July 1, 2003 and it does not have a material effect on our consolidated financial statements.

Allowance for Uncollectibles – Our bad debt allowance is estimated primarily based on analysis of history and future expectations of our retail and our wholesale customers in each of our operating companies. For retail customers, our estimates are based on our actual historical write-offs, net of recoveries, and the aging of accounts receivable balances. Our assumptions are reviewed at least quarterly and adjustments are made to our bad debt allowance as appropriate. For our wholesale customers, we use a statistical model based on our aging of accounts receivable balances. Our risk categories, risk percentages and reserve balance assumptions built into the model are reviewed monthly and the bad debt allowance is adjusted accordingly.

Cumulative Effect of Accounting Changes

Directory accounting Effective January 1, 2003, we changed our method of recognizing revenues and expenses related to publishing directories from the "issue basis" method to the "amortization" method. The issue basis method recognizes revenues and expenses at the time the initial delivery of the related directory is completed. Consequently, quarterly income tends to vary with the number and size of directory titles published during a quarter. The amortization method recognizes revenues and expenses ratably over the life of the directory, which

is typically 12 months. Consequently, quarterly income tends to be more consistent over the course of a year. We decided to change methods because the amortization method has now become the more prevalent method used among significant directory publishers. This change permits a more meaningful comparison between our directory segment and other publishing companies (or publishing segments of larger companies).

Our directory accounting change resulted in a noncash charge of \$1,136, net of an income tax benefit of \$714, recorded as a cumulative effect of accounting change on the Consolidated Statement of Income as of January 1, 2003. The effect of this change was to increase consolidated pretax income and our directory segment income for 2003 by \$80 (\$49 net of tax, or \$0.01 per diluted share).

Depreciation accounting On January 1, 2003, we adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (FAS 143). FAS 143 sets forth how companies must account for the costs of removal of long-lived assets when those assets are no longer used in a company's business, but only if a company is legally required to remove such assets. FAS 143 requires that companies record the fair value of the costs of removal in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. To determine whether we have a legal obligation to remove our long-lived assets, we reviewed state and federal law and regulatory decisions applicable to our subsidiaries, primarily our wireline subsidiaries, which have long-lived assets. Based on this review, we concluded that we are not legally required to remove any of our long-lived assets, except in a few minor instances.

However, in November 2002, we were informed that the Securities and Exchange Commission (SEC) staff concluded that certain provisions of FAS 143 require that we exclude costs of removal from depreciation rates and accumulated depreciation balances in certain circumstances upon adoption, even where no legal removal obligations exist. In our case, this means that for plant accounts where our estimated costs of removal exceed the estimated salvage value, we are prohibited from accruing removal costs in those depreciation rates and accumulated depreciation balances in excess of the salvage value. For our other long-lived assets, where our estimated costs of removal are less than the estimated salvage value, we will continue to accrue the costs of removal in those depreciation rates and accumulated depreciation balances.

Therefore, in connection with the adoption of FAS 143 on January 1, 2003, we reversed all existing accrued costs of removal for those plant accounts where our estimated costs of removal exceeded the estimated salvage value. The noncash gain resulting from this reversal was \$3,684, net of deferred taxes of \$2,249, recorded as a cumulative effect of accounting change on the Consolidated Statement of Income as of January 1, 2003.

In addition, in 2003, TDC A/S (TDC), the Danish communications company in which we then held an investment accounted for on the equity method, recorded

a loss upon adoption of FAS 143. Our share of that loss was \$7, which included no tax effect. This noncash charge of \$7 was also recorded as a cumulative effect of accounting change on the Consolidated Statement of Income as of January 1, 2003.

Beginning in 2003, for those plant accounts where our estimated costs of removal previously exceeded the estimated salvage value, we expense all costs of removal as we incur them (previously those costs had been recorded in our depreciation rates). As a result, our 2003 depreciation expense decreased and our operations and support expense increased as these assets were removed from service. The effect of this change was to increase consolidated pretax income and our wireline segment income for 2003 by \$280 (\$172 net of tax, or \$0.05 per diluted share). However, over the life of the assets, total operating expenses recognized under this new accounting method will be approximately the same as under the previous method (assuming the cost of removal would be the same under both methods).

Goodwill and other intangible assets accounting On January 1, 2002, we adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" (FAS 142). Adoption of FAS 142 means that we stopped amortizing goodwill, and at least annually, we will test the remaining book value of goodwill for impairment. Any impairments subsequent to adoption will be recorded in operating expenses. We also stopped amortizing goodwill recorded on our equity investments. This embedded goodwill will continue to be tested for impairment under the accounting rules for equity investments, which are based on comparisons between fair value and carrying value. Our total cumulative effect of accounting change from adopting FAS 142 was a noncash charge of \$1,820, net of an income tax benefit of \$5, recorded as of January 1, 2002.

The carrying value of our goodwill at December 31, 2004 of \$1,625 was allocated to the following segments: \$724 to Wireline, \$8 to Directory, and \$893 to Other. Our amortized intangible assets, consisting primarily of customer lists, trademarks, and internally developed and purchased software had a gross carrying value of \$1,122 and accumulated amortization of \$719 at December 31, 2004. Our unamortized intangible assets, consisting of wireless licenses, had a gross carrying value of \$25 at December 31, 2004.

At December 31, 2003, the carrying value of our goodwill of \$1,611 was allocated to the following segments: \$717 to Wireline, \$8 to Directory, and \$886 to Other. Our amortized intangible assets had a gross carrying value of \$2,100 and accumulated amortization of \$691 at December 31, 2003. Our unamortized intangible assets had a gross carrying value of \$23 at December 31, 2003.

Adjusted results The amounts in the following table have been adjusted assuming that we had retroactively applied to 2002 the new directory and depreciation accounting methods, discussed above.

Year Ended December 31,	2004	2003	2002
Income before extraordinary item and cumulative effect of accounting changes – as reported	\$5,887	\$ 5,971	\$7,473
Directory change, net of tax	—	—	(107)
Depreciation change, net of tax	—	—	172
Income before extraordinary item and cumulative effect of accounting changes – as adjusted	\$5,887	\$ 5,971	\$7,538
Basic earnings per share			
Income before extraordinary item and cumulative effect of accounting changes – as reported	\$ 1.78	\$ 1.80	\$ 2.24
Directory change, net of tax	—	—	(0.03)
Depreciation change, net of tax	—	—	0.05
Income before extraordinary item and cumulative effect of accounting changes – as adjusted	\$ 1.78	\$ 1.80	\$ 2.26
Diluted earnings per share			
Income before extraordinary item and cumulative effect of accounting changes – as reported	\$ 1.77	\$ 1.80	\$ 2.23
Directory change, net of tax	—	—	(0.03)
Depreciation change, net of tax	—	—	0.05
Income before extraordinary item and cumulative effect of accounting changes – as adjusted	\$ 1.77	\$ 1.80	\$ 2.25
Net income – as reported	\$5,887	\$ 8,505	\$5,653
Remove extraordinary item and cumulative effect of accounting changes	—	(2,534)	—
Directory change, net of tax	—	—	(107)
Depreciation change, net of tax	—	—	172
Net income – as adjusted	\$5,887	\$ 5,971	\$5,718
Basic earnings per share			
Net income – as reported	\$ 1.78	\$ 2.56	\$ 1.70
Remove extraordinary item and cumulative effect of accounting changes	—	(0.76)	—
Directory change, net of tax	—	—	(0.03)
Depreciation change, net of tax	—	—	0.05
Net income – as adjusted	\$ 1.78	\$ 1.80	\$ 1.72
Diluted earnings per share			
Net income – as reported	\$ 1.77	\$ 2.56	\$ 1.69
Remove extraordinary item and cumulative effect of accounting changes	—	(0.76)	—
Directory change, net of tax	—	—	(0.03)
Depreciation change, net of tax	—	—	0.05
Net income – as adjusted	\$ 1.77	\$ 1.80	\$ 1.71

Property, Plant and Equipment – Property, plant and equipment is stated at cost. The cost of additions and substantial improvements to property, plant and equipment is capitalized. The cost of maintenance and repairs of property, plant and equipment is charged to operating expenses. Property, plant and equipment are depreciated using straight-line methods over their estimated economic lives. Certain subsidiaries follow composite group depreciation methodology, accordingly, when a portion of their depreciable property, plant and equipment is retired in the ordinary course of business, the gross book

value is reclassified to accumulated depreciation, no gain or loss is recognized on the disposition of this plant.

Software Costs – It is our policy to capitalize certain costs incurred in connection with developing or obtaining internal use software. Capitalized software costs are included in Property, Plant and Equipment and are amortized over three years. Software costs that do not meet capitalization criteria are expensed immediately.

Goodwill – Goodwill represents the excess of consideration paid over net assets acquired in business combinations. Goodwill is not amortized but is tested annually for impairment. We have completed our annual impairment testing for 2004 and determined that no impairment exists. During 2004, the carrying amount of our goodwill increased which included acquisitions by our subsidiaries.

Advertising Costs – Advertising costs for advertising products and services or promoting our corporate image are expensed as incurred.

Foreign Currency Translation – Our foreign investments generally report their earnings in their local currencies. We translate our share of their foreign assets and liabilities at exchange rates in effect at the balance sheet dates. We translate our share of their revenues and expenses using average rates during the year. The resulting foreign currency translation adjustments are recorded as a separate component of accumulated other comprehensive income in the accompanying Consolidated Balance Sheets. Gains and losses resulting from exchange-rate changes on transactions denominated in a currency other than the local currency are included in earnings as incurred.

Derivative Financial Instruments – We record derivatives on the balance sheet at fair value. We do not invest in derivatives for trading purposes. We use derivatives from time to time as part of our strategy to manage risks associated with our contractual commitments. For example, we use interest rate swaps to limit exposure to changes in interest rates on our debt obligations (see Note 8). We account for our interest rate swaps using mark-to-market accounting and include gains or losses from interest rate swaps when paid or received in interest expense on our Consolidated Statements of Income. Amounts paid or received on interest rate forward contracts are amortized over the period of the related interest payments.

Stock-Based Compensation – As discussed more fully in Note 12, under various plans, senior and other management and nonmanagement employees and nonemployee directors have received stock options, performance stock units and other nonvested stock units. We account for these plans using the preferable fair value recognition provisions of FAS 123. Under this method, the estimated fair value of the options granted is amortized to expense over the options' vesting period. In December 2004, the FASB revised FAS 123 (FAS 123(R)) which among other items, requires the expensing of stock-based compensation. The statement is effective for the first interim or annual period beginning after June 15, 2005. As we had previously adopted the expensing provisions of FAS 123, we do not expect FAS 123(R) to have a significant effect on our compensation expense when adopted.

Pension and Postretirement Benefits – See Note 10 for a comprehensive discussion of our pension and postretirement benefit expense, including a discussion of the actuarial assumptions

**NOTE 2. ACQUISITIONS, DISPOSITIONS,
AND VALUATION AND OTHER ADJUSTMENTS**

Acquisitions – In December 2004, our subsidiary Sterling Commerce, Inc (Sterling), agreed to acquire Yantra Corporation (Yantra) for approximately \$170 in cash. Yantra is a provider of distributed order management and supply chain fulfillment solutions. This transaction closed on January 25, 2005.

In November 2004, a subsidiary in our directory segment entered into a joint venture agreement with BellSouth Corporation (BellSouth) and purchased the internet directory provider YellowPages.com (YPC) for approximately \$98, our portion of which was \$65.

Dispositions – In September 2004, we sold our interest in the directory advertising business in Illinois and northwest Indiana to R H Donnelley Corporation (Donnelley) for net proceeds of approximately \$1,397. The sale included SBC's interest in DonTech II Partnership, a partnership between Donnelley and SBC that was the exclusive sales agent for Yellow Pages advertising in those two areas. This transaction closed in the third quarter of 2004 and we recorded a gain of approximately \$1,357 (\$827 net of tax) in our third-quarter 2004 financial results. During the third quarter of 2004, we changed our reporting for this portion of the directory business to discontinued operations (see Note 17).

During 2004, we sold our investment in Danish telecommunications provider TDC for approximately \$2,864 in cash. We reported a net loss of approximately \$138 (\$66 net of tax). The details of this disposition follow.

In June 2004, we sold approximately 69.4 million shares of TDC for approximately \$2,125 in cash. Approximately 51.3 million shares were sold to certain institutional investors located in Europe, the United States and elsewhere. TDC also repurchased 18.1 million shares. After this transaction, we owned approximately 20.6 million shares of TDC. We reported a loss of approximately \$191 (\$101 net of tax) in our second-quarter 2004 financial results due to this transaction.

As a result of this June transaction, SBC-designated directors resigned all of their board seats and we removed all of our employees from day-to-day operations at TDC. Accordingly, as we no longer exerted significant influence on TDC's operations, we were required to change from the equity method of accounting to the cost method of accounting for our remaining interest in TDC during June 2004. Therefore, we ceased recording proportionate results from TDC as equity income in our financial results from the date of this transaction.

We had previously agreed to not sell our remaining approximate 20.6 million shares of TDC until December 6, 2004, subject to various exceptions, including for sales made with the prior written consent of the investment banks that conducted the sale of a portion of our shares in TDC in June of 2004. However, we received approval by those banks on November 3, 2004, and sold our

remaining approximate 20.6 million shares of TDC for approximately \$739 in cash. We reported a gain of approximately \$53 (\$35 net of tax) in our fourth-quarter 2004 financial results due to this transaction.

During 2004, we also sold our investment in South African telecommunications provider Telkom S.A. Limited (Telkom) for approximately \$1,186 in cash. We reported a loss of approximately \$82 (\$55 net of tax). The details of this disposition follow.

In June 2004, we sold approximately 50% of our stake in Telkom for approximately \$543 in cash to South African and international institutional investors. We reported a loss of approximately \$68 (\$45 net of tax) in our second-quarter 2004 financial results due to this transaction. Because we retained significant representation on Telkom's board of directors and participation and influence on operations, we continued to use the equity method of accounting for our then-remaining interest in Telkom.

We had previously agreed to not sell any of our remaining interest prior to the date of the release of Telkom's interim financial results (which was scheduled for November 15, 2004), subject to various exceptions, including for sales made with the prior written consent of the investment banks that conducted the sale of a portion of our shares in Telkom in June of 2004. We received the written consent of those investment banks and in November 2004, we sold our remaining interest in Telkom for approximately \$643 in cash. We reported a loss of approximately \$14 (\$10 net of tax) in our fourth-quarter 2004 financial results due to this transaction.

In March 2004, in connection with Belgacom S.A.'s (Belgacom) initial public offering (IPO), we disposed of our entire investment in Belgacom. Both our investment and TDC's investment in Belgacom were held through Belgacom's minority stockholder, ADSB Telecommunications B.V. (ADSB). In a series of transactions culminating with the IPO, we reported a combined direct and indirect net gain of approximately \$1,067 (\$715 net of tax) in our 2004 financial results. Approximately \$235 of this pretax gain was reported as equity income, reflecting our indirect ownership through TDC (which also disposed of its interest). We received approximately \$2,063 in cash from the disposition of our direct interest.

Net proceeds from the 2004 dispositions of our international investments were generally used to fund our share of the purchase price paid by Cingular to acquire AT&T Wireless. See Note 16 for additional information on this acquisition.

In October 2002, we agreed to sell our 15% interest in Cegetel S.A. (Cegetel) to Vodafone Group PLC (Vodafone). The pending sale removed our significant influence and required us to change our accounting for Cegetel to the cost method from the equity method at the time of the agreement. With this change, the value of our investment is reflected in the "Other Assets" line on our December 31, 2002 Consolidated Balance Sheet. The sale was completed in January 2003, and we received cash proceeds of \$2,270 and recorded a pretax gain of approximately \$1,574.

In the second quarter of 2002, we entered into two agreements with Bell Canada Holdings Inc. (Bell Canada)

(1) to redeem a portion of our ownership in Bell Canada and (2) to give BCE, Inc (BCE) the right to purchase our remaining interest in Bell Canada. In June 2002, we entered into an agreement to redeem a portion of our ownership in Bell Canada, representing approximately 4% of the company, for an \$873 short-term note, resulting in a pretax gain of approximately \$148. Under the terms of the agreement, on July 15, 2002 when we received the proceeds from the short-term note, we purchased approximately 9 million shares of BCE, the majority stockholder of Bell Canada, for approximately 250 Canadian dollars (CAD) (\$164 at July 15, 2002 exchange rates). In the second quarter of 2003, we sold these BCE shares for \$173 in cash and recorded a pretax gain of approximately \$9. In the fourth quarter of 2002, BCE exercised its right to purchase our remaining 16% interest in Bell Canada at a price of 4,990 CAD. We received proceeds of \$3,158, consisting of approximately 8.9 million shares of BCE stock and the remainder of \$2,997 in cash and recognized a pretax gain of approximately \$455. In the third quarter of 2003, we sold the BCE stock for \$191 in cash and recorded a pretax gain of approximately \$31.

Restructuring of Investments – In the fourth quarter of 2002, we internally restructured our ownership in several investments, including Sterling. As part of this restructuring, a newly created subsidiary borrowed \$244 from an independent party at an annual interest rate of 4.79%, repayable in five years. Additionally, a total of \$43 of preferred securities in subsidiaries was sold to independent parties. The preferred interests receive preferred dividends at a 5.79% annual rate, paid quarterly. As we remain the primary beneficiary after the restructuring, the preferred securities are classified as “Other noncurrent liabilities” on our Consolidated Balance Sheets, and no gain or loss was recorded on the transaction. As a result, we recognized in net income \$280 of tax benefits on certain financial expenses and losses that were not previously eligible for deferred tax recognition (see Note 9).

Valuation Adjustments – In January 2002, we purchased from América Móvil S A de C V (América Móvil) its approximately 50% interest in Cellular Communications of Puerto Rico (CCPR) for cash and a note redeemable for our investment in Telecom Américas Ltd (Telecom Américas). We retained the right to settle the note by delivering Telecom Américas shares. This represented a forward sale of our interest in Telecom Américas. In connection with this transaction, we reviewed the values at which we would carry CCPR and our interest in Telecom Américas and recognized a charge of \$390 (\$262 net of tax) for the reduction of our direct and indirect book values to the value indicated by the transaction. We based this valuation on a contemporaneous transaction involving CCPR and an independent third party. The charges were recorded in both other income (expense) – net (\$341) and equity in net income of affiliates (\$49). América Móvil exercised its option to acquire our shares of Telecom Américas in July 2002.

All other cost investments accounted for under Statement of Financial Accounting Standards No. 115, “Accounting for Certain Investments in Debt and Equity Securities” (FAS 115) are periodically reviewed to determine

whether an investment’s decline in value is other than temporary. If so, the cost basis of the investment is written down to fair value, which becomes the new cost basis.

2002 Workforce Reduction and Related Charges –

During 2002, our continuing review of staffing needs led to decisions to further reduce our number of management and nonmanagement employees. In 2002, we recorded charges of approximately \$356 (\$224 net of tax) for severance and real estate costs related to workforce-reduction programs. As discussed in Note 10, these workforce-reduction programs also required us to record \$486 in special termination benefits and net pension settlement gains of \$29.

NOTE 3. EARNINGS PER SHARE

A reconciliation of the numerators and denominators of basic earnings per share and diluted earnings per share for income from continuing operations for the years ended December 31, 2004, 2003 and 2002 are shown in the table below.

Year Ended December 31,	2004	2003	2002
Numerators			
Numerator for basic earnings per share			
Income from continuing operations	\$4,979	\$5,859	\$7,361
Dilutive potential common shares			
Other stock-based compensation	9	9	7
Numerator for diluted earnings per share	\$4,988	\$5,868	\$7,368
Denominators			
Denominator for basic earnings per share			
Weighted-average number of common shares outstanding (000,000)	3,310	3,318	3,330
Dilutive potential common shares (000,000)			
Stock options	2	1	8
Other stock-based compensation	10	10	10
Denominator for diluted earnings per share	3,322	3,329	3,348
Basic earnings per share			
Income from continuing operations	\$ 1.50	\$ 1.77	\$ 2.21
Income from discontinued operations	0.28	0.03	0.03
Extraordinary item	—	—	—
Cumulative effect of accounting changes	—	0.76	(0.54)
Net income	\$ 1.78	\$ 2.56	\$ 1.70
Diluted earnings per share			
Income from continuing operations	\$ 1.50	\$ 1.76	\$ 2.20
Income from discontinued operations	0.27	0.04	0.03
Extraordinary item	—	—	—
Cumulative effect of accounting changes	—	0.76	(0.54)
Net income	\$ 1.77	\$ 2.56	\$ 1.69

At December 31, 2004, 2003 and 2002, we had issued and outstanding options to purchase approximately 214 million, 231 million and 229 million shares of SBC common stock. The exercise prices of options to purchase a weighted average of 191 million, 212 million and 180 million shares in 2004, 2003, and 2002 exceeded the average market price of SBC stock. Accordingly, we did not include these amounts in determining the dilutive potential common shares for the respective periods. At December 31, 2004, the exercise price of 32 million share options were below market price. Of these options, 16 million will expire by the end of 2007.

NOTE 4. SEGMENT INFORMATION

Our segments are strategic business units that offer different products and services and are managed accordingly. Under GAAP segment reporting rules, we analyze our various operating segments based on segment income (expense) – net and income tax expense are managed only on a total company basis and are, accordingly, reflected only in consolidated results. Therefore, these items are not included in the calculation of each segment's percentage of our consolidated results. We have five reportable segments that reflect the current management of our business: (1) wireline, (2) Cingular, (3) directory, (4) international, and (5) other.

The wireline segment provides both retail and wholesale landline telecommunications services, including local and long-distance voice, switched access, data and messaging services and satellite television services through our agreement with EchoStar Communications Corp. (EchoStar).

The Cingular segment reflects 100% of the results reported by Cingular, our wireless joint venture, excluding the effects of Cingular's February 2005 announcement. In February 2005, we announced we were recording a charge against fourth-quarter 2004 results to reflect the correction of an error relating to the lease accounting practices of Cingular. Cingular restated previous financial results. Our prior-years' financial results were not restated due to the immateriality of this adjustment to the results of operations, cash flows and financial position for the current year or any individual or prior period. As a result of the charge, we reduced our fourth-quarter 2004 equity in net income of affiliates by approximately \$105. This charge does not affect Cingular's cash flows and is primarily related to the timing of recording rental expense which would balance out over the life of the affected operating leases. Because this was a noncash charge which had an immaterial impact on reported segment results for the

periods presented and since the information we used during the years presented to analyze this segment did not include this adjustment, in the segment tables following we present 100% of Cingular's revenues and expenses excluding this adjustment under "Total segment operating revenues" and "Total segment operating expenses." The \$105 reduction to equity in net income of affiliates is reflected in the "Other" segment for the 2004 operating results. Although we analyze Cingular's revenues and expenses under the Cingular segment, we eliminate the Cingular segment in our consolidated financial statements. In our consolidated financial statements, we report our 60% proportionate share of Cingular's results as equity in net income of affiliates. For segment reporting, we report this equity in net income of affiliates in our other segment.

The directory segment includes our directory operations, including Yellow and White Pages advertising and electronic publishing. Results for this segment are shown under the amortization method which means that revenues and direct expenses are recognized ratably over the life of the directory title, typically 12 months. Results for all periods presented in this segment have been restated to reflect the sale of our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley (see Note 2).

Our international segment includes all investments with primarily international operations. The other segment includes results from paging services, all corporate and other operations as well as the Cingular equity income, as discussed above.

In the following tables, we show how our segment results are reconciled to our consolidated results reported in accordance with GAAP. The Wireline, Cingular, Directory, International and Other columns represent the segment results of each such operating segment. The Consolidation and Elimination column adds in those line items that we manage on a consolidated basis only: interest expense, interest income and other income (expense) – net. This column also eliminates any intercompany transactions included in each segment's results. Since our 60% share of the results from Cingular is already included in the Other column, the Cingular Elimination column removes the results of Cingular shown in the Cingular segment. In the balance sheet section of the tables below, our investment in Cingular is included in the "Investment in equity method investees" line item in the Other column (\$26,830 in 2004 and \$5,118 in 2003).

Segment results, including a reconciliation to SBC consolidated results, for 2004, 2003 and 2002 are as follows

At December 31, 2004 or for the year ended	Wireline	Cingular	Directory	International	Other	Consolidation and Elimination	Cingular Elimination	Consolidated Results
Revenues from external customers	\$36,857	\$19,436	\$3,665	\$ 22	\$ 243	\$ —	\$(19,436)	\$ 40,787
Intersegment revenues	30	—	94	—	1	(125)	—	—
Total segment operating revenues	36,887	19,436	3,759	22	244	(125)	(19,436)	40,787
Operations and support expenses	25,809	14,834	1,644	31	(37)	(125)	(14,834)	27,322
Depreciation and amortization expenses	7,454	3,079	9	—	101	—	(3,079)	7,564
Total segment operating expenses	33,263	17,913	1,653	31	64	(125)	(17,913)	34,886
Segment operating income	3,624	1,523	2,106	(9)	180	—	(1,523)	5,901
Interest expense	—	900	—	—	—	1,023	(900)	1,023
Interest income	—	12	—	—	—	492	(12)	492
Equity in net income of affiliates	—	(390)	—	812	61	—	390	873
Other income (expense) – net	—	(82)	—	—	—	922	82	922
Segment income before income taxes	3,624	163	2,106	803	241	391	(163)	7,165
Segment assets	66,131	82,284	3,153	14,041	107,825	(82,306)	(82,284)	108,844
Investment in equity method investees	—	2,723	63	1,494	27,071	—	(2,723)	28,628
Expenditures for additions to long-lived assets	4,999	3,463	1	—	99	—	(3,463)	5,099
At December 31, 2003 or for the year ended	Wireline	Cingular	Directory	International	Other	Consolidation and Elimination	Cingular Elimination	Consolidated Results
Revenues from external customers	\$36,508	\$15,483	\$3,701	\$ 30	\$ 259	\$ —	\$(15,483)	\$ 40,498
Intersegment revenues	32	—	72	—	4	(108)	—	—
Total segment operating revenues	36,540	15,483	3,773	30	263	(108)	(15,483)	40,498
Operations and support expenses	24,735	11,105	1,637	47	33	(108)	(11,105)	26,344
Depreciation and amortization expenses	7,763	2,089	21	—	86	—	(2,089)	7,870
Total segment operating expenses	32,498	13,194	1,658	47	119	(108)	(13,194)	34,214
Segment operating income	4,042	2,289	2,115	(17)	144	—	(2,289)	6,284
Interest expense	—	856	—	—	—	1,242	(856)	1,242
Interest income	—	14	—	—	—	603	(14)	603
Equity in net income of affiliates	—	(323)	—	606	647	—	323	1,253
Other income (expense) – net	—	(74)	—	—	—	1,818	74	1,818
Segment income before income taxes	4,042	1,050	2,115	589	791	1,179	(1,050)	8,716
Segment assets	68,450	25,526	2,638	14,339	68,281	(53,475)	(25,526)	100,233
Investment in equity method investees	—	2,288	—	6,747	5,295	—	(2,288)	12,042
Expenditures for additions to long-lived assets	5,147	2,734	1	—	71	—	(2,734)	5,219

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Dollars in millions except per share amounts

For the year ended December 31, 2002	Wireline	Cingular	Directory	International	Other	Consolidation and Elimination	Cingular Elimination	Consolidated Results
Revenues from external customers	\$38,529	\$14,903	\$3,887	\$ 35	\$370	\$ —	\$(14,903)	\$42,821
Intersegment revenues	30	—	79	—	19	(128)	—	—
Total segment operating revenues	38,559	14,903	3,966	35	389	(128)	(14,903)	42,821
Operations and support expenses	24,148	10,532	1,631	85	69	(128)	(10,532)	25,805
Depreciation and amortization expenses	8,442	1,850	30	—	106	—	(1,850)	8,578
Total segment operating expenses	32,590	12,382	1,661	85	175	(128)	(12,382)	34,383
Segment operating income	5,969	2,521	2,305	(50)	214	—	(2,521)	8,438
Interest expense	—	911	—	—	—	1,382	(911)	1,382
Interest income	—	29	—	—	—	561	(29)	561
Equity in net income of affiliates	—	(265)	—	1,152	769	—	265	1,921
Other income (expense) - net	—	(123)	—	—	—	733	123	733
Segment income before income taxes	5,969	1,251	2,305	1,102	983	(88)	(1,251)	10,271

Geographic Information

Our investments outside of the United States are primarily accounted for under the equity method of accounting. Accordingly, we do not include in our operating revenues and expenses the revenues and expenses of these individual investees. Therefore, less than 1% of our total operating revenues for all years presented are from outside the United States.

Long-lived assets consist primarily of net property, plant and equipment, goodwill, and the book value of our equity investments, which are shown in the table below.

December 31,	2004	2003
United States	\$78,806	\$59,033
Denmark	—	3,246
Belgium	—	1,236
Mexico	1,221	1,079
South Africa	—	919
Other foreign countries	272	268
Total	\$80,299	\$65,781

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is summarized as follows at December 31

	Lives (years)	2004	2003
Land	—	\$ 643	\$ 639
Buildings	35-45	11,909	11,519
Central office equipment	3-10	55,703	55,120
Cable, wiring and conduit	10-50	52,860	52,076
Other equipment	5-15	9,749	9,590
Software	3	4,222	3,599
Under construction	—	1,091	1,380
		136,177	133,923
Accumulated depreciation and amortization		86,131	81,795
Property, plant and equipment - net		\$ 50,046	\$ 52,128

Our depreciation expense was \$7,447 in 2004, \$7,667 in 2003 and \$8,379 in 2002.

Certain facilities and equipment used in operations are leased under operating or capital leases. Rental expenses under operating leases were \$479 for 2004, \$420 for 2003 and \$586 for 2002. At December 31, 2004, the future minimum rental payments under noncancelable operating leases for the years 2005 through 2009 were \$327, \$250, \$185, \$145 and \$122 with \$257 due thereafter. Capital leases are not significant.

SpectraSite Agreement

In August 2000, we reached an agreement with SpectraSite, Inc., (SpectraSite) under which we granted SpectraSite the exclusive rights to lease space on a number of our communications towers. These operating leases were scheduled to close over a period ending in 2002 (subsequently extended to 2004). SpectraSite would sublease space on the towers to

Cingular and also agreed to build or buy new towers for Cingular over the next five years. Cingular's sublease payments to SpectraSite reduce Cingular's net income and partially offset the rental income we receive from SpectraSite.

Under the terms of the original agreement, we received a combination of cash and stock as complete prepayment of rent with the closing of each leasing agreement. The value of the prepayments were recorded as deferred revenue and recognized in income as revenue over the life of the leases. In November 2001, we received \$35 from SpectraSite in consideration for amending the agreement to reduce the maximum number of towers subject to its terms and to extend the schedule for tower closings until first quarter of 2004. The balance of deferred revenue was \$628 in 2004, \$605 in 2003 and \$604 in 2002.

In late 2002, SpectraSite and certain of its senior debt holders agreed to restructure its debt. To effect the restructuring, SpectraSite filed a "prearranged" plan of reorganization under Chapter 11 of the United States Bankruptcy Code. We agreed with SpectraSite, subject to completion of its Chapter 11 reorganization, to decrease the number of towers to be leased to SpectraSite and to extend the schedule for tower closing until the third quarter of 2004. In addition, we exchanged all of our shares in SpectraSite for warrants to purchase shares representing less than 1% of the restructured company with no significant financial impact on us. SpectraSite emerged from bankruptcy in 2003.

NOTE 6. EQUITY METHOD INVESTMENTS

We account for our nationwide wireless joint venture, Cingular, and our investments in equity affiliates under the equity method of accounting.

Cingular – The following table is a reconciliation of our investments in and advances to Cingular as presented on our Consolidated Balance Sheets:

	2004	2003
Beginning of year	\$11,003	\$10,468
Contributions	21,688	—
Equity in net income	30	613
Other adjustments	966	(78)
End of year	\$33,687	\$11,003

Undistributed earnings from Cingular were \$2,511 and \$2,481 at December 31, 2004 and 2003. During 2004, we made an equity contribution to Cingular in connection with its acquisition of AT&T Wireless (see Note 16). Other adjustments in 2004 included the net activity of \$972 under our revolving credit agreement with Cingular, consisting of a reduction of \$30 (reflecting Cingular's repayment of advances during 2004) and an increase of \$1,002 (reflecting the December 31, 2004 balance of advances to Cingular under this revolving credit agreement) (See Note 15).

We account for our 60% economic interest in Cingular under the equity method of accounting in our consolidated financial statements since we share control equally (i.e., 50/50) with our 40% economic partner in the joint venture. We have equal voting rights and representation on the Board of Directors that controls Cingular.

The following table presents summarized financial information for Cingular at December 31, or for the period

then ended excluding the effects of Cingular's February 2005 adjustment (see Note 4). The adjustment had a cumulative effect of approximately \$175 on Cingular's net income. Cingular's management believes that the impact of this adjustment is not material to any previously issued financial statements. However, since the cumulative adjustment required to make this correction was material to Cingular's 2004 financial results, prior-period results were restated. Cingular's restated financial statements are available as Exhibit 13-b to our 2004 Form 10-K. The \$105 reduction in our equity income from Cingular is reflected in 2004 in the above table reconciling our investments in and advances to Cingular.

	2004	2003	2002
Income Statements			
Operating revenues	\$19,436	\$15,483	\$14,903
Operating income	1,523	2,289	2,521
Net income	226	1,022	1,207
Balance Sheets			
Current assets	\$ 5,570	\$ 3,300	
Noncurrent assets	76,714	22,226	
Current liabilities	8,013	3,187	
Noncurrent liabilities	29,569	13,855	

We have made advances to Cingular that totaled \$5,855 and \$5,885 at December 31, 2004 and 2003, which mature in June 2008. These advances bear interest at an annual rate of 6.0%. During 2004, Cingular repaid \$30 of these advances in accordance with the terms of a revolving credit agreement (see Note 15). We earned interest income on these advances of \$356 during 2004, \$397 in 2003 and \$441 in 2002. This interest income does not have a material impact on our net income as it is mostly offset when we record our share of equity income in Cingular.

Other Equity Method Investments – Our investments in equity affiliates include primarily international investments. The following table is a reconciliation of our investments in equity affiliates as presented on our Consolidated Balance Sheets:

	2004	2003
Beginning of year	\$ 6,924	\$5,859
Additional investments	100	—
Equity in net income	843	640
Dividends received	(331)	(288)
Currency translation adjustments	(53)	867
Dispositions	(4,995)	(89)
Other adjustments	(690)	(65)
End of year	\$ 1,798	\$6,924

The currency translation adjustment for 2004 primarily reflects the effect of exchange rate fluctuations on our investments in TDC, Teléfonos de México, S.A. de C.V. (Telmex) and Telkom. Dispositions for 2004 reflect the sale of TDC shares of \$2,619, Belgacom shares of \$1,190, Telkom shares of \$1,114 (see Note 2), Telmex L shares of \$63 and América Móvil L shares of \$9. Other adjustments for 2004 include an adjustment of \$686 resulting from our change from the equity method to the cost method of accounting for our investment in TDC (see Note 2).

The currency translation adjustment for 2003 primarily reflects the effect of exchange rate fluctuations on our investments in TDC, Belgacom and Telkom. Dispositions for 2003 reflect the decrease in our ownership percentage of Belgacom.

Undistributed earnings from equity affiliates were \$1,377 and \$2,496 at December 31, 2004 and 2003.

As of December 31, 2004, our investments in equity affiliates included a 7.6% interest in Telmex, Mexico's national telecommunications company, and a 7.8% interest in America Móvil, primarily a wireless provider in Mexico, with telecommunications investments in the United States and Latin America. We are a member of a consortium that holds all of the class AA shares of Telmex stock, representing voting control of the company. Another member of the consortium, Carso Global Telecom, S.A. de C.V., has the right to appoint a majority of the directors of Telmex. We also are a member of a consortium that holds all of the class AA shares of America Móvil stock, representing voting control of the company. Another member of the consortium, Americas Telecom S.A. de C.V., has the right to appoint a majority of the directors of América Móvil.

During 2004, we sold our entire investment in Danish telecommunications provider TDC for approximately \$2,864 in cash. We reported a net loss of approximately \$138 (\$66 net of tax). We also sold our entire investment in South African telecommunications provider Telkom during 2004 for approximately \$1,186 in cash. We reported a net loss of approximately \$82 (\$55 net of tax). See Note 2 for details of these transactions.

Following our initial disposition of part of TDC, the remaining portion was reclassified to a cost investment, reflected in "other adjustments" in the table above. As noted, that remaining investment was also sold during 2004.

In March 2004, in connection with Belgacom's IPO, we disposed of our entire investment in Belgacom. We received approximately \$2,063 in cash from the disposition of our direct interest and reported a combined direct and indirect net gain of approximately \$1,067 (\$715 net of tax). See Note 2 for details of this transaction.

In 2002, we entered into two agreements with Bell Canada: (1) to redeem a portion of our ownership in Bell Canada, representing approximately 4% of the company; and (2) to give BCE the right to purchase our remaining interest in Bell Canada. BCE exercised its right to purchase our remaining interest in Bell Canada during the fourth quarter of 2002. See Note 2 for a more detailed discussion on this divestiture.

In 2002, we agreed to sell to Vodafone our 15% equity interest in Cegetel, a joint venture that owns 80% of the second-largest wireless provider in France. The pending sale removed our significant influence and required us to change our accounting for Cegetel to the cost method from the equity method. This transaction closed in the first quarter of 2003. (See Note 2.)

The following table presents summarized financial information of our significant international investments accounted for using the equity method, taking into account all adjustments necessary to conform to GAAP but excluding our purchase adjustments, including goodwill, at

December 31 or for the year then ended. As noted above, during 2004 we completely disposed of our investments in TDC, Belgacom and Telkom. Accordingly, those investments are not included in the 2004 column in the following table.

	2004	2003	2002
Income Statements			
Operating revenues	\$22,800	\$34,747	\$30,414
Operating income	6,487	9,067	8,102
Net income	4,131	4,689	6,493
Balance Sheets			
Current assets	\$ 5,101	\$11,282	
Noncurrent assets	21,280	40,895	
Current liabilities	5,493	10,101	
Noncurrent liabilities	12,280	23,393	

At December 31, 2004, we had goodwill of approximately \$313 related to our international investments in equity affiliates.

The fair value of our investment in Telmex, based on the equivalent value of Telmex L shares at December 31, 2004, was approximately \$1,724. The fair value of our investment in América Móvil, based on the equivalent value of América Móvil L shares at December 31, 2004, was approximately \$2,504. Our weighted-average share of operating revenues shown above was 8% in 2004 and 17% in 2003 and 2002.

NOTE 7. DEBT

Long-term debt of SBC and its subsidiaries, including interest rates and maturities, is summarized as follows at December 31:

	2004	2003
Notes and debentures¹		
0.00% – 5.98% 2004 – 2038 ²	\$11,105	\$ 5,987
6.03% – 7.85% 2004 – 2043 ³	11,429	10,894
8.85% – 9.50% 2005 – 2016	141	153
	22,675	17,034
Unamortized discount – net of premium	(142)	(122)
Total notes and debentures	22,533	16,912
Capitalized leases	35	65
Total long-term debt, including current maturities	22,568	16,977
Current maturities of long-term debt	(1,337)	(880)
Total long-term debt	\$21,231	\$16,097

¹The fair value of our variable rate interest rate swaps of \$79 in 2004 and \$90 in 2003 was reported with its corresponding debt.

²Includes \$1,000 of 4.18% Puttable Reset Securities (PURS) maturing in 2021 with a put option by holder in 2005 and \$250 of 5.95% debentures maturing in 2038 with a put option by holder to elect repayment in December 2004. The option to elect repayment on \$239 of the \$250 debentures was exercised and the debt was subsequently repaid in 2005. The remaining \$11 million of debentures will mature in 2038 since the option to elect repayment expired unexercised. If the option by holder to elect repayment of the \$1,000 of PURS is exercised in 2005, we would refinance that amount with long-term debt.

³Includes \$125 of 6.35% debentures maturing in 2026 with a put option by holder in 2006.

At December 31, 2004, the aggregate principal amounts of long-term debt and weighted-average interest rate scheduled for repayment for the years 2005 through 2009, excluding the effect of interest rate swaps, were \$1,337 (6.6%), \$2,638 (5.9%), \$913 (6.3%), \$700 (6.3%) and \$3,185

(4 8%) with \$13,858 (6 1%) due thereafter As of December 31, 2004, we were in compliance with all covenants and conditions of instruments governing our debt Substantially all of our outstanding long-term debt is unsecured

Financing Activities

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash (see Note 16) In connection with the acquisition, we entered into an investment agreement with BellSouth and Cingular Under the investment agreement, we and BellSouth funded, by means of an equity contribution to Cingular, a significant portion of the merger consideration for the acquisition Based on our 60% equity ownership of Cingular, and after taking into account cash on hand at AT&T Wireless, we provided additional equity of approximately \$21,600 to fund the consideration In exchange for this equity contribution, Cingular issued to us and BellSouth new membership interests in Cingular In October 2004, we entered into a \$12,000, 364-day revolving credit agreement with certain investment and commercial banks to fund our \$21,600 equity contribution On October 26, 2004, we borrowed \$8,750 under this agreement at an interest rate based on the daily federal funds rate, with an initial rate of 1 76% plus applicable margin We repaid this borrowing with proceeds from commercial paper borrowings We terminated this credit agreement as of November 26, 2004 To partially repay these commercial paper borrowings, in November 2004, we issued \$5,000 of long-term debt consisting of \$2,250 of 4 125%, 5-year notes, \$2,250 of 5 100% 10-year notes, and \$500 of 6 150% 30-year bonds We also used the aggregate net proceeds of approximately \$1,383 from the dispositions in November 2004 of our remaining interests in TDC and Telkom to further reduce our commercial paper borrowings

In August 2004, we received net proceeds of \$1,487 from the issuance of \$1,500 of long-term debt, of which \$750 has an interest rate of 5 625% and matures June 15, 2016 The remainder of the debt carries an interest rate of 6 45% and matures June 15, 2034

In October 2004, we entered into a three-year credit agreement totaling \$6,000 with a syndicate of banks replacing our \$4,250, 364-day credit agreement that was terminated October 18, 2004 The expiration date of the current credit agreement is October 18, 2007 Advances under this agreement may be used for general corporate purposes, including support of commercial paper borrowings and other short-term borrowings There is no material adverse change provision governing the drawdown of advances under this credit agreement However, we are subject to a debt-to-EBITDA (a metric defined in the agreement and nominally representing earnings before interest, taxes, depreciation and amortization, although other adjustments are also included) covenant, and if advances are received, we are subject to a negative pledge covenant, both as defined in the agreement Defaults under the agreement, which would permit the lenders to accelerate required payment, include nonpayment of principal or interest beyond any applicable grace period, failure by SBC or any subsidiary to pay when due other debt above a threshold amount that results in acceleration of that debt (commonly referred to as "cross-acceleration") or commencement by a creditor of

enforcement proceedings within a specified period after a money judgment above a threshold amount has become final, acquisition by any person of beneficial ownership of more than 50% of SBC common shares or a change of more than a majority of SBC's directors in any 24-month period other than as elected by the remaining directors (commonly referred to as a "change of control"), material breaches of representations in the agreement, failure to comply with the negative pledge or debt-to-EBITDA ratio covenants described above, failure to comply with other covenants for a specified period after notice, failure by SBC or certain affiliates to make certain minimum funding payments under the Employee Retirement Income Security Act of 1974, as amended (ERISA), and specified events of bankruptcy or insolvency We are in compliance with all covenants under the agreement We had no borrowings outstanding under committed lines of credit as of December 31, 2004 or 2003

Debt maturing within one year consists of the following at December 31

	2004	2003
Commercial paper	\$4,397	\$ 999
Current maturities of long-term debt	1,337	880
Total	\$5,734	\$1,879

The weighted-average interest rate on commercial paper debt at December 31, 2004 and 2003 was 2 26% and 1 08%

NOTE 8. FINANCIAL INSTRUMENTS

The carrying amounts and estimated fair values of our long-term debt, including current maturities, and other financial instruments, are summarized as follows at December 31

	2004		2003	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Notes and debentures	\$22,533	\$23,628	\$16,912	\$18,094
Commercial paper	4,397	4,397	999	999
Cingular note receivable	5,855	5,855	5,885	5,885
Available-for-sale equity securities	732	732	844	844
EchoStar note receivable	453	453	441	441
Preferred stock of subsidiaries	393	393	393	393

The fair values of our notes and debentures were estimated based on quoted market prices, where available, or on the net present value method of expected future cash flows using current interest rates The carrying amount of commercial paper borrowings approximates fair value

Our notes receivable from Cingular are recorded at face value, and the carrying amounts approximate fair values The fair value of our EchoStar note receivable was based on the present value of cash and interest payments, which is accreted on the note up to the face value of \$500 over a three-year period on a straight line basis

Our available-for-sale equity securities are carried at fair value, and realized gains and losses on these equity securities were included in "Other income (expense) - net" on the Consolidated Statements of Income The fair value

of more than 95% of our available-for-sale equity securities was determined based on quoted market prices and the carrying amount of the remaining securities approximates fair value. Gross realized gains on our available-for-sale equity securities were \$323 in 2004, \$1,775 in 2003 and \$735 in 2002. Gross realized losses on these securities were \$191 in 2004 and \$0 in 2003 and 2002. These gains and losses were determined using the specific identification method. Our proceeds from the sales of our available-for-sale equity securities were \$3,188 in 2004, \$2,975 in 2003 and \$4,020 in 2002.

Our short-term investments, other short-term and long-term held-to-maturity investments and customer deposits are recorded at amortized cost, and the carrying amounts approximate fair values. In addition, we held other short-term held-to-maturity securities of \$99 as compared to \$378 at December 31, 2003. At December 31, 2004, we did not hold any other long-term held-to-maturity securities, which mature within two years from the date of purchase, and had \$84 at December 31, 2003.

Preferred Stock Issuances by Subsidiaries – In the fourth quarter of 2002, we restructured our holdings in certain investments, including Sterling. As part of this restructuring, a newly created subsidiary issued approximately \$43 of preferred stock, which was included in “Other noncurrent liabilities” on the Consolidated Balance Sheets. The preferred stock will accumulate dividends at an annual rate of 5.79% and can be converted, at the option of the holder, to common stock (but not a controlling interest) of the subsidiary at any time. (See Note 2)

In June 1997 and December 1999, an SBC subsidiary issued \$250 and \$100 of preferred stock in private placements. Beginning in May 2004, the holders of the preferred stock may require the subsidiary to redeem the shares at any time. At December 31, 2004, the \$350 of preferred stock in subsidiaries was included in “Other current liabilities” on the Consolidated Balance Sheets. Holders of these securities receive quarterly dividends based on a rolling three-month London Interbank Offer Rate (LIBOR), which was 2.75% at December 31, 2004.

Derivatives – We use interest rate swaps and interest rate forward contracts to manage interest rate risk. Each swap matches exact maturity dates of the underlying debt to which they are related, allowing for perfectly effective hedges. Each utilized forward contract matches the interest payments of the underlying debt to which they are related, allowing for perfectly effective hedges. The notional amounts, carrying amounts and estimated fair values of our derivative financial instruments are summarized as follows at December 31:

	Notional Amount	Carrying Amount	Fair Value
2004			
Interest rate swaps	\$4,250	\$79	\$79
2003			
Interest rate swaps	\$3,500	\$90	\$90

At December 31, 2004, we had interest rate swaps with a notional value of \$4,250 and a fair value of approximately \$79. In January 2004, we entered into \$750 in variable interest rate swap contracts on our 6.25% fixed rate debt that matures in March 2011. The fair value of our interest rate swaps was included in “Other Assets” on the Consolidated Balance Sheets.

In April 2004, we entered into interest rate forward contracts with a notional amount of \$5,250 to partially hedge interest expense related to financing of Cingular’s acquisition of AT&T Wireless. During the third quarter of 2004, we utilized a notional amount of \$1,500 of these interest rate forward contracts, and incurred settlement costs of \$52 (\$34 net of tax benefit), by issuing \$1,500 of long-term debt of which \$750 matures in June 2016, with the remainder maturing in June 2034. The settlement costs are accounted for as a component of “Other comprehensive income” and are being amortized as interest expense over the term of the interest payments of the related debt issuances. During the fourth quarter of 2004, we issued additional long-term debt and utilized the remaining amount of our interest rate forward contracts for a settlement cost of \$250 (\$162 net of tax benefit), which will be accounted for as previously mentioned.

NOTE 9. INCOME TAXES

Significant components of our deferred tax liabilities and assets (as restated for discontinued operations) are as follows at December 31:

	2004	2003
Depreciation and amortization	\$13,725	\$13,438
Equity in foreign affiliates	706	945
Other	4,372	4,281
Deferred tax liabilities	18,803	18,664
Employee benefits	2,197	3,261
Currency translation adjustments	300	228
Allowance for uncollectibles	320	277
Unamortized investment tax credits	73	86
Other	1,014	954
Deferred tax assets	3,904	4,806
Deferred tax assets valuation allowance	145	144
Net deferred tax liabilities	\$15,044	\$14,002

At December 31, 2004 and 2003, net deferred tax liabilities include a deferred tax asset of \$605 and \$558 relating to compensation expense under FAS 123. Full realization of this deferred tax asset requires stock options to be exercised at a price equaling or exceeding the sum of the strike price plus the fair value of the option at the grant date. The provisions of FAS 123, however, do not allow a valuation allowance to be recorded unless the company’s future taxable income is expected to be insufficient to recover the asset. Accordingly, there can be no assurance that the stock price of SBC common shares will rise to levels sufficient to realize the entire tax benefit currently reflected in our balance sheet. See Note 12 for additional discussion of FAS 123.

The change in the valuation allowance for 2003 is the result of an evaluation of the uncertainty associated with the realization of certain deferred tax assets unrelated to FAS 123. The valuation allowance is maintained in deferred tax assets for certain federal and state loss carryforwards that may not be realized.

The components of income tax expense are as follows:

	2004	2003	2002
Federal			
Current	\$1,145	\$ (528)	\$ 314
Deferred – net	843	3,046	2,254
Amortization of investment tax credits	(32)	(24)	(30)
	1,956	2,494	2,538
State, local and foreign			
Current	427	(37)	152
Deferred – net	(197)	400	220
	230	363	372
Total	\$2,186	\$2,857	\$2,910

In the fourth quarter of 2002, we internally restructured our ownership in several investments, including Sterling (see Note 2). The restructuring included the issuance of external debt (see Note 7) and the issuance and sale of preferred stock in subsidiaries (see Note 8). As we remain the primary beneficiary after the restructuring, the preferred securities are classified as "Other noncurrent liabilities" on our Consolidated Balance Sheet, and no gain or loss was recorded on the transaction. As a result of the sale of preferred stock, we recognized in net income \$280 of tax benefits on certain financial expenses and losses that were not previously eligible for deferred tax recognition.

A reconciliation of income tax expense and the amount computed by applying the statutory federal income tax rate (35%) to income before income taxes, income from discontinued operations, extraordinary items and cumulative effect of accounting change is as follows:

	2004	2003	2002
Taxes computed at federal statutory rate	\$2,508	\$3,051	\$3,595
Increases (decreases) in income taxes resulting from:			
State and local income taxes – net of federal income tax benefit	213	241	260
Restructuring/sale of preferred interest	—	—	(280)
Effects of international operations	(222)	(230)	(354)
Medicare reimbursements	(89)	(8)	—
Tax settlements	(65)	(41)	(171)
Other – net	(159)	(156)	(140)
Total	\$2,186	\$2,857	\$2,910

Effects of international operations include items such as foreign tax credits, sales of foreign investments and the effects of undistributed earnings from international

operations. Deferred taxes are not provided on the undistributed earnings of subsidiaries operating outside the United States that have been or are intended to be permanently reinvested.

NOTE 10. PENSION AND POSTRETIREMENT BENEFITS

Pensions – Substantially all of our employees are covered by one of various noncontributory pension and death benefit plans. At December 31, 2004, management employees participated in pension plans that include either cash balance or defined lump sum pension benefit formula. Additionally, the pension plans for all management employees include a traditional pension benefit formula, stated as a percentage of the employees' adjusted career income. A management employee's pension benefit is the greater of the amount calculated under (i) the cash balance or defined lump sum formula or (ii) the traditional benefit formula. In the fourth quarter of 2004 the management pension plan was amended, effective January 15, 2005, to freeze benefit accruals under the cash balance formula and to require that all future benefit accruals be based upon the plan's traditional pension formula (i.e., a stated percentage of employees' adjusted career income). Each employee's existing cash balance will continue to earn interest at a variable annual rate. After this change, management employees, at retirement, can elect to receive the portion of their pension benefit derived under the cash balance or defined lump sum as a lump sum or an annuity. The remaining pension benefit, if any, will be paid as an annuity if its value exceeds a stated monthly amount. The pension benefit formula for most nonmanagement employees is based on a flat dollar amount per year according to job classification. Most nonmanagement employees can elect to receive their pension benefits in either a lump sum payment or an annuity.

Our objective in funding the plans, in combination with the ERISA standards, is to accumulate assets sufficient to meet the plans' obligations to provide benefits to employees upon their retirement. Required funding is based on the present value of future benefits, which is similar to the projected benefit obligation discussed later. In April 2004, a law was enacted that provides for a temporary replacement of the 30-year treasury rate used in measuring a plan sponsor's pension liability for funding purposes. The new law allows a plan sponsor to use a rate based on corporate bond yields (which traditionally has been higher than the 30-year treasury rate) in measuring its pension liability in 2004 and 2005. While the change has no effect on pension liabilities or costs for financial reporting purposes (which are governed by GAAP), using a higher rate will lower the pension liability, thus lowering the funding requirements for plan sponsors. Any plan contributions, as determined by ERISA regulations, are made to a pension trust for the benefit of plan participants.

Although no significant cash contributions were required under ERISA regulations during 2004, in July we voluntarily contributed approximately \$1,000 to the pension trusts for the benefit of plan participants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Dollars in millions except per share amounts

During 2005, under ERISA regulations, we are not required to make any cash contributions to the trust for our pension plans

We use a December 31 measurement date for calculating the values reported for plan assets and benefit obligations for our plans. For defined benefit pension plans, the benefit obligation is the "projected benefit obligation," the actuarial present value, as of the measurement date, of all benefits attributed by the pension benefit formula to employee service rendered to that date. The following table presents this reconciliation and shows the change in the projected benefit obligation for the years ended December 31

	2004	2003
Benefit obligation at beginning of year	\$27,617	\$26,148
Service cost – benefits earned during the period	818	732
Interest cost on projected benefit obligation	1,642	1,666
Amendments	(87)	1
Actuarial loss	774	1,931
Special termination benefits	29	71
Benefits paid	(2,604)	(2,932)
Benefit obligation at end of year	\$28,189	\$27,617

The following table presents the change in the value of pension plan assets for the years ended December 31 and the pension plans' funded status at December 31

	2004	2003
Fair value of plan assets at beginning of year	\$28,154	\$24,999
Actual return on plan assets	3,259	5,584
Employer contribution	1,001	500
Benefits paid ¹	(2,601)	(2,929)
Fair value of plan assets at end of year ²	\$29,813	\$28,154
Funded status (fair value of plan assets less benefit obligation) ³	\$ 1,624	\$ 537
Unrecognized prior service cost	968	1,397
Unrecognized net (gain) loss	6,748	6,588
Unamortized transition asset	(11)	(67)
Net amount recognized	\$ 9,329	\$ 8,455

¹Benefits paid include benefits transferred between plans during the year

²Plan assets include SBC common stock of \$6 and \$6 and SBC bonds of \$1 and \$2 at December 31, 2004 and 2003

³Funded status is not indicative of our ability to pay ongoing pension benefits. Required pension funding is determined in accordance with ERISA regulations

Amounts recognized in our Consolidated Balance Sheets at December 31 are listed below and are included in the discussions following these tables

	2004	2003
Prepaid pension cost ¹	\$9,329	\$8,455
Additional minimum pension liability ²	(1)	(2,720)
Intangible asset ¹	—	894
Accumulated other comprehensive income	1	1,132
Deferred tax asset	—	694
Net amount recognized	\$9,329	\$8,455

¹Included in "Other Assets"

²Included in "Postemployment benefit obligation"

The following table presents the components of net pension cost (benefit) recognized in our Consolidated Statements of Income (gains are denoted with parentheses and losses are not)

	2004	2003	2002
Service cost – benefits earned during the period	\$ 818	\$ 732	\$ 645
Interest cost on projected benefit obligation	1,642	1,666	1,780
Expected return on plan assets	(2,684)	(2,456)	(3,429)
Amortization of prior service cost and transition asset	188	94	100
Recognized actuarial (gain) loss	44	53	(233)
Net pension cost (benefit)	\$ 8	\$ 89	\$(1,137)

In determining the projected benefit obligation and the net pension cost (benefit), we used the following significant weighted-average assumptions

	2004	2003	2002
Discount rate for determining projected benefit obligation at December 31	6.00%	6.25%	6.75%
Discount rate in effect for determining net pension cost (benefit)	6.25%	6.75%	7.50%
Long-term rate of return on plan assets	8.50%	8.50%	9.50%
Composite rate of compensation increase for determining projected benefit obligation at December 31	4.00%	4.25%	4.25%
Composite rate of compensation increase for net pension cost (benefit)	4.25%	4.25%	4.25%

Our assumed discount rate of 6.00% at December 31, 2004 reflects the hypothetical rate at which the projected benefit obligation could be effectively settled or paid out to participants on that date. We determined our discount rate based on a range of factors, including the rates of return on high-quality, fixed-income corporate bonds available at the measurement date and the related expected duration for the obligations. We reduced the discount rate at December 31, 2004 and 2003 by 0.25% and by 0.50% respectively, resulting in an increase in our pension plan benefit obligation of approximately \$575 and \$1,081 at December 31, 2004 and 2003. Should actual experience differ from actuarial assumptions, the projected benefit obligation and net pension cost (benefit) would be affected.

Our expected long-term rate of return on plan assets of 8.5% for 2004 reflects the average rate of earnings expected on the funds invested, or to be invested, to provide for the benefits included in the projected benefit obligations. We consider many factors that include, but are not limited to, historic returns on plan assets, current market information on long-term returns (e.g., long-term bond rates) and current and target asset allocations between asset categories. The target asset allocation

is determined based on consultations with external investment advisors

Our expected composite rate of compensation increase of 4.0% for 2004 reflects the long-term average rate of salary increases. Based on historic salary increase experience and management's expectations of future salary increases, we reduced our expected composite rate of compensation increase assumption from 4.25% at December 31, 2003 to 4.0% at December 31, 2004. This 0.25% decrease reduced our pension benefit obligation approximately \$17 at December 31, 2004 and is expected to decrease our 2005 pension expense \$8.

As previously noted, the projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to previously rendered employee service. The calculation of the obligation generally consists of estimating the amount of retirement income payments in future years after the employee retires or terminates service and calculating the present value at the measurement date. The amount of benefit to be paid depends on a number of future events incorporated into the pension benefit formula, including estimates of average life of employees/survivors and average years of service rendered. It is measured based on assumptions concerning future interest rates and future employee compensation levels.

In contrast to the projected benefit obligation, the accumulated benefit obligation represents the actuarial present value of benefits based on employee service and compensation as of a certain date and does not include an assumption about future compensation levels. On a plan-by-plan basis, if the accumulated benefit obligation exceeds plan assets and at least this amount has not been accrued, an additional minimum liability must be recognized, partially offset by an intangible asset for unrecognized prior service cost, with the remainder a direct charge to equity net of deferred tax benefits. These items are included in the table above that presents the amounts recognized in our Consolidated Balance Sheets at December 31. Effective December 31, 2004, we merged substantially all of our pension plan participants into one of our existing plans. This activity, while having no impact on our consolidated asset or liability balances, did change the comparison of the accumulated benefit obligation to plan assets for the remaining existing plan, significantly reducing our additional minimum liability for two of the plans recorded in 2003. However, at December 31, 2004, for one of our plans, the accumulated benefit obligation (aggregate balance of \$2) exceeded plan assets (aggregate balance of \$1). This resulted in an additional minimum liability of \$1 (net of deferred taxes of less than \$1). At December 31, 2003, for three of our plans, the accumulated benefit obligation (aggregate balance of \$13,724) exceeded plan assets (aggregate balance of \$13,016). Because of our increased asset returns in 2003, during the fourth quarter of 2003 we were able to reduce our minimum liability by \$735, which resulted in an additional minimum liability of \$1,132 (net of deferred taxes of \$694). These reclassifications in equity, while adjusting comprehensive income, will not affect our future results of operations or cash flows.

Shown below is a summary of our obligations and the fair value of plan assets for the years ended December 31

	2004	2003
Projected benefit obligation	\$28,189	\$27,617
Accumulated benefit obligation	26,849	25,249
Fair value of plan assets	29,813	28,154

In December 2004, we announced a prospective change in the calculation of pension benefits provided to management employees. Effective January 15, 2005, the pension calculation formula for management employees will be based upon a stated percentage of employees' adjusted career income. Each management employees' existing cash balance account will continue to earn interest at a variable annual rate. This change reduced our projected benefit obligation approximately \$140 at December 31, 2004 and is expected to decrease our 2005 pension expense \$100.

When we initially implemented the cash balance formula, the change in liability required the establishment of a prior service cost deferral for the plan. With the current change to eliminate future service contributions to the cash balance plan, we determined during our annual review of prior service costs that the cash balance prior service cost was impaired and that the remaining amounts deferred must be immediately recognized. Accordingly, we wrote off approximately \$99 of prior service cost in the fourth quarter of 2004. This impairment will decrease our pension expense approximately \$19 each year for the next five years.

In May 2004, we agreed to a new five-year contract with the Communications Workers of America (CWA), which was ratified by the CWA members in July 2004. The labor agreement covers more than 100,000 employees and replaces a three-year contract that expired in April 2004.

In June 2004, we agreed to a new five-year contract with the International Brotherhood of Electrical Workers (IBEW), which was ratified by the IBEW members in August 2004. The labor agreement covers approximately 11,000 employees and replaces a three-year agreement that expired in June 2004. The agreement provides for similar benefit changes as that of the CWA agreement.

Among other things, the labor agreements provided for changes to active nonmanagement employees' pension benefits. Pension band increases will be similar to that of the wage increases, an annual average of 2.5% excluding cost-of-living adjustments. These changes decreased pension expense approximately \$13 in 2004.

During 2004, 2003 and 2002, as part of our workforce reduction programs, an enhanced retirement program was offered to eligible Pacific Telesis Group (PTG) nonmanagement employees. This program offered eligible employees who voluntarily decided to terminate employment an enhanced pension benefit and increased eligibility for postretirement medical, dental and life insurance benefits. Employees that accepted this offer and terminated employment before December 31 totaled approximately 144 in 2004, 339 in 2003 and 3,600 in 2002. In addition to the net pension cost (benefit) reported in the tables above, enhanced pension benefits related to this program were

Dollars in millions except per share amounts

recognized as an expense of \$22 in 2004, \$42 in 2003 and \$456 in 2002

The IRS sets, and can adjust quarterly, the interest rate applicable for calculations of lump sum payments from pension plans. An increase in the interest rate has a negative impact on the lump sum pension calculation for some of our employees. During certain quarters of 2004 and 2003, we chose to extend the pension plan lump sum benefit payout rate for a specified period of time, allowing our employees to receive a higher payout of their pension benefits. The extension of the lump sum benefit payout rate was accounted for as a special termination benefit and was recorded in addition to the net pension cost (benefit) reported in the tables above. We recognized expenses of approximately \$7 in 2004 and \$28 in 2003 associated with these special termination benefits.

Also, in addition to the net pension cost (benefit) reported in the table disclosing the components of our net pension cost (benefit) and the aforementioned enhanced benefit and special termination costs, we recognized approximately \$29 in net settlement gains in 2002. Net settlement gains in 2002 include settlement losses during the latter part of the year, reflecting the continued investment losses sustained by the plan.

Plan assets consist primarily of private and public equity, government and corporate bonds and real estate. The asset allocations are maintained to meet ERISA requirements. The principal investment objectives are to ensure the availability of funds to pay pension benefits as they become due under a broad range of future economic scenarios, to maximize long-term investment return with an acceptable level of risk based on our pension obligations, and to be broadly diversified across and within the capital markets to insulate asset values against adverse experience in any one market. Each asset class has a broadly diversified style. Substantial biases toward any particular investing style or type of security are avoided by managing the aggregation of all accounts with portfolio benchmarks. Asset and benefit obligation forecasting studies are conducted periodically, generally every two to three years, or when significant changes have occurred in benefits, participant demographics or funded status. Decisions regarding investment policy are made with an understanding of the effect of asset allocation on funded status, future contributions and pension expense. The current asset allocation policy is based on a forecasting study conducted in 2002.

The pension plan weighted-average asset target and actual allocations, by asset category are as follows:

	Target Allocation 2005	Percentage of Plan Assets at December 31, 2004	2003
Equity securities			
Domestic	40% – 50%	47%	49%
International	12% – 18%	17	17
Debt securities	25% – 35%	29	27
Real estate	3% – 6%	2	3
Other	4% – 7%	5	4
Total		100%	100%

At December 31, 2004, securities held include 233,908 shares of SBC common stock with a fair value of approximately \$6, and \$1 in SBC bonds with a notional amount of \$1. During 2004, SBC bonds purchased and sold totaled approximately \$14 and \$15, respectively. Holdings in SBC securities represented approximately 0.02% of total plan assets at December 31, 2004.

At December 31, 2004, benefit payments expected to be paid for the years 2005 through 2009 were \$2,598, \$2,259, \$2,317, \$2,393 and \$2,508 with \$12,808 to be paid in the five years thereafter. These expected benefit payments are estimated using the same assumptions used in determining our benefit obligation at December 31, 2004. Because benefit payments will depend on future employment and compensation levels, average years employed at SBC and average life spans, among other factors, changes in any of these factors could significantly affect these expected amounts.

Postretirement Benefits – We provide certain medical, dental and life insurance benefits to substantially all retired employees under various plans and accrue actuarially determined postretirement benefit costs as active employees earn these benefits. We maintain Voluntary Employee Beneficiary Association (VEBA) trusts to partially fund these postretirement benefits, however, there are no ERISA or regulatory requirements that these postretirement benefit plans be funded annually. In accordance with a February 2004 California Public Utility Commission decision, in the first quarter of 2004 we funded approximately \$232 to a VEBA trust. During the third quarter of 2004, we voluntarily contributed \$1,000 to a VEBA trust to partially fund postretirement benefits.

During the second quarter of 2004, we agreed to new five-year labor agreements with the CWA and IBEW. The agreements provide for additional contributions from current employees toward certain medical and prescription drug co-pays. We also agreed in an agreement with the CWA, that prior to expiration of the agreement, we would contribute \$2,000 to a VEBA trust to partially fund current and future retiree health care, \$1,000 of which was contributed during the third quarter of 2004.

In January 2004, the majority of nonmanagement retirees were informed of medical coverage changes. We subsequently announced modifications to these changes, which were contingent upon reaching an agreement with the CWA. Agreement was reached and, as modified, effective January 1, 2005, medical coverage for nonmanagement retirees will require increased co-pays and deductibles for prescription drugs and certain medical services. These changes reduced our postemployment cost approximately \$440 in 2004.

In May 2004, the FASB issued guidance (referred to as FSP FAS 106-2) on how employers should account for provisions of the Medicare Act, which was enacted in December 2003. The Medicare Act allows employers that sponsor a postretirement health care plan that provides a prescription drug benefit to receive a subsidy for the cost of providing that drug benefit. In order for employers, such as us, to receive the subsidy payment under the Medicare Act, the value of our offered prescription drug plan must be at least equal to the value of the standard

prescription drug coverage provided under Medicare Part D. Due to our lower deductibles and better coverage of drug costs, we believe that our plan is of greater value than Medicare Part D.

The preliminary guidance issued by the FASB (referred to as FSP FAS 106-1) permitted us to recognize immediately this subsidy in our financial statements. Accordingly, our accumulated postretirement benefit obligation, at our December 31, 2003 measurement date, decreased by \$1,629. We accounted for the Medicare Act as a plan amendment and recorded the adjustment in the amortization of our liability, from the date of enactment of the Medicare Act, December 2003. The final guidance issued by the FASB, FSP FAS 106-2, requires us to account for the Medicare Act as an actuarial gain or loss, recording the change as a change in accounting principle. Therefore, because our initial accounting for the effects of the Medicare Act differed from the final guidance issued by the FASB in FSP FAS 106-2, we have restated our first-quarter 2004 results by increasing our expense approximately \$11 to reflect the recognition of the Medicare Act as an actuarial gain or loss. Due to the immaterial impact of the change in accounting on 2003 (since the Medicare Act was enacted in December), we did not record a cumulative effect of accounting change as of January 1, 2004.

We expect that accounting for the Medicare Act will result in an annual decrease in our prescription drug expenses ranging from \$200 to \$300 in future years. Our accounting for the Medicare Act decreased our postretirement cost approximately \$255 in 2004 and \$22 in 2003. Our accounting assumes that the plans we offer will continue to provide drug benefits equivalent to Medicare Part D, that these plans will continue to be the primary plan for our retirees and that we will receive the subsidy. We expect that the Medicare Act will not have a significant effect on our retirees' participation in our postretirement benefit plan.

For postretirement benefit plans, the benefit obligation is the "accumulated postretirement benefit obligation," the actuarial present value as of a date of all future benefits attributed under the terms of the postretirement benefit plan to employee service rendered to that date.

The following table presents a reconciliation of the beginning and ending balances of the benefit obligation and shows the change in the accumulated postretirement benefit obligation for the years ended December 31.

	2004	2003
Benefit obligation at beginning of year	\$27,231	\$24,564
Service cost – benefits earned during the period	383	378
Interest cost on accumulated postretirement benefit obligation	1,495	1,602
Medicare Act initial recognition	—	(1,629)
Amendments	(2,320)	(53)
Actuarial (gain) loss	(423)	3,552
Special termination benefits	3	2
Benefits paid	(1,255)	(1,185)
Benefit obligation at end of year	\$25,114	\$27,231

The following table sets forth the change in the value of plan assets for the years ended December 31, the plans' funded status at December 31 and the accrued postretirement benefit obligation liability recognized in our Consolidated Balance Sheets at December 31.

	2004	2003
Fair value of plan assets at beginning of year	\$ 6,967	\$ 4,917
Actual return on plan assets	830	1,167
Employer contribution ¹	1,232	1,312
Benefits paid	(337)	(429)
Fair value of plan assets at end of year ²	\$ 8,692	\$ 6,967
Unfunded status (fair value of plan assets less benefit obligation) ³	\$ (16,422)	\$ (20,263)
Unrecognized prior service cost (benefit)	(3,022)	(2,664)
Unrecognized net loss	10,173	12,788
Accrued postretirement benefit obligation	\$ (9,271)	\$ (10,139)

¹2003 includes reimbursements from a VEBA trust to us of \$167 for qualified claims paid by us. At the time of reimbursement we made a contribution of \$167 to a different VEBA.

²Plan assets include SBC common stock of \$7 and \$5 and SBC bonds of \$2 and \$0 at December 31, 2004 and 2003.

³(Unfunded) funded status is not indicative of our ability to pay ongoing postretirement benefits. As noted above, while many companies do not, we maintain trusts to partially fund these postretirement benefits, however, there are no ERISA or other regulations requiring that these postretirement benefit plans be funded annually.

The following table presents the components of postretirement benefit cost recognized in our Consolidated Statements of Income (gains are denoted with brackets and losses are not).

	2004	2003	2002
Service cost – benefits earned during the period	\$ 383	\$ 378	\$ 293
Interest cost on accumulated postretirement benefit obligation	1,495	1,602	1,430
Expected return on assets	(720)	(525)	(689)
Amortization of prior service cost (benefit)	(349)	(122)	(28)
Recognized actuarial (gain) loss	470	413	49
Postretirement benefit cost ¹	\$1,279	\$1,746	\$1,055

¹During 2004 and 2003, the Medicare Act reduced postretirement benefit cost by \$255 and \$22. This effect is included in several line items above.

The fair value of plan assets allocated to the payment of life insurance benefits was \$557 and \$535 at December 31, 2004 and 2003. At December 31, 2004 and 2003, the accrued life insurance benefits included in the accrued postretirement benefit obligation were \$1,147 and \$1,059.

In addition to the postretirement benefit cost reported in the table above, enhanced benefits related to the PTG nonmanagement early retirement program were recognized as an expense of \$3, \$2 and \$30 in 2004, 2003 and 2002.

The medical cost trend rate in 2005 is 8.0% for retirees 64 and under and 9.0% for retirees 65 and over, trending to an expected increase of 5.0% in 2009 for all retirees, prior to adjustment for cost-sharing provisions of the medical and dental plans for certain retired employees.

Dollars in millions except per share amounts

The assumed dental cost trend rate in 2005 is 5.0%. A one percentage-point change in the assumed combined medical and dental cost trend rate would have the following effects:

	One Percentage-Point Increase	One Percentage-Point Decrease
Increase (decrease) in total of service and interest cost components	\$ 277	\$ (219)
Increase (decrease) in accumulated postretirement benefit obligation	3,087	(2,521)

We used the same significant assumptions for the discount rate, long-term rate of return on plan assets and composite rate of compensation increase used in calculating the accumulated postretirement benefit obligation and related postretirement benefit costs that we used in developing the pension information. The reduction in the discount rate at December 31, 2004 and 2003 resulted in an increase in our postretirement benefit obligation of approximately \$803 and \$1,800, respectively. Should actual experience differ from the actuarial assumptions, the accumulated postretirement benefit obligation and postretirement benefit cost would be affected in future years.

For the majority of our labor contracts that contain an annual dollar value cap for the purpose of determining contributions required from nonmanagement retirees, we have waived the cap during the relevant contract periods and thus not collected contributions from those retirees. Therefore, in accordance with the substantive plan provisions required in accounting for postretirement benefits under GAAP, we do not account for the cap in the value of our accumulated postretirement benefit obligation (i.e., for GAAP purposes, we assumed the cap would be waived for all future contract periods).

Plan assets consist primarily of private and public equity, government and corporate bonds. The principal investment objectives are to ensure the availability of funds to pay postretirement benefits as they become due under a broad range of future economic scenarios, to maximize long-term investment return with an acceptable level of risk, and to be broadly diversified across and within the capital markets to insulate asset values against adverse experience in any one market. At December 31, 2004, the asset allocation policy was based on a forecasting study conducted in 2000. Since that study, additional retiree benefits for certain employees have been paid from plan assets, which dictated a slightly more conservative asset allocation. In addition, paying these benefits has required a deviation from the policy to allow for an increase in the portfolio's liquidity by allocating more assets to fixed income securities and less to international equity. A forecasting study is currently being conducted and it is expected that the asset allocations will be re-evaluated in 2005.

The postretirement benefit plan weighted-average asset target and actual allocations, by asset category are as follows:

	Target Allocation 2005	Percentage of Plan Assets at December 31, 2004	Percentage of Plan Assets at December 31, 2003
Equity securities			
Domestic ¹	50% – 60%	51%	46%
International	15% – 25%	14	15
Debt securities	20% – 30%	32	27
Real estate	none	—	—
Other	0% – 10%	3	12
Total		100%	100%

¹At December 31, 2003, Domestic equity securities did not include the funds from our late December 2003 voluntary VEBA contribution. The subsequent investment in January 2004 resulted in an allocation within the target range.

At December 31, 2004, securities held include 282,900 shares of SBC common stock with a fair value of approximately \$7, and \$2 in SBC bonds with a notional amount of \$2. During 2004, SBC common stock purchased totaled approximately 109,000 shares and SBC bonds purchased and sold totaled \$503 and \$501, respectively. Holdings in SBC securities represented approximately 0.11% of total plan assets at December 31, 2004.

At December 31, 2004, benefit payments expected to be paid for the years 2005 through 2009 were \$1,299, \$1,326, \$1,403, \$1,473 and \$1,536 with \$8,362 to be paid in the five years thereafter. These expected benefit payments are estimated using the same assumptions used in determining our benefit obligation at December 31, 2004. Included in these benefit payments are expected Medicare Act reimbursements of \$64, \$69, \$75 and \$81 for 2006 through 2009 with \$513 expected in the five years thereafter. There are no Medicare Act reimbursements assumed for 2005 because the program does not begin until 2006. Because benefit payments will depend on future employment and compensation levels, average years employed at SBC and average life spans, among other factors, changes in any of these factors could significantly affect these expected amounts.

Combined Net Pension and Postretirement Cost (Benefit) – The following table combines net pension cost (benefit) with postretirement benefit cost (gains are denoted with parentheses and losses are not).

	2004	2003	2002
Net pension cost (benefit)	\$ 8	\$ 89	\$(1,137)
Postretirement benefit cost	1,279	1,746	1,055
Combined net pension and postretirement cost (benefit)	\$1,287	\$1,835	\$ (82)

Our combined net pension and postretirement cost decreased in 2004 primarily due to the previously discussed changes affecting nonmanagement retirees, which decreased our cost approximately \$440, better than expected asset returns in 2003, which decreased our cost \$322, and the previously discussed accounting for the Medicare Act, which decreased our cost \$255. These were partially offset by the following three factors:

- Higher-than-expected medical and prescription drug claims increased our cost approximately \$156
- The reduction of the discount rates used to calculate service and interest cost from 6.75% to 6.25%, in response to lower corporate bond interest rates, increased our cost approximately \$141
- Our decision to extend to 2004 our 2003 medical cost rates, prior to adjustment for cost-sharing provisions of the medical and dental plans for certain retired employees, of 9.0% for retirees 64 and under and 10.0% for retirees 65 and over. This decision, which was in response to rising claim costs, increased the trend rate because we kept 2009 as the year in which we assume our medical cost trend rate will reach a final 5% expected annual increase. This increase in the medical cost trend rate increased our cost approximately \$83

Because of the continued high cost of our combined net pension and postretirement benefits, we have taken steps to implement additional cost controls. As previously discussed, in December 2004, we announced a change in the calculation of pension benefits provided to management employees, which is expected to decrease our 2005 pension expense approximately \$100.

As a result of these economic impacts and assumption changes discussed above, we expect a combined net pension and postretirement cost of between \$1,400 and \$1,550 in 2005. Approximately 10% of these costs will be capitalized as part of construction labor, providing a small reduction in the net expense recorded. While we will continue our cost-cutting efforts discussed above, certain factors, such as investment returns, depend largely on trends in the U.S. securities markets and the general U.S. economy. In particular, uncertainty in the securities markets and U.S. economy could result in investment returns less than those assumed and a decline in the value of plan assets used in pension and postretirement calculations, which under GAAP we will recognize over the next several years. Should the securities markets decline and medical and prescription drug costs continue to increase significantly, we would expect increasing annual combined net pension and postretirement costs for the next several years. Additionally, should actual experience differ from actuarial assumptions, combined net pension and postretirement cost would be affected in future years.

The weighted-average expected return on assets assumption, which reflects our view of long-term returns, is one of the most significant of the weighted-average assumptions used to determine our actuarial estimates of pension and postretirement benefit expense. Based on our long-term expectations of market returns in future years, our long-term rate of return on plan assets is 8.5% for 2005. If all other factors were to remain unchanged, we expect a 1% decrease in the expected long-term rate of return would cause 2005 combined pension and postretirement cost to increase approximately \$388 over 2004 (analogous change would result from a 1% increase).

Under GAAP, the expected long-term rate of return is calculated on the market-related value of assets (MRVA). GAAP requires that actual gains and losses on pension and postretirement plan assets be recognized in the MRVA

equally over a period of not more than five years. We use a methodology, allowed under GAAP, under which we hold the MRVA to within 20% of the actual fair value of plan assets, which can have the effect of accelerating the recognition of excess actual gains and losses into the MRVA to less than five years. Largely due to investment returns in 2003, this methodology did not have a significant additional effect on our 2004 combined net pension and postretirement expense. Due to investment losses on plan assets experienced through 2002, this methodology contributed approximately \$605 to our combined net pension and postretirement cost in 2003 as compared with the methodology that recognizes gains and losses over a full five years. This methodology did not have a significant effect on our 2004 or 2002 combined net pension and postretirement benefit as the MRVA was almost equal to the fair value of plan assets. We do not expect this methodology to have a significant incremental impact on our combined net pension and postretirement costs in 2005.

Supplemental Retirement Plans – We also provide senior- and middle-management employees with nonqualified, unfunded supplemental retirement and savings plans. While these plans are unfunded, we have assets in a designated nonbankruptcy remote trust that are used to provide for these benefits. These plans include supplemental pension benefits as well as compensation deferral plans, some of which include a corresponding match by us based on a percentage of the compensation deferral. Expenses related to these plans were \$154, \$142 and \$142 in 2004, 2003 and 2002. Liabilities of \$1,726 and \$1,718 related to these plans have been included in “Other noncurrent liabilities” on our Consolidated Balance Sheets at December 31, 2004 and 2003. At December 31, 2004, the accumulated benefit obligation of certain of the plans exceeded the recorded liability, requiring us to recognize a direct charge to equity of \$190 (net of deferred taxes of \$116) at December 31, 2004.

NOTE 11. EMPLOYEE STOCK OWNERSHIP PLANS (ESOP)

We maintain contributory savings plans that cover substantially all employees. Under the savings plans, we match in SBC stock a stated percentage of eligible employee contributions, subject to a specified ceiling.

We extended the terms of certain ESOPs through previous internal refinancing of the debt, which resulted in approximately 75 million of allocated SBC shares and significantly less than 1 million unallocated SBC shares remaining in one of those ESOPs at December 31, 2002. This internal refinancing of ESOP debt was paid off in December 2002 with our matching contributions to the savings plan, dividends paid on SBC shares and interest earned on funds held by the ESOPs. At December 31, 2004 and 2003, there were no debt-financed SBC shares held by the ESOPs, allocated or unallocated.

In 2004 and 2003, our match of employee contributions to the savings plans was fulfilled with purchases of SBC's stock on the open market. Prior to December 31, 2002, our match of employee contributions to the savings plan was fulfilled with shares of stock purchased with the proceeds of an ESOP note and the purchases of SBC's stock in the

open market. Shares purchased with the proceeds of an ESOP note were released for allocation to the accounts of employees as employer-matching contributions were earned by participants and paid to the ESOP by us. In 2004 and 2003, the benefit cost was based on the cost of shares allocated to participating employees' accounts. Prior to December 31, 2002, benefit cost was based on a combination of the contributions to the savings plans and the cost of shares allocated to participating employees' accounts. Prior to December 31, 2002, both benefit cost and interest expense on the ESOP notes were reduced by dividends on SBC's shares held by the ESOPs and interest earned on the ESOPs' funds.

Information related to the ESOPs and the savings plans is summarized below:

	2004	2003	2002
Benefit expense – net of dividends and interest income	\$316	\$300	\$216
Total expense	\$316	\$300	\$216
Company contributions for ESOPs	\$ —	\$ —	\$165
Dividends and interest income for debt service	\$ —	\$ —	\$ 8

NOTE 12. STOCK-BASED COMPENSATION

Under our various plans, senior and other management and nonmanagement employees and nonemployee directors have received stock options, performance stock units and other nonvested stock units. Stock options issued through December 31, 2004 carry exercise prices equal to the market price of the stock at the date of grant and have maximum terms ranging from five to ten years. Beginning in 1994 and ending in 1999, certain Ameritech employees were awarded grants of nonqualified stock options with dividend equivalents. Depending upon the grant, vesting of stock options may occur up to five years from the date of grant, with most options vesting on a graded basis over three years (1/3 of the grant vests after one year, another 1/3 vests after two years and the final 1/3 vests after three years from the grant date). Performance stock units are granted to key employees based upon the common stock price at the date of grant and are awarded in the form of common stock and cash at the end of a two- or three-year period, subject to the achievement of certain performance goals. Nonvested stock units are valued at the market price of the stock at the date of grant and vest over a three- to five-year period. As of December 31, 2004, we were authorized to issue up to 40 million shares of stock (in addition to shares that may be issued upon exercise of outstanding options or upon vesting of performance stock units or other nonvested stock units) to officers, employees and directors pursuant to these various plans.

We use an accelerated method of recognizing compensation cost for fixed awards with graded vesting, which essentially treats the grant as three separate awards, with vesting periods of 12, 24 and 36 months for those that vest over three years. As noted above, a majority of our options vest over three years, and for those we recognize approximately 61% of the associated compensation

expense in the first year, 28% in the second year and the remaining 11% in the third year. As allowed by FAS 123, we accrue compensation cost as if all options granted subject only to a service requirement are expected to vest. The effects of actual forfeitures of unvested options are recognized (as a reversal of expense) as they occur.

The compensation cost that has been charged against income for these plans and our other stock-based compensation plans is as follows:

	2004	2003	2002
Stock option expense under FAS 123	\$ 75	\$183	\$390
Performance stock units	65	27	11
Mark-to-market effect on dividend equivalents	—	4	(36)
Other	13	30	8
Total	\$153	\$244	\$373

The estimated fair value of the options when granted is amortized to expense over the options' vesting period. The weighted-average fair value of each option granted during 2004, 2003 and 2002 was \$4.06, \$3.88 and \$6.57. The fair value for these options was estimated at the date of grant, using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2004	2003	2002
Risk-free interest rate	4.21%	3.64%	4.33%
Dividend yield	5.00%	4.40%	3.04%
Expected volatility factor	23.78%	22.38%	23.22%
Expected option life in years	7.00	6.74	4.36

Information related to options is summarized below (shares in millions):

	Number	Weighted-Average Exercise Price
Outstanding at January 1, 2002	207	\$ 37.21
Granted	36	35.50
Exercised	(7)	20.80
Forfeited/Expired	(7)	41.20
Outstanding at December 31, 2002		
(154 exercisable at weighted-average price of \$36.48)	229	37.31
Granted	15	24.71
Exercised	(6)	19.64
Forfeited/Expired	(7)	37.09
Outstanding at December 31, 2003		
(181 exercisable at weighted-average price of \$37.66)	231	36.94
Granted	4	25.08
Exercised	(11)	20.79
Forfeited/Expired	(10)	38.48
Outstanding at December 31, 2004		
(195 exercisable at weighted-average price of \$38.20)	214	\$ 37.46

Information related to options outstanding at December 31, 2004

Exercise Price Range	\$15 77- \$17 49	\$17 50- \$29 99	\$30 00- \$35 49	\$35 50- \$58 88
Number of options (in millions)				
Outstanding	1	48	7	158
Exercisable	1	38	7	149
Weighted-average exercise price				
Outstanding	\$15 77	\$25 09	\$33 93	\$41 54
Exercisable	\$15 77	\$25 21	\$33 93	\$41 87
Weighted-average remaining contractual life	0 04 years	4 23 years	4 23 years	5 77 years

As of December 31, additional shares available under stock options with dividend equivalents were less than 1 million in 2004 and approximately 1 million in both 2003 and 2002

Additionally, performance shares and other stock units of 6,757,781 in 2004, 2,942,591 in 2003, and 937,094 in 2002 were issued with a weighted-average, grant-date fair value of \$26 09, \$24 44 and \$35 30, respectively

NOTE 13. STOCKHOLDERS' EQUITY

From time to time, we repurchase shares of common stock for distribution through our employee benefit plans or in connection with certain acquisitions. In December 2003, the Board of Directors authorized the repurchase of up to 350 million shares of SBC common stock. This authorization replaced previous authorizations and will expire on December 31, 2008. As of December 31, 2004, we had repurchased approximately 17 million shares of the 350 million shares of common stock that were previously authorized to be repurchased.

NOTE 14. ADDITIONAL FINANCIAL INFORMATION

Balance Sheets	December 31,	
	2004	2003
Deferred directory expenses (included in Other current assets)	\$ 505	\$ 506
Accounts payable and accrued liabilities		
Accounts payable	\$ 2,241	\$ 3,102
Advance billing and customer deposits	1,325	1,252
Compensated future absences	798	823
Accrued interest	376	364
Accrued payroll	1,138	1,178
Other	4,160	3,939
Total accounts payable and accrued liabilities	\$10,038	\$10,658

Statements of Income	2004	2003	2002
Advertising expense	\$ 862	\$ 867	\$ 432
Interest expense incurred	\$1,054	\$1,279	\$1,440
Capitalized interest	(31)	(37)	(58)
Total interest expense	\$1,023	\$1,242	\$1,382

Statements of Cash Flows	2004	2003	2002
Cash paid during the year for			
Interest	\$1,043	\$1,359	\$1,480
Income taxes, net of refunds	506	1,321	1,315

Statements of Stockholders' Equity	2004	2003	2002
Accumulated other comprehensive income is comprised of the following components, net of taxes, at December 31			
Foreign currency translation adjustment	\$ (555)	\$ (427)	\$ (988)
Unrealized gains (losses) on securities	391	427	10
Unrealized gains (losses) on cash flow hedges	(196)	—	—
Accumulated other comprehensive income (loss)	\$ (360)	\$ —	\$ (978)

No customer accounted for more than 10% of consolidated revenues in 2004, 2003 or 2002

NOTE 15. TRANSACTIONS WITH CINGULAR

We have made advances to Cingular that totaled \$5,855 at December 31, 2004 and \$5,885 at December 31, 2003. These advances bear interest at an annual rate of 6 0% and mature in June 2008. During 2004, Cingular repaid \$30 of these advances in accordance with the terms of the revolving credit agreement mentioned below. We earned interest income on these advances of \$356 during 2004, \$397 in 2003, and \$441 in 2002.

Effective August 1, 2004, we and BellSouth agreed to finance Cingular's capital and operating cash requirements to the extent Cingular requires funding above the level provided by operations. Cingular's Board of Directors also approved the termination of its bank credit facilities and its intention to cease issuing commercial paper and long-term debt. In addition, we and BellSouth entered into a one-year revolving credit agreement with Cingular to provide short-term financing for operations on a pro rata basis at an interest rate of LIBOR plus 0 05%. The agreement is renewable annually upon agreement of the parties. This agreement includes a provision for the repayment of our and BellSouth's advances made to Cingular in the event there are no outstanding amounts due under the revolving credit agreement and to the extent Cingular has excess cash, as defined by the agreement. At December 31, 2004, our share of advances to Cingular related to this revolving credit agreement was approximately \$1,002 and was reflected as an increase in "Investments in and Advances to Cingular Wireless" on our Consolidated Balance Sheet.

We generated revenues of \$602 in 2004, \$539 in 2003 and \$349 in 2002 for services sold to Cingular. These revenues were primarily from access and long-distance services sold to Cingular on a wholesale basis, and commissions revenue related to customers added through SBC sales sources. The offsetting expense amounts are recorded by Cingular, and 60% of these expenses are

Included in our "Equity in net income of affiliates" line when we report our 60% proportionate share of Cingular's results

NOTE 16. CINGULAR ACQUISITION OF AT&T WIRELESS

On October 26, 2004, Cingular acquired AT&T Wireless for approximately \$41,000 in cash. In connection with the acquisition, we entered into an investment agreement with BellSouth and Cingular. Under the investment agreement, we and BellSouth funded, by means of an equity contribution to Cingular, a significant portion of the merger consideration for the acquisition. Based on our 60% equity ownership of Cingular and after taking into account cash on hand at AT&T Wireless, we provided additional equity of approximately \$21,600 to fund the consideration. In exchange for this equity contribution, Cingular issued to us and BellSouth new membership interests in Cingular. Equity ownership and management control of Cingular remain unchanged after the acquisition.

As a joint venture, we account for our investment in Cingular under the equity method of accounting, recording 60% of Cingular's earnings as "Equity in net income of affiliates." As a result of this transaction, we recorded the \$21,600 contributed to Cingular to complete the AT&T Wireless acquisition as an increase in "Investments in and Advances to Cingular Wireless," and the components of the funding by recording the related \$8,750 of debt issued as "Debt maturing within one year" and "Long-Term Debt," and a reduction in "Cash and Cash Equivalents" of \$12,850. In connection with funding our equity contribution to Cingular, on October 26, 2004, we borrowed \$8,750 through drawings from our \$12,000, 364-day revolving credit facility, which we entered into on October 12, 2004. We repaid this borrowing with proceeds from commercial paper borrowings. On November 3, 2004, we issued \$5,000 in long-term debt to partially repay these commercial paper borrowings. The \$5,000 of long-term debt consisted of \$2,250 of 4 125% 5-year notes, \$2,250 of 5 100% 10-year notes and \$500 of 6 150% 30-year bonds. See Note 8 for a description of interest rate forward contracts also entered into related to the acquisition.

NOTE 17. DISCONTINUED OPERATIONS

In July 2004, we entered into an agreement to sell our interest in the directory advertising business in Illinois and northwest Indiana to Donnelley. In September 2004, we completed the sale and received net proceeds of approximately \$1,397 and recorded a gain of approximately \$1,357 (\$827 net of tax).

In accordance with Statement of Financial Accounting Standards No. 144, "Accounting for Impairment or Disposal of Long-Lived Assets," we have reclassified the results from our directory advertising business in Illinois and northwest Indiana as discontinued operations, restating previously reported results to reflect the reclassification on a comparable basis. The operational results and the gain associated with the sale of this business are presented in the "Income From Discontinued Operations, net of tax" line item on the Consolidated Statements of Income.

Prior to the reclassification, these results were reported in our directory segment.

Summarized financial information for the Illinois and northwest Indiana directory advertising business is as follows:

Year ended December 31,	2004	2003	2002
Operating revenues	\$311	\$481	\$485
Operating income	132	186	186
Income taxes	51	74	74
Net income from operations	81	112	112
Gain on disposal, net of tax	827	—	—

The assets and liabilities of the discontinued operations are presented separately under the captions "Assets of discontinued operations" and "Liabilities of discontinued operations" on our Consolidated Balance Sheets at December 31, 2004 and 2003. As of December 31, 2004, the liabilities of \$310 are primarily tax liabilities associated with the gain on the disposition. Additional detail related to the assets and liabilities of discontinued operations follows:

December 31,	2004	2003
Accounts receivable, net	\$ —	\$ 18
Deferred expenses	—	207
Noncurrent assets	—	27
Total Assets	—	252
Accounts payable and accrued liabilities	—	82
Other current liabilities	310	235
Noncurrent liabilities	—	11
Total Liabilities	\$310	\$328

NOTE 18. CONTINGENT LIABILITIES

In addition to issues specifically discussed elsewhere, we are party to numerous lawsuits, regulatory proceedings and other matters arising in the ordinary course of business. In our opinion, although the outcomes of these proceedings are uncertain, they should not have a material adverse effect on the company's financial position, results of operations or cash flows.

NOTE 19. SUBSEQUENT EVENT

On January 30, 2005, we agreed to acquire AT&T Corp (AT&T) in a transaction in which each share of AT&T common stock will be exchanged for 0.77942 shares of SBC common stock. At the closing of the transaction, AT&T also will pay each AT&T stockholder a special dividend of \$1.30 per share. Based on the closing price of SBC stock on January 28, 2005, the exchange ratio equals \$18.41 per share and the total transaction is valued at approximately \$16,000, including the special dividend. After the acquisition, AT&T will be a wholly owned subsidiary of SBC. The transaction has been approved by the Board of Directors of each company and also must be approved by the stockholders of AT&T. The transaction is subject to review by the Department of Justice and approval by the Federal Communications Commission and various other regulatory authorities. We expect the transaction to close in late 2005 or early 2006.

NOTE 20. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table represents our quarterly financial results

Calendar Quarter	Total Operating Revenues	Operating Income	Net Income	Basic Earnings Per Share	Diluted Earnings Per Share	Income Before Extraordinary Item and Cumulative Effect of Accounting Changes			Discontinued Operations		
						Income	Basic Earnings Per Share	Diluted Earnings Per Share	Income	Basic Earnings Per Share	Diluted Earnings Per Share
2004											
First	\$10,012	\$1,516	\$1,937	\$0.59	\$0.58	\$1,937	\$0.59	\$0.58	\$ 26	\$0.01	\$0.01
Second	10,196	1,440	1,168	0.35	0.35	1,168	0.35	0.35	33	0.01	0.01
Third	10,292	1,698	2,094	0.63	0.63	2,094	0.63	0.63	849	0.25	0.25
Fourth	10,287	1,247	688	0.21	0.21	688	0.21	0.21	—	—	—
Annual	\$40,787	\$5,901	\$5,887	1.78	1.77	\$5,887	1.78	1.77	\$908	0.28	0.27
2003											
First	\$10,255	\$1,854	\$4,996	\$1.50	\$1.50	\$2,455	\$0.74	\$0.74	\$ 28	\$0.01	\$0.01
Second	10,117	1,699	1,388	0.42	0.42	1,388	0.42	0.42	30	0.01	0.01
Third	10,150	1,561	1,216	0.37	0.37	1,216	0.37	0.37	30	0.01	0.01
Fourth	9,976	1,170	905	0.27	0.27	912	0.28	0.28	24	0.01	0.01
Annual	\$40,498	\$6,284	\$8,505	2.56	2.56	\$5,971	1.80	1.80	\$112	0.03	0.04

The first quarter of 2003 includes an extraordinary loss of \$7, net of taxes of \$4, related to consolidation of real estate leases under FIN 46 (see Note 1)

The operating revenue and operating income data in the table above has been restated to reflect the third-quarter 2004 reclassification of discontinued operations (see Note 17). This restatement decreased our previously reported total operating revenues and operating income, and the quarterly impacts are presented below. The restated amounts for the third quarter of 2003 were reflected in our September 30, 2004, Form 10-Q and therefore are not reflected in the table below.

Calendar Quarter	Total Operating Revenues	Operating Income
2004		
First	\$(116)	\$(43)
Second	(118)	(54)
2003		
First	\$(120)	\$(44)
Second	(119)	(51)
Fourth	(122)	(42)

In addition to the impacts of discontinued operations

- The first-quarter 2004 reclassification of certain universal service fund payments and gross receipts taxes increased our previously reported fourth-quarter 2003 operating revenues by \$31
- The second-quarter 2004 restatement related to our accounting for the Medicare Act decreased our previously reported first-quarter 2004 operating income and net income by \$11, or approximately \$0.01 per share, assuming dilution

The following table presents our quarterly stock price information

Calendar Quarter	Stock Price		
	High	Low	Close
2004			
First	\$27.73	\$23.18	\$24.54
Second	25.68	23.50	24.25
Third	26.88	22.98	25.95
Fourth	27.29	24.55	25.77
2003			
First	\$31.65	\$18.85	\$20.06
Second	27.35	19.65	25.55
Third	26.88	21.65	22.25
Fourth	26.15	21.16	26.07

The consolidated financial statements have been prepared in conformity with U S generally accepted accounting principles. The integrity and objectivity of the data in these financial statements, including estimates and judgments relating to matters not concluded by year end, are the responsibility of management, as is all other information included in the Annual Report, unless otherwise indicated.

The financial statements of SBC Communications Inc (SBC) have been audited by Ernst & Young LLP, Independent Registered Public Accounting Firm. Management has made available to Ernst & Young LLP all of SBC's financial records and related data, as well as the minutes of stockholders' and directors' meetings. Furthermore, management believes that all representations made to Ernst & Young LLP during its audit were valid and appropriate.

Management maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed by SBC is recorded, processed, summarized, accumulated and communicated to its management, including its principal executive and principal financial officers, to allow timely decisions regarding required disclosure, and reported within the time periods specified by the Securities and Exchange Commission's rules and forms.

Management also seeks to ensure the objectivity and integrity of its financial data by the careful selection of its managers, by organizational arrangements that provide an appropriate division of responsibility and by communication programs aimed at ensuring that its policies, standards and managerial authorities are understood throughout the organization.

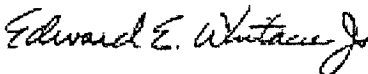
The Audit Committee of the Board of Directors meets periodically with management, the internal auditors and the independent auditors to review the manner in which they are performing their respective responsibilities and to discuss auditing, internal accounting controls and financial reporting matters. Both the internal auditors and the independent auditors periodically meet alone with the Audit Committee and have access to the Audit Committee at any time.

Assessment of Internal Control

The management of SBC is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rule 13a-15(f) or 15d-15(f) under the Securities Exchange Act of 1934. SBC's internal control system was designed to provide reasonable assurance to the company's management and board of directors regarding the preparation and fair presentation of published financial statements.

SBC management assessed the effectiveness of its internal control over financial reporting as of December 31, 2004. In making this assessment, SBC management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework. Based on our assessment we believe that, as of December 31, 2004, SBC's internal control over financial reporting is effective based on those criteria.

Ernst & Young LLP, an independent registered public accounting firm, has issued an attestation report on management's assessment of the company's internal control over financial reporting. The attestation report is included on page 68.



Edward E. Whitacre Jr.
Chairman of the Board and
Chief Executive Officer



Richard G. Lindner
Senior Executive Vice President and
Chief Financial Officer

The Board of Directors and Stockholders
SBC Communications Inc

We have audited the accompanying consolidated balance sheets of SBC Communications Inc (the Company) as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of SBC Communications Inc at December 31, 2004 and 2003, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, in 2003 the Company changed its method of recognizing revenues and expenses related to publishing directories, as well as the method of accounting for the costs of removal of long-term assets. Also, as discussed in Note 1 to the consolidated financial statements, in 2002 the Company changed its method of accounting for goodwill and other intangibles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 25, 2005 expressed an unqualified opinion thereon.

Ernst & Young LLP

Ernst & Young LLP
San Antonio, Texas
February 25, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The Board of Directors and Stockholders
SBC Communications Inc

We have audited management's assessment as described in the "Assessment of Internal Control," included in the accompanying Report of Management, that SBC Communications Inc (SBC) maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria) SBC's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit

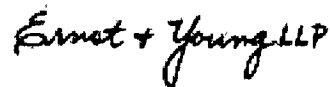
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States) Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances We believe that our audit provides a reasonable basis for our opinion

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate

In our opinion, management's assessment that SBC maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria Also, in our opinion, SBC maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of SBC as of December 31, 2004 and 2003, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2004 of SBC and our report dated February 25, 2005 expressed an unqualified opinion thereon



Ernst & Young LLP
San Antonio, Texas
February 25, 2005

SBC BOARD OF DIRECTORS
(as of February 1, 2005)

Edward E. Whitacre Jr., 63 ^(2,4,5)



Chairman of the Board and
Chief Executive Officer
SBC Communications Inc
San Antonio, Texas

SBC Director since October 1986
Background Telecommunications

August A. Busch III, 67 ^(2,3,4)



Lead Director

Chairman of the Board
Anheuser-Busch Companies, Inc
St. Louis, Missouri

SBC Director since October 1983
Southwestern Bell Telephone
Director 1980-1983
Background Brewing, family entertainment,
manufacturer of aluminum beverage
containers

Gilbert F. Amelio, Ph.D., 62 ^(1,6)



Senior Partner
Sienna Ventures
Sausalito, California

SBC Director since February 2001
Advisory Director 1997-2001
Pacific Telesis Director 1995-1997
Background Technology,
electronics engineering

Clarence C. Barksdale,* 72 ^(1,4,7)



Retired Chairman of the Board
and Chief Executive Officer
Center Bancorporation
Trustee Emeritus

Washington University
St. Louis, Missouri
SBC Director since October 1983
Southwestern Bell Telephone
Director 1982-1983
Background Banking, education

The Honorable William P. Clark,* 73 ^(2,3)



Of Counsel
Clark, Cali and Negranti, LLP
San Luis Obispo, California

SBC Director since April 1997
Pacific Telesis Director 1985-1997
Background Law, ranching

Martin K. Eby Jr., 70 ^(1,6)



Retired Chairman and
Chief Executive Officer
The Eby Corporation
Wichita, Kansas

SBC Director since June 1992
Background General building construction

James A. Henderson, 70 ^(4,5,6)



Retired Chairman and
Chief Executive Officer
Cummins Inc
Columbus, Indiana

SBC Director since October 1999
Ameritech Director 1983-1999
Indiana Bell Telephone Director 1978-1983
Background Manufacturing

Charles F. Knight, 69 ^(2,4,5)



Chairman Emeritus
Emerson Electric Co
St. Louis, Missouri

SBC Director since October 1983
Southwestern Bell Telephone
Director 1974-1983
Background Electrical manufacturing

Lynn M. Martin, 65 ^(5,7)



Chair of the Council for the
Advancement of Women
Advisor to the Firm
Deloitte & Touche LLP

President
The Martin Hall Group, LLC
Chicago, Illinois
SBC Director since October 1999
Ameritech Director 1993-1999
Background Consulting, former
Congresswoman and Secretary of Labor

John B. McCoy, 61 ^(3,4,5)



Retired Chairman and
Chief Executive Officer
BANK ONE CORPORATION
Columbus, Ohio

SBC Director since October 1999
Ameritech Director 1991-1999
Background Banking

Mary S. Metz, Ph.D., 67 ^(3,7)



Chair of the Board of Trustees
American Conservatory Theater
San Francisco, California

SBC Director since April 1997
Pacific Telesis Director 1986-1997
Background Education, administration

Toni Rembe, Esq., 68 ^(2,7)



Retired Partner
Pillsbury Winthrop LLP
San Francisco, California

SBC Director since January 1998
Advisory Director 1997-1998
Pacific Telesis Director 1991-1997
Background Law

S. Donley Ritchey, 71 ^(1,3)



Managing Partner
Alpine Partners
Retired Chairman and
Chief Executive Officer

Lucky Stores, Inc
Danville, California
SBC Director since April 1997
Pacific Telesis Director 1984-1997
Background Diversified retail

Joyce M. Roché, 57 ^(5,7)



President and
Chief Executive Officer
Girls Incorporated
New York, New York

SBC Director since October 1998
Southern New England Telecommunications
Director 1997-1998
Background Marketing

Dr. Laura D'Andrea Tyson, 57 ^(2,5)



Dean
London Business School
London, England

SBC Director since October 1999
Ameritech Director 1997-1999
Background Economics, education

Patricia P. Upton, 66 ^(4,6,7)



President and
Chief Executive Officer
Aromatique, Inc
Heber Springs, Arkansas

SBC Director since June 1993
Background Manufacturing and
marketing of decorative fragrances

Committees of the Board:

- (1) Audit
- (2) Corporate Development
- (3) Corporate Governance
and Nominating
- (4) Executive
- (5) Finance/Pension
- (6) Human Resources
- (7) Public Policy and
Environmental Affairs

*Retiring effective April 29, 2005

EXECUTIVES OF SBC AND ITS SUBSIDIARIES

<p>SBC Senior Executives</p> <p>Edward E. Whitacre Jr., 63 Chairman & Chief Executive Officer SBC Communications Inc</p> <p>John H. Atterbury III, 56 Group President-IP Services SBC Communications Inc</p> <p>James W. Callaway, 58 Group President SBC Communications Inc</p> <p>James D. Ellis, 61 Senior Executive Vice President & General Counsel SBC Communications Inc</p> <p>Karen E. Jennings, 54 Senior Executive Vice President-Human Resources & Communications SBC Communications Inc</p> <p>James S. Kahan, 57 Senior Executive Vice President-Corporate Development SBC Communications Inc</p> <p>Richard G. Lindner, 50 Senior Executive Vice President & Chief Financial Officer SBC Communications Inc</p> <p>Forrest E. Miller, 52 Group President-External Affairs & Planning SBC Communications Inc</p> <p>John T. Stankey, 42 Senior Executive Vice President & Chief Technology Officer SBC Communications Inc</p> <p>Randall L. Stephenson, 44 Chief Operating Officer SBC Communications Inc</p> <p>Rayford Wilkins Jr., 53 Group President SBC Communications Inc</p> <p>Other Executives</p> <p>Dorothy T. Attwood, 45 Senior Vice President-Regulatory Planning & Policy SBC Services, Inc</p> <p>Terry D. Bailey, 48 President-Consumer Markets SBC Southwest</p> <p>Selim Bingol, 44 Senior Vice President-Corporate Communications SBC Operations, Inc</p> <p>William A. Blase Jr., 49 President & Chief Executive Officer SBC Southwest</p> <p>Kirk R. Brannock, 47 President-Network Services SBC Midwest</p> <p>Cynthia J. Brinkley, 45 President-Missouri SBC Missouri</p> <p>Connie L. Browning, 51 President-Ohio SBC-Ohio</p> <p>Donald E. Cain, 51 President-Oklahoma SBC-Oklahoma</p> <p>Ramona S. Carlow, 42 Vice President-Regulatory & External Affairs SBC East</p> <p>Louis R. Casali, 53 President SBC Advanced Solutions, Inc</p> <p>Margaret M. Cerrudo, 56 Senior Vice President-Human Resources SBC Operations, Inc</p>	<p>Lea Ann Champion, 46 Senior Executive Vice President-IP Operations & Services (Mass Markets) SBC Operations, Inc</p> <p>George K. Contopoulos, 59 Senior Vice President-SBC Dish Network SBC Operations, Inc</p> <p>Catherine M. Coughlin, 47 President-Business Communications Services SBC Midwest</p> <p>Patricia Diaz Dennis, 58 Senior Vice President & Assistant General Counsel SBC Services, Inc</p> <p>Richard C. Dietz, 58 Vice President-Investor Relations SBC Communications Inc</p> <p>William R. Drexel, 48 Senior Vice President, General Counsel & Secretary SBC West</p> <p>Maurice E. Drilling, 49 President-Arkansas SBC-Arkansas</p> <p>James M. Epperson Jr., 49 Senior Vice President-State Legislative & Political Affairs SBC Services, Inc</p> <p>Robert E. Ferguson, 45 Group President & CEO Enterprise Business Services SBC Operations, Inc</p> <p>George S. Fleetwood, 51 President-Indiana SBC-Indiana</p> <p>Andrew M. Geisse, 48 Chief Information Officer SBC Services, Inc</p> <p>Ynocencio Gonzalez, 47 President SBC Long Distance</p> <p>Jose M. Gutierrez, 43 President-Industry Markets/Diversified Businesses SBC Operations, Inc</p> <p>Michael Q. Hamilton, 49 President-Global & Enterprise Markets (West) SBC Operations, Inc</p> <p>Timothy S. Harden, 51 President SBC Telecom, Inc</p> <p>Scott C. Helbing, 50 Senior Vice President-Consumer Marketing SBC Operations, Inc</p> <p>Carrie J. Hightman, 47 President-Illinois SBC Illinois</p> <p>Priscilla L. Hill-Ardoin, 53 Senior Vice President-Regulatory Compliance SBC Services, Inc</p> <p>William C. Huber, 39 President-Network Services SBC West</p> <p>John D. Hull, 52 Vice President-External Affairs-South SBC-California</p> <p>Susan A. Johnson, 39 Senior Vice President-Corporate Planning SBC Operations, Inc</p> <p>Vicki D. Jones, 43 Senior Vice President-Product Development SBC Operations, Inc</p>	<p>Francis J. Jules, 48 President-Global & Enterprise Markets (East) SBC Telecom, Inc</p> <p>Mark A. Keiffer, 44 Senior Vice President-Business Marketing SBC Operations, Inc</p> <p>David D. Kerr, 52 President-Kansas SBC-Kansas</p> <p>Jonathan P. Klug, 49 Vice President-Treasurer SBC Communications Inc</p> <p>Paul V. La Schiazza, 47 President-Wisconsin SBC Wisconsin</p> <p>Linda S. Legg, 54 Vice President, General Counsel & Secretary SBC Directory Operations</p> <p>Michele M. Macauda, 48 President & Chief Executive Officer SBC East</p> <p>Robin G. MacGillivray, 50 President-Business Communications Services SBC West</p> <p>Paul K. Mancini, 58 Senior Vice President & Assistant General Counsel SBC Services, Inc</p> <p>Cynthia G. Marshall, 45 Senior Vice President-Regulatory & Constituency Relations SBC California</p> <p>Norma Martinez Lozano, 48 President-Diversified Businesses SBC Operations, Inc</p> <p>William B. McCullough, 53 Vice President-Competitive Analysis SBC Services, Inc</p> <p>Shawn M. McKenzie, 46 President-Consumer Markets SBC Midwest</p> <p>Timothy P. McKone, 40 Senior Vice President-Federal Relations SBC Services, Inc</p> <p>Maureen P. Merkle, 55 President-Procurement SBC Services, Inc</p> <p>John T. Montford, 61 Senior Vice President-State Legislative & Regulatory Affairs SBC Services, Inc</p> <p>Carmen P. Nava, 42 President-Consumer Markets SBC West</p> <p>Jan L. Newton, 51 President-Texas SBC Texas</p> <p>David C. Nichols, 47 Senior Vice President-External Affairs-South SBC California</p> <p>Dennis M. Payne, 52 President & Chief Executive Officer SBC Directory Operations</p> <p>T. Michael Payne, 54 Senior Vice President & General Counsel SBC Operations, Inc</p> <p>Richard P. Resnick, 39 President-SBCI Mexico SBC International, Inc</p> <p>Christopher T. Rice, 47 Executive Vice President-Network Planning & Engineering SBC Services, Inc</p>	<p>Alfred G. Richter Jr., 54 Senior Vice President, General Counsel & Secretary SBC Southwest</p> <p>Joy Rick, 56 Vice President & Secretary SBC Communications Inc</p> <p>A. Dale Robertson, 56 Executive Vice President-Standardization SBC Operations, Inc</p> <p>Michael A. Rodriguez, 54 Senior Vice President-Labor Relations SBC Services, Inc</p> <p>Mark E. Roysse, 46 Senior Vice President-Sales Operations Support SBC Operations, Inc</p> <p>Charles E. Rudnick, 52 President-Business Communications Services SBC Southwest</p> <p>Sylvia I. Samano, 49 President-SBC Nevada SBC-Nevada</p> <p>James B. Shelley, 51 Senior Vice President-State Regulatory Affairs SBC Services, Inc</p> <p>Charles H. Smith, 61 President & Chief Executive Officer SBC West</p> <p>James C. Smith, 55 Senior Vice President-FCC SBC Services, Inc</p> <p>John J. Stephens, 45 Vice President & Controller SBC Communications Inc</p> <p>Joyce M. Taylor, 47 Senior Vice President-External Affairs-North SBC California</p> <p>Van H. Taylor, 56 President-Network Services SBC Southwest</p> <p>W. Fred Taylor, 58 President SBC DataComm, Inc</p> <p>Randy J. Tomlin, 45 Senior Vice President-Network Planning Support SBC Services, Inc</p> <p>Gail F. Torreano, 54 President-Michigan SBC Michigan</p> <p>Michael J. Viola, 50 Vice President-Corporate Finance SBC Communications Inc</p> <p>Joe W. Walkowiak, 57 President & Chief Executive Officer SBC Midwest</p> <p>D. Wayne Watts, 51 Senior Vice President & Assistant General Counsel SBC Operations, Inc</p> <p>Lora K. Watts, 48 President-External Affairs SBC West</p> <p>Stephen G. Welch, 61 Senior Executive Vice President-Policy & Planning SBC Services, Inc</p> <p>Richard Welday, 36 Senior Vice President-Sales SBC Directory Operations</p> <p>Angiolina M. Wiskocil, 52 Senior Vice President-Enterprise Software Solutions SBC Services, Inc</p>
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Toll-Free Stockholder Hotline

Call us at 1-800-351-7221 between 8 a.m. and 7 p.m. Central time Monday through Friday TDD 1-888-403-9700 for help with

- Account inquiries
- Requests for assistance, including stock transfers
- Information on The DirectSERVICE™ Investment Program for Shareholders of SBC Communications Inc (sponsored and administered by EquiServe Trust Company, N.A.)

Written Requests

Please mail all account inquiries and other requests for assistance regarding your stock ownership to

SBC Communications Inc
c/o EquiServe Trust Company, N.A.
P.O. Box 43078
Providence, RI 02940-3078

Please mail requests for transactions involving stock transfers or account changes to

SBC Communications Inc
c/o EquiServe Trust Company, N.A.
P.O. Box 43070
Providence, RI 02940-3070

You may also reach the transfer agent for SBC at sbc@equiserve.com

The DirectSERVICE™ Investment Program for Shareholders of SBC Communications Inc. is sponsored and administered by EquiServe Trust Company, N.A. The program allows current stockholders to reinvest dividends, purchase additional SBC stock or enroll in an individual retirement account

For more information, call 1-800-351-7221

Stock Trading Information

SBC is listed on the New York, Chicago and Pacific stock exchanges as well as The Swiss Exchange. SBC is traded on the London Stock Exchange through the SEAQ International Markets facility

Ticker symbol (NYSE) SBC

Newspaper stock listing SBC or SBC Comm

Information on the Internet

Information about SBC is available on the Internet. Visit our home page on the World Wide Web at www.sbc.com

Annual Meeting

The annual meeting of stockholders will be held at 9 a.m. Friday, April 29, 2005, at

Alzafar Shrine Temple
901 North Loop 1604 West
San Antonio, Texas 78216

Independent Auditor

Ernst & Young LLP
1900 Frost Bank Tower
100 W. Houston
San Antonio, Texas 78205

Requests for 10-K

The SBC Form 10-K, filed with the Securities and Exchange Commission, is available in paper form by request and on our home page on the World Wide Web at www.sbc.com/investor_relations

Investor Relations

Securities analysts and other members of the professional financial community may call the Investor Relations Hotline at 210-351-3327

General Information – Corporate Offices

SBC Communications Inc
175 E. Houston
P.O. Box 2933
San Antonio, Texas 78299-2933
210-821-4105

Printed on recycled paper

SBC Communications Inc.

175 E Houston
P O Box 2933
San Antonio, Texas 78299-2933
210-821-4105



SURETY RIDER

SAFECO Insurance Company
PO Box 34526
Seattle, WA 98124-1526

To be attached to and form a part of

Bond No. 6259875

Type of Bond: Telecommunications Services Provider Bond

dated effective 02/18/2005
(MONTH-DAY-YEAR)

executed by Southwestern Bell Communications Services Inc. d/b/a SBC Long Distance, as Principal,
(PRINCIPAL)

and by SAFECO INSURANCE COMPANY OF AMERICA, as Surety.

In favor of North Dakota Public Service Commission
(OBLIGEE)

In consideration of the mutual agreements herein contained the Principal and the Surety hereby consent to changing
the principal name

From: Southwestern Bell Communications Services Inc. d/b/a SBC Long Distance

To: SBC Long Distance, LLC d/b/a SBC Long Distance

Nothing herein contained shall vary, alter or extend any provision or condition of this bond except as herein expressly stated.

This rider is effective 04/15/2005
(MONTH-DAY-YEAR)

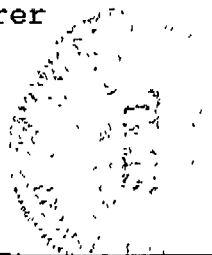
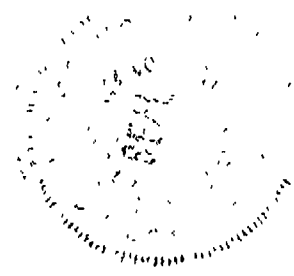
Signed and Sealed 04/15/2005
(MONTH-DAY-YEAR)

SBC Long Distance, LLC d/b/a SBC Long Distance
(PRINCIPAL)

By: Thomas S. Clemens
(PRINCIPAL) Thomas S. Clemens Asst Treasurer

SAFECO INSURANCE COMPANY OF AMERICA
(SURETY)

By: Ronald J. Walton
(ATTORNEY-IN-FACT) Ronald J. Walton



ACKNOWLEDGMENT BY SURETY

STATE
OF Texas)
County of Bexar) ss.

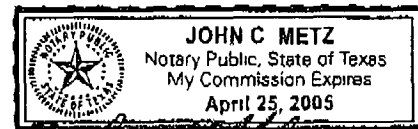
On this 15th day of April, 2005, before me personally
appeared Ronald J. Walton, known to me to be the Attorney-in-Fact of
Safeco Insurance Company of America

_____, the corporation
that executed the within instrument, and acknowledged to me that such corporation executed the same.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed my official seal, at my office in the aforesaid
County, the day and year in this certificate first above written.

My Commission Expires: 4/28/05

(Seal)



John C. Metz
JOHN C. METZ



POWER OF ATTORNEY

SAFECO INSURANCE COMPANY OF AMERICA
GENERAL INSURANCE COMPANY OF AMERICA
HOME OFFICE: SAFECO PLAZA
SEATTLE, WASHINGTON 98185

No. 9872

KNOW ALL BY THESE PRESENTS:

That SAFECO INSURANCE COMPANY OF AMERICA and GENERAL INSURANCE COMPANY OF AMERICA, each a Washington corporation, does each hereby appoint

***** RONALD J. WALTON; JANET M. DUNCAN; JONATHAN P. KLUG; KENNETH C. LONG; San Antonio, Texas*****

its true and lawful attorney(s)-in-fact, with full authority to execute on its behalf fidelity and surety bonds or undertakings and other documents of a similar character issued in the course of its business, and to bind the respective company thereby

IN WITNESS WHEREOF, SAFECO INSURANCE COMPANY OF AMERICA and GENERAL INSURANCE COMPANY OF AMERICA have each executed and attested these presents

this 22nd day of October, 2004

Handwritten signature of Christine Mead

CHRISTINE MEAD, SECRETARY

Handwritten signature of Mike McGavick

MIKE MCGAVICK, PRESIDENT

CERTIFICATE

Extract from the By-Laws of SAFECO INSURANCE COMPANY OF AMERICA and of GENERAL INSURANCE COMPANY OF AMERICA:

"Article V, Section 13 - FIDELITY AND SURETY BONDS . the President, any Vice President, the Secretary, and any Assistant Vice President appointed for that purpose by the officer in charge of surety operations, shall each have authority to appoint individuals as attorneys-in-fact or under other appropriate titles with authority to execute on behalf of the company fidelity and surety bonds and other documents of similar character issued by the company in the course of its business . On any instrument making or evidencing such appointment, the signatures may be affixed by facsimile . On any instrument conferring such authority or on any bond or undertaking of the company, the seal, or a facsimile thereof, may be impressed or affixed or in any other manner reproduced; provided, however, that the seal shall not be necessary to the validity of any such instrument or undertaking."

Extract from a Resolution of the Board of Directors of SAFECO INSURANCE COMPANY OF AMERICA and of GENERAL INSURANCE COMPANY OF AMERICA adopted July 28, 1970.

"On any certificate executed by the Secretary or an assistant secretary of the Company setting out,

- (i) The provisions of Article V, Section 13 of the By-Laws, and
(ii) A copy of the power-of-attorney appointment, executed pursuant thereto, and
(iii) Certifying that said power-of-attorney appointment is in full force and effect,

the signature of the certifying officer may be by facsimile, and the seal of the Company may be a facsimile thereof."

I, Christine Mead, Secretary of SAFECO INSURANCE COMPANY OF AMERICA and of GENERAL INSURANCE COMPANY OF AMERICA, do hereby certify that the foregoing extracts of the By-Laws and of a Resolution of the Board of Directors of these corporations, and of a Power of Attorney issued pursuant thereto, are true and correct, and that both the By-Laws, the Resolution and the Power of Attorney are still in full force and effect.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the facsimile seal of said corporation

this 15th day of April, 2005



Handwritten signature of Christine Mead

CHRISTINE MEAD, SECRETARY

**IMPORTANT NOTICE TO SURETY BOND CUSTOMERS REGARDING
THE TERRORISM RISK INSURANCE ACT OF 2002**

As a surety bond customer of one of the SAFECO insurance companies (SAFECO Insurance Company of America, General Insurance Company of America, First National Insurance Company of America, American States Insurance Company or American Economy Insurance Company), it is our duty to notify you that the Terrorism Risk Insurance Act of 2002 extends to "surety insurance". This means that under certain circumstances we may be eligible for reimbursement of certain surety bond losses by the United States government under a formula established by this Act.

Under this formula, the United States government pays 90% of losses caused by certified acts of terrorism that exceed a statutorily established deductible to be paid by the insurance company providing the bond. The Act also establishes a \$100 billion cap for the total of all losses to be paid by all insurers for certified acts of terrorism. Losses on some or all of your bonds may be subject to this cap.

This notice does not modify any of the existing terms and conditions of this bond, the underlying agreement guaranteed by this bond, any statutes governing the terms of this bond or any generally applicable rules of law.

At this time there is no premium change resulting from this Act.

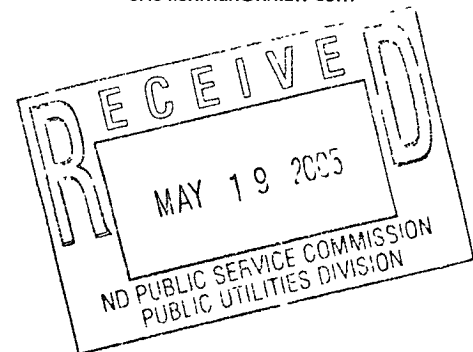
ORIGINAL

Eric Fishman
202 828 1849
eric.fishman@hklaw.com

May 18, 2005

Federal Express Delivery

Ilona A. Jeffcoat-Sacco, Executive Secretary
North Dakota Public Service Commission
600 East Boulevard
Department 408
Bismarck, North Dakota 58505-0480



Re: SBC Long Distance, LLC d/b/a SBC Long Distance
Application and Request for Expedited Action, Affidavit of Joe Carrisalez

Dear Ms. Jeffcoat-Sacco:

On behalf of SBC Long Distance, LLC d/b/a SBC Long Distance, please find an original and six (6) copies of the signed and notarized Affidavit of Joe Carrisalez, for incorporation with SBC Long Distance's concurrently filed Application and Request for Expedited Action. By this filing, SBC Long Distance seeks authority to provide competitive local-exchange telecommunications service in the State of North Dakota.

Please acknowledge receipt of this filing by date-stamping and returning the additional copy of this filing in the addressed, self-stamped envelope.

Should you have any questions about this matter, please contact the undersigned counsel.

Respectfully submitted,


HOLLAND & KNIGHT LLP

Eric Fishman, Esq.
Counsel to SBC Long Distance, LLC d/b/a SBC Long Distance

Enclosures

2856635_v1

BEFORE THE PUBLIC SERVICE COMMISSION
IN AND FOR THE STATE OF NORTH DAKOTA

In Re: The Application Of)
SBC Long Distance, LLC d/b/a)
SBC Long Distance For)
a Certificate Of Public Convenience and)
Necessity To Provide Competitive) Case No. _____
Facilities-Based Local Exchange)
Telecommunications Services)
Within The State Of North Dakota)
_____)

AFFIDAVIT OF JOE CARRISALEZ

STATE OF CALIFORNIA)
) ss.
County of Alameda)

JOE CARRISALEZ, duly sworn upon oath, deposes and declares.

(1) I am Executive Director - Regulatory of SBC Long Distance, LLC d/b/a SBC Long Distance, am over the age of eighteen (18) years, have personal knowledge of the matters contained herein, and am competent to testify thereto;

(2) I have reviewed the application of SBC Long Distance, LLC d/b/a SBC Long Distance in the above-captioned proceeding, and believe that the statements and exhibits attached thereto are true and correct to the best of my knowledge, information and belief;

(3) SBC Long Distance, LLC d/b/a SBC Long Distance ("SBC-LD") is a wholly owned subsidiary of SBC Communications Inc. ("SBC"). SBC-LD has numerous other affiliates.

(4) SBC-LD was issued a Certificate of Authority to transact business in the State of North Dakota on May 13, 2005.

(5) SBC-LD proposes to provide competitive local exchange carrier services including, but not limited to, basic local service and custom calling features, and data services to commercial and residential subscribers primarily in Qwest Communications exchanges. SBC-LD further proposes to provide exchange access services to interconnecting carriers. SBC-LD does not propose to offer alternative operator services to the transient public.

(6) SBC-LD's services will be available to subscribers twenty-four hours per day, seven days per week, at rates, terms and conditions established by SBC-LD and reflected in SBC-LD's tariff, filed with the Commission. SBC-LD assumes full responsibility for marketing and sales, billing and customer service functions. Services will be offered and provided in accordance with applicable North Dakota laws and Commission rules and regulations.

(7) SBC-LD does not currently have plans to construct facilities of its own in the State of North Dakota, but does not foreclose the possibility of constructing such facilities in the future. SBC-LD will initially rely on underlying carrier unbundled network elements and resold services.

(8) Applicant has been granted authority to provide interexchange telecommunications services in all fifty states.¹ SBC Long Distance, LLC d/b/a SBC Long Distance currently has authority to provide competitive local exchange services in the following states: Alabama, Alaska, Arizona, Colorado, Delaware, Florida, Georgia,

¹ Concurrently with this filing, SBC Long Distance, LLC d/b/a SBC Long Distance is submitting with the Commission an Application for Certificate of Registration. This registration will supersede the registrations previously issued to, and currently held by, SBC Long Distance, Inc. d/b/a SBC Long Distance (formerly known as Southwestern Bell Communications Services, Inc. d/b/a SBC Long Distance) on July 30, 1997 (Certificate No. 457) and March 17, 2004 in Case No. PU-04-84 (Certificate No. 960).

Hawaii, Idaho, Iowa, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Mississippi, Montana, Nebraska, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota (under the name SBC Long Distance, Inc.), Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Utah, Vermont, Virginia, Washington, West Virginia, Wyoming, and the District of Columbia. No other applications for competitive local exchange authority approval are pending. SBC-LD has not been denied a certificate of authority to provide telecommunications services, nor has any regulatory or other legal enforcement action been taken against the Applicant, including revocation of a certificate of authority.

(9) SBC-LD intends to market its services through in-house marketing professionals, although Applicant may in the future avail itself of telemarketing, if economically advantageous. Applicant does not currently plan to maintain or employ any staff within the State of North Dakota.

(10) SBC-LD possesses the managerial, technical, and financial qualifications to execute its business plan, provide its proposed telecommunications services, and operate and maintain facilities over which its services will be deployed. SBC-LD has provided competitive telecommunications services for nearly a decade. SBC-LD possesses the managerial and technical qualifications to execute its business plan, provide reliable telecommunications services, operate and maintain facilities over which its services will be deployed. SBC-LD's senior management team has extensive business experience in the telecommunications industry, including marketing, network operations, and financial analysis/accounting. SBC-LD's senior management team has substantial experience in managing major telecommunications operations through

previous employment with SBC and/or SBC affiliates. SBC-LD's senior managers are well qualified to oversee and direct SBC-LD's operations. SBC-LD's network employees were recruited from SBC or SBC affiliates, and maintain extensive technical network operations experience, and significantly contribute to network quality and reliability.

(11) SBC-LD's financial standing is impeccable as demonstrated by the 2004 Annual Report of its parent company, SBC Communications Inc., attached as **Exhibit E** to SBC-LD's Application.² These documents demonstrate that SBC-LD is adequately capitalized to provide reliable, long-term service to subscribers in the State of North Dakota. SBC-LD does not require construction of its own facilities, nor does it have plans to construct facilities of its own at this time. SBC-LD is fully funded and requires no additional external capitalization to initiate and sustain its operations.

(12) Pursuant to Commission Policy 5-06-98, SBC-LD has posted a bond for an amount of \$25,000.00, the minimum amount of financial surety required to indemnify any deposits or advanced payments collected from SBC-LD North Dakota Subscribers.

(13) SBC-LD is prepared to support the ongoing quality and reliability of its service. Customer service representatives are available twenty-four (24) hours per day, seven (7) days per week and can be reached at Applicant's toll free number is (877) 366-3200. The customer's first point of contact for billing or service complaints is Applicant's Customer Service Department's trained representatives. If, after contacting Applicant's customer service representative, the customer remains dissatisfied, the customer may be connected with Applicant's assigned Customer Service Manager. Customers will be advised that they may contact the Commission at any time for

² Additional financial information is available on the World Wide Web at http://www.sbc.com/investor_relations/

PU-05-300

SENDER: COMPLETE THIS SECTION	COMPLETE THIS SECTION ON DELIVERY	
<ul style="list-style-type: none"> Complete items 1, 2, and 3 Also complete item 4 if Restricted Delivery is desired. Print your name and address on the reverse so that we can return the card to you Attach this card to the back of the mailpiece, or on the front if space permits 	<p>A Signature <input checked="" type="checkbox"/> Agent <input checked="" type="checkbox"/> Addressee</p> <p>B Received by (Printed Name) C Date of Delivery</p> <p>A HUFF 05/27</p> <p>D Is delivery address different from item 1? <input type="checkbox"/> Yes If YES, enter delivery address below <input type="checkbox"/> No</p>	
<p>1. Article Addressed to</p> <p>Eric Fishman Holland Knight LLP 2099 Pennsylvania Ave NW Ste 100 Washington DC 20006</p>	<p>3. Service Type</p> <p><input checked="" type="checkbox"/> Certified Mail <input type="checkbox"/> Express Mail <input type="checkbox"/> Registered <input type="checkbox"/> Return Receipt for Merchandise <input type="checkbox"/> Insured Mail <input type="checkbox"/> C O D</p> <p>4. Restricted Delivery? (Extra Fee) <input type="checkbox"/> Yes</p>	
<p>2. Article Number (Transfer from service label) <u>7003 2260 0001 3516 8897</u></p>		

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<ul style="list-style-type: none"> Complete items 1, 2, and 3. Also complete item 4 if Restricted Delivery is desired. Print your name and address on the reverse so that we can return the card to you Attach this card to the back of the mailpiece, or on the front if space permits. 	<p>A Signature <input checked="" type="checkbox"/> Agent <input checked="" type="checkbox"/> Addressee</p> <p>B Received by (Printed Name) C Date of Delivery</p> <p>E. STEWART 7/5/05</p> <p>D Is delivery address different from item 1? <input type="checkbox"/> Yes If YES, enter delivery address below. <input type="checkbox"/> No</p>	
<p>1. Article Addressed to</p> <p>Eric Fishman Holland Knight LLP 2099 Pennsylvania Ave NW Ste 100 Washington DC 20006</p>	<p>3. Service Type</p> <p><input type="checkbox"/> Certified Mail <input type="checkbox"/> Express Mail <input type="checkbox"/> Registered <input type="checkbox"/> Return Receipt for Merchandise <input type="checkbox"/> Insured Mail <input type="checkbox"/> C O D.</p> <p>4. Restricted Delivery? (Extra Fee) <input type="checkbox"/> Yes</p>	
<p>2. Article Number (Transfer from service label) <u>7004 2890 0000 5451 4830</u></p>		

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